Australian Government

A tax plan for our future
Stronger • Fairer • Simpler

TAX FORUM 4-5 October 2011

STATEMENT OF REFORM PRIORITIES

PARTICIPANT NAME AND POSITION

Mark Rantall (CEO)

ORGANISATION

Financial Planning Association of Australia Ltd (FPA)

STATEMENT OF PRIORITIES

Around two or three pages, please. Please address both of these issues:

1. What are your priority reform directions for the tax and transfer system?

The purpose of Australia's future tax system is to collect revenue from residents and businesses to build a pool of resources to help fund essential services for all Australians, particularly those in most need of assistance. Australia's future tax system should be simple, efficient and equitable, which are fundamental principles the FPA believes must underpin our nation's tax system.

Further to making our tax system more efficient, we believe equity and long term sustainability are important factors for reform. In particular the pressures an ageing population will place on the tax system must be considered today in order to reduce the pressures for tomorrow.

The FPA believe that the following three key reform directions can assist:

(1) Encourage a savings culture by making financial advice more affordable
(2) Remove Superannuation Guarantee from Contribution Caps to facilitate increase in SG from 9% to 12%
(3) Improve Income Stream Product Innovation to Address Longevity Risk

❖ **<u>Encouraging a savings culture by making financial advice more affordable</u>**

The FPA supports the governments proposal to increase superannuation guarantee from 9% to 12% and believes this will significantly contribute to the retirement adequacy of many working Australians. However, not all Australians can rely only on the superannuation guarantee and in order to cater for those wanting to engage in their financial wellbeing, personalised financial advice from a professional financial planner should be encouraged.

Currently only one in five Australians access financial advice and the Future of Financial Advice reforms will help improve trust and confidence for Australians to want to seek advice. However, the reality is not all will be willing or able to pay for the advice.

Government incentives to help consumers pay for advice, such as tax rebates and tax deductibility of advice fees would help consumers make sound and informed financial decisions, improve retirement income adequacy and reduce reliance on the age pension. Access to such incentives should be capped to ensure they assist those Australians who are in most need of assistance.

Currently, a fee for service arrangement for preparation of an initial financial plan is not tax deductible under section 8-1 of the Income Tax Assessment Act 1997.

Consumers are paying for personal financial advice in varying ways that result in different taxation treatments for no apparent public benefit. This variety of treatment appears to be contrary to the ATO's obligation under the Taxpayers Charter it adopted in November 2003 to treat tax payers consistently.

The inability to claim a tax deduction for the fees associated with an initial financial plan acts as a disincentive for people to take the first step towards organising their finances on a strategic basis.

Financial planners provide valuable advice that is important for the long-term economic welfare of Australians. The financial planning profession is uniquely positioned to help Australians build their wealth and plan for a financially independent retirement.

Allowing initial fees to be tax deductible would greatly assist consumers' access to affordable financial advice. While this would involve some additional costs to Government, these costs would be significantly outweighed by the longer-term benefits. This revenue cost could be controlled by including caps on either the size of the tax deduction or an income cap on those able to receive a deduction.

- **Remove Superannuation Guarantee from Contribution Caps to facilitate increase in SG from 9% to 12%**

To support a savings culture and encourage Australians to save for their retirement, the Superannuation Contribution Caps, while necessary, continues to be a road block (perceived more so than real) for many Australians wanting to maximise their retirement nest egg. The FPA however do not want to debate the contribution caps at this tax forum, rather we wish the forum to consider the merits of our proposal to have superannuation guarantee (SG) contributions be removed from the concessional contribution cap.

Concessional contributions include personal deductible contributions, superannuation guarantee contributions and voluntary employer contributions, including salary sacrifice. The penalties for breaching the caps are applied at the member level but the control of contributions can be outside the control of the fund member, creating administrative complexity.

For this reason it is recommend that superannuation guarantee contributions (which are mandated under specific rules) be removed from the concessional contribution cap. This will become increasingly important with the proposed increase of the superannuation guarantee from nine to 12 percent.

- **Improve Income Stream Product Innovation to Address Longevity Risk**

A person entering retirement currently has very little choice in income stream design. Options are limited to an account-based income stream, a lifetime guaranteed income stream, and a fixed-term guaranteed income stream. Only a very small percentage of retirees use lifetime or fixed-term income streams. Given that most of the retirees who choose income streams choose account-based income streams, most product development has taken place in this space.

The longevity of an account-based income stream depends on the balance, earnings rate and amount withdrawn each year. Longevity risk can be specifically managed using lifetime income streams. However, these products are largely unpopular in their current forms, for a variety of reasons:

- Cultural aversion to locking money away;
- Low levels of retirement savings and the need to maintain flexibility;
- Low rates of return due to the conservative pricing and capital reserve policies; and
- The potential for a loss of capital due to unused account balances being directed, on death, to the annuity provider's 'reserve account' – not the estate of the retiree.

The FPA suggests that the industry should be encouraged to create commercial solutions and options within the superannuation system which are funded from contributions by individuals on their own behalf so that they have full visibility and control.

This will require changes to the superannuation and tax legislation. A major inhibitor to the development of products is the wording of the Superannuation Industry (Supervisions) legislation that determines what is defined as "an income stream" to be eligible for the tax exemption on current pension assets. This limits creative product development.

A policy objective stated in the May 2006 Federal Budget was to simplify the superannuation legislation to allow product development and to move away from a prescriptive legislative approach. However, the changes implemented on 20 September 2007 did not achieve this objective. This is evidenced by the fact that a longevity income stream developed by one product manufacturer provided a longevity solution with lifetime guarantees but failed to qualify for the exemption on pension assets, due to the methodology to share profits among the members of the fund. This product has since been removed from the market.

Further change is needed to create a legislative environment that promotes product development that caters for longevity risk and the diverse consumer needs in retirement, within a level playing field for providers.

To this extent, the FPA supports Recommendation 21 of the Australia's Future Tax System Review (AFTSR) and would encourage the tax forum to consider the benefits of this recommendation.

R21: *The government should support the development of a longevity insurance market within the private sector.*

- The government should issue long-term securities, but only where this is consistent with its fiscal obligations, to help product providers manage the investment risk associated with longevity insurance.
- The government should make available the data needed to create and maintain a longevity index that would assist product providers to hedge longevity risk.

- The government should remove the prescriptive rules in the Superannuation Industry (Supervision) Regulations 1994 relating to income streams that restrict product innovation. This should be done in conjunction with the recommendation to have a uniform tax on earnings on all superannuation assets.

2. How are your proposals financed over the short and longer term?

The FPA appreciates that these proposals will need to be adequately costed and would unlikely be implemented until such time as the budget was in surplus. However, we do consider that these proposals have a long term economic benefit and that should they not be implemented there will likely be a future cost to the economy far greater then that would apply in financing these measures today.

LIST OF ATTACHMENTS

Feel free to attach supporting papers if you wish. Please list them here.

- FPA Submission to Henry Tax Review.