Accelerating Australia's Economic Recovery

Proposals to promote growth in the Australian economy as we emerge from the COVID-19 pandemic

FSC FINANCIAL SERVICES COUNCIL

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Foreword

As Australia's federal and state governments meet as the National Cabinet to develop a new economic agenda to get Australia back to work, other recovery plans are being developed by one of the country's largest sectors - financial services.

SALLY LOANE
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Financial Services Council

Australia's $2.7 trillion superannuation industry could prove to be a vital tool in the road to recovery.

The Financial Services Council (FSC) has developed this report - Accelerating Australia's Economic Recovery - with policy ideas sourced across our four portfolios of membership in superannuation, fund management, life insurance and financial advice.

The recommendations in this report build on our platform of sound, evidence-based policy positions, to determine what will make the most impact as we move towards economic recovery, such as reducing company tax for all businesses, promoting the modernisation of obsolete systems and products, simplifying payroll tax and abolishing stamp duty on life insurance.

The FSC has developed a plan to democratise investment in critical domestic infrastructure development, making these projects not only attractive but also accessible to every Australian with money in superannuation.

The new Australian Superannuation and Infrastructure Investment Vehicles (ASIIVs) will unlock a large chunk of funds - around $1.7 trillion in choice and Self-Managed Superannuation Funds (SMSFs) - for infrastructure projects from investors who today have limited access to them.

The FSC and its members are here to do our bit to drive Australia's long-term economic recovery. By implementing the reforms raised in this report, the National Cabinet and Commonwealth Government can get the best bang for the nation's buck and get Australia back up on its feet.

Investing in Nation Building Infrastructure

Australia's superannuation industry manages almost $2.7 trillion in domestic savings that can be harnessed to invest in infrastructure to accelerate Australia's economic recovery.

The FSC has recommended to the National COVID-19 Coordination Commission the creation of new 'Australian Superannuation and Infrastructure Investment Vehicles' (ASIIVs). ASIIVs are designed to:

1. Accelerate the financing of new infrastructure projects by providing governments access to additional sources of capital; and
2. Expand access to existing asset recycling programs to all categories of superannuation investors.

The strength of ASIIVs is that they will enable governments to more effectively tap into categories of investors seeking the steady income stream that infrastructure can often provide, including the almost $700 billion SMSF sector and the $1 trillion invested by 'choice' customers.

The FSC recommends the National Cabinet agree to establish two categories of ASIIVs:

- Single-asset ASIIVs to finance new infrastructure developments, for investors seeking exposure to a specific asset, such as community housing; and
- Multi-asset ASIIVs that 'bundle' existing infrastructure assets, collectively producing a predictable and stable yield, and allowing different levels of Governments to contribute assets into the vehicle.

ASIIVs will encourage asset recycling by creating collective vehicles that governments can participate in through the National Cabinet, freeing up capital to allow investment in new infrastructure projects.

ASIIVs also overcome the current reliance on institutional investors for ownership of infrastructure. Recent experience has shown direct ownership of infrastructure by a narrow field of investors generates perceptions of liquidity risk that undermines public confidence in the superannuation system.

ASIIVs address these concerns by being:

- Tradeable on secondary markets, supporting liquidity and facilitating price discovery;
- Available to retail investors through existing platforms; and
- Unitised and regularly valued by independent consultants.

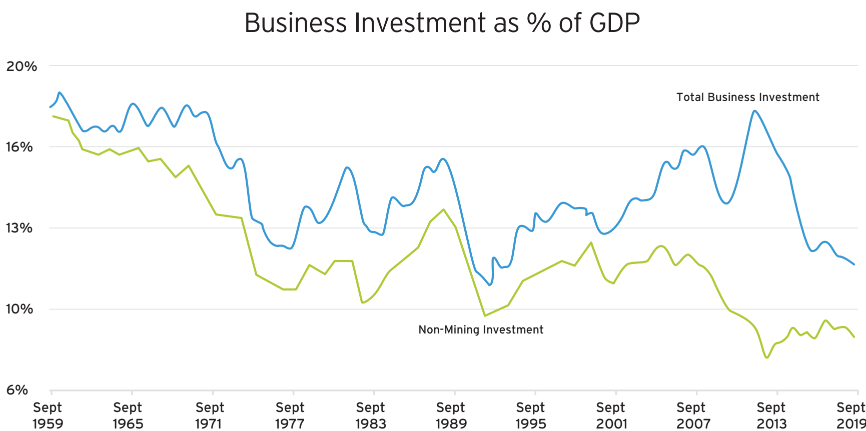
To maximise the attractiveness of ASIIVs to investors tax issues with funds owning infrastructure should be resolved, including the double taxation of funds owning depreciating assets and the 'trapping' of tax losses in the fund.

Tax Reform to Promote Economic Growth

Reduce the company tax rate to 25 per cent for all companies

The FSC recommends the Government prioritise lowering the company tax rate to 25 per cent for all companies.

Australia's company tax rate is now one of the highest in the world and is the second highest in the developed world. Over the past decade Australia has experienced weak business investment, which fell significantly during the mining boom and remains at historically low levels.



Source: ABS National Accounts, table 24 from 2000 onwards; ABS Australian System of National Accounts, table 52 pre-2000

Cutting the company tax rate would make Australia internationally competitive and promote business investment, economic growth and higher employment. Australia's recent cut in the company tax rate for small business has had a positive effect on employment and investment[1] and in the current environment it is important to extend the same incentives to invest to larger companies.

1 AlphaBeta (2018) *Do company tax cuts boost jobs, wages and investment?*

The economic benefit of a competitive tax rate is well established:

- A 2017 study[2] found a one per cent cut in company tax will increase employment by between 0.2 and 0.4 per cent. Applying this to Australia, this implies that a cut in company tax rate from 30 per cent to 25 per cent for all business would increase employment by between 3.3 per cent and 6.6 per cent;
- A 2012 European study[3] of the impact of company tax on 55,000 businesses across nine European countries found that a one-dollar increase in the corporate tax burden decreased total wages by 49 cents in the long run, through a combination of lower wages or employment.
- A 2018 US study[4] of a sample of businesses operating in multiple states between 1977 and 2011 found that a one per cent increase in the corporate tax rate corresponds to a 0.4 per cent decline in employment.
- An OECD study in 2017[5] found company tax reductions boosted economic growth as well as the incomes of the poor, while having no significant impact on income distribution; and there were no discernible differences in results for countries with imputation systems, such as Australia.

Abolish Stamp Duties

FSC supports the state governments calling for stamp duties to be abolished, including on insurance products and property transactions. Stamp duties are a volatile revenue source for state governments, unsuited to funding the services they are expected to deliver, such as education and healthcare.

Stamp duties on products issued by life insurers discourage Australians from having adequate coverage to protect themselves and their families from hardship. They are also recognised as one of the most inefficient taxes in the economy[6] and cost Australians $644 million in 2018–19.[7]

Stamp duties on life insurance products coupled to superannuation accounts erode retirement savings by an estimated $235 million each year.[8] Stamp duties on property transactions also act as a substantial barrier to the merger of superannuation funds and reduce the efficiency of the system.

2 Hanson and Brannon (2017) "Corporate Income Taxes and Labor: An Investigation of Empirical Evidence" *Tax Notes*, July 24.

3 Arulampalam, Devereux and Maffini (2012) "The direct incidence of corporate income tax on wages" *European Economic Review* 56(6).

4 Giroud and Rauh (2018) "State Taxation and the Reallocation of Business Activity: Evidence from Establishment-Level Data." *Journal of Political Economy* 127(3).

5 Akgun, Cournède and Fournier (2017) *The effects of the tax mix on inequality and growth*, OECD Economics Department Working Paper 1447.

6 Henry Tax Review (2010); KPMG (2010) CGE Analysis of the Current Australian Tax System.

7 FSC estimate for the 2018–19 financial year based on an FSC member survey and APRA data.

8 FSC estimate for the 2018–19 financial year based on survey of FSC members and analysis of APRA data.

Stamp duties on life insurance products are also:[9]

- Complex and have high compliance costs for business;
- Regressive and unfair for consumers; and
- Imposed at higher tax rates in Australia than other developed countries.

There is extensive evidence supporting the abolition of stamp duties:

- Henry Tax Review (2010)
- Financial System Inquiry (2014)
- Productivity Commission report 'Rethinking Regulation' (2006)
- Deloitte Access Economics Analysis of State Tax Report (2011)

Simplify Payroll Tax

The FSC supports lowering payroll taxes to the greatest extent possible as they are among the more inefficient taxes levied in Australia.[10] We recommend that state governments first, however, prioritise removing anomalies in payroll taxes that penalise small businesses and undermine existing exemptions.[11]

Sole trader case study:

- Financial planners who are sole traders but are licensed by a larger advice licensee can be subject to payroll tax on payments from the licensee.
- If the planner then employs staff, they can gain an exemption from payroll tax.
- This perversely means a sole trader can have a higher payroll tax rate than a business that employs staff.

9 See FSC submission to NSW Review of Federal Financial Relations.

10 KPMG Econtech (2010) CGE Analysis of the Current Australian Tax System; Nassios et al (2019) The economic impact and efficiency of state and federal taxes in Australia, Centre of Policy Studies/IMPACT Centre Working Papers G-289.

11 See details in FSC submission to NSW Review of Federal Financial Relations.

Superannuation

The superannuation system has the potential to play a significant role in Australia's economic recovery. To support this role we recommend the Government prioritise legislating an objective for superannuation and implement reforms to make the system more efficient.

The FSC also recommends the Government implement temporary measures to help consumers rebuild their retirement savings after recent market volatility and where members have withdrawn savings under the Government's early release scheme.

Restoring superannuation balances

The COVID-19 pandemic has impacted savings across the sector, with the industry-wide rate of return for the March quarter being -10.3 per cent, and for the year being -3.3 per cent.[12]

Market volatility has disproportionately impacted Australians close to retirement and those who have accessed their savings early to alleviate hardship.

The FSC recommends targeted measures to help these categories of Australians rebuild their retirement savings, including:

- A co-contribution scheme for members who participated in the hardship policy, where the Government contributes $1 for every $5 in voluntary contributions made by a member (to a maximum $10,000 member contribution);
- A concessional cap of $50,000 for those over the age of 50 years for the 2020-21 financial year, with the option of 'carrying forward' unused value; and
- A steady increase in the preservation age to 62 years, to promote mature-age workforce participation and restore the 5-year link to the Age Pension eligibility.

12 APRA (2020) Quarterly superannuation performance statistics highlights, March 2020.

Making superannuation more efficient

The Government should prioritise the recommendations of the Royal Commission into Financial Services and the Productivity Commission (PC) that individuals should have a single default account, that they carry between jobs, to avoid account balance erosion.

The Royal Commission and PC were clear that consumers should carry with them their existing account or an account with the first fund they choose when they enter the workforce.[13] The PC found this would save individuals $2.6 billion each year.[14]

The Government should also prioritise implementing its preferred model for allocating default members to high performing superannuation funds.

The PC recommended removing the selection of default funds from the industrial relations system. The COVID-19 pandemic provides real-world support for this proposal by exposing concentration risks, particularly where a fund's membership was skewed towards a particular industry or age cohort.

Electronic communications

The COVID-19 pandemic is expected to have shifted many customers to online financial transacting, potentially a significant productivity improvement. There are regulatory barriers, however, to superannuation members engaging with their fund online.

The Electronic Transactions Regulations 2000 (ETR) currently exclude notices under superannuation law. Where funds do not have up-to-date postal addresses, particularly for disengaged members, it becomes more expensive and complex to contact them.

Case Study:

- The recent Protecting Your Superannuationlegislation required funds to contact large numbers of members.
- The SIS Act exemption from the ETR meant that this was not allowable.
- Superannuationfunds were required to undergo the expensive process of manually printing and mailing letters, many of which went unopened.

Government should amend the ETR to remove the exemption and allow electronic communications for all aspects of superannuation.

13 Royal Commission into Financial Services recommendation 3.4, Productivity Commission Final Report of inquiry into Superannuation, Recommendation 1.

14 Productivity Commission Final Report of inquiry into Superannuation, page 30.

Funds Management

Accelerate skilled, high net wealth migration

The Significant Investor Visa (SIV) program has been a success, leading to direct investment in Australia of more than $11 billion since it commenced.[15] The program enables Australia to compete internationally for skilled and high net worth migrants and could play a significant role in accelerating Australia's economic growth.

The Department of Home Affairs is currently reviewing the program, which should be completed as a matter of urgency to provide policy certainty for applicants. The success of the program as a driver of economic growth is inhibited by significant delays in processing times for applications. Applications can frequently take up to 15 months.

The FSC recommends the cost of the visa class, currently from $7,880, be increased to fully offset the cost of a service level agreement that ensures all applications are finalised within three months. Migrants under the program would be subject to screening and quarantine periods consistent with the current COVID-19 health advice.

Case Study:

- One of the visa's biggest successes has been at Mort & Co, in regional Australia. Mort & Co is headquartered in Toowoomba and is one of Australia's largest independent cattle feedlot businesses.
- Investment through the SIV program helped develop additional cattle capacity at its feedlots. Mort & Co has employed 30 per cent more staff since the initial investment.
- Mort & Co now employs over 150 people and has expanded and employed locally at its feedlots in Grassdale and Pinegrove, Queensland, and Gunnee, NSW.

15 Department of Home Affairs, February 2020 SIV Statistics.

Promote Australia as a financial centre

The Government should prioritise the introduction of the Corporate Collective Investment Vehicle (CCIV), which will provide the opportunity to accelerate growth in Australia's funds management industry by establishing an investment vehicle with a legal structure more familiar to investors in the Asian region.

To maximise the adoption and growth benefits of CCIVs, the Government should ensure the taxation of the CCIV is the same as the current tax treatment of Attribution Managed Investment Trusts (AMITs). This will ensure the CCIV meets the Government's commitment that the CCIV would increase our international competitiveness.[16]

Micro-Economic Tax Reform

The Government has announced, but not implemented, funds management tax reforms that should be prioritised to ensure accelerated growth of the sector, including:

- Reforms to fix issues with the Taxation of Financial Arrangements, particularly foreign exchange hedging.[17]
- Reforms to fix issues with the Investment Manager Regime (IMR).[18]
- Expand the functional currency election to certain trusts and partnerships.[19]

Tax reforms should include a suite of additional measures that would make the fund management industry more competitive, including:

- Simplify the withholding tax system for managed investments by replacing numerous different rates, with multiple exemptions, with a simpler lower rate of withholding tax for all non-exempt payments.
- Prioritise tax treaties with Luxembourg and Hong Kong, which are key financial capitals, consistent with Government commitment that Australia's tax treaty network remains aligned to our trading relationships.[20]
- Cancel proposals to remove the CGT discount for managed funds, which would overtax them compared to other trusts and individuals.
- Allow AMITs to access CGT rollover relief that is available to other trusts.
- Ensure the correct Australian taxation of foreign capital gains after the Burton v Commissioner decision.

16 See Explanatory Material on 2019 draft of CCIV corporate law rules at paragraph 1.10.

17 Announced in the 2016-17 Budget. See also http://kmo.ministers.treasury.gov.au/media-release/126-2017/

18 Announced on 19 July 2017: http://kmo.ministers.treasury.gov.au/media-release/064-2017/

19 Announced in the 2011-12 Budget and recommitted to in 2013: http://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2019-05/MR008-2013.pdf

20 See: https://dfat.gov.au/about-us/publications/Pages/action-plan-to-boost-australian-services-exports.aspx

Investment in modern financial products

Maintaining high-cost legacy technology systems are a significant drag on the performance of the Australian financial system. They can also result in fund management, insurance and superannuation customers being stranded in obsolete products, which can be more expensive.

The Government should establish a rationalisation framework to encourage financial service companies to invest to close legacy systems. This would increase domestic business investment and lower ongoing costs for companies and consumers.

Transferring these customers to contemporary products, on a 'better off overall' basis, would lower fees, increase competition, improve product disclosure and reduce technology risk.

To ensure adequate consumer protections the FSC would support using independent oversight to verify customer benefits before they are transferred to modern products. It would also require a Government commitment to ensure there are no tax or social security penalties.

A modernisation framework has been supported by independent reviews, including:

- The Productivity Commission report 'Rethinking Regulation' (2006);
- The Financial System Inquiry (2014) and the Government's response to this Inquiry; and
- The Report of the Parliamentary Joint Committee on Corporations and Financial Services into the Life Insurance Industry (2018).

Financial Advice

Increase access to affordable advice

COVID-19 has seen a surge in demand for financial advice on a range of matters such as redundancy, retirement, life insurance, and early access to superannuation.

Cost and regulation are the biggest barriers to delivering and receiving financial advice. The median cost of up-front advice is currently approximately $3,600.[21] The cost of financial advice is expected to continue to increase as a result of regulatory change and the loss of advisers from the industry over recent years.[22]

The FSC recommends the Government implement a temporary, 2-year reform to enable scalable advice to help Australians through this period of economic uncertainty. Scaled advice would be documented through a Record of Advice and allow a client to seek advice on a specific subject, such as the impact of a redundancy or a hardship withdrawal from superannuation.

This proposal is designed to build upon relief provided by ASIC in April 2020 when it enabled the industry to provide affordable and timely financial advice to customers during the COVID-19 pandemic.[23]

As an additional consumer safeguard an independent review could be held part-way through the program to determine whether the advice being provided was helping customers better managing their financial affairs. The advice provided under this program would also continue to broadly operate within the established best interest duty and be free from conflicted remuneration, which would continue to be prohibited.

Providing scaled advice will have economic and social benefits including:

- Improved financial decisions that benefit personal wealth and the economy, such as debt management;[24]
- Reduced likelihood of individuals making poor investment choices which could cost them their life savings;
- Reduced pressure on public financial counsellors and the voluntary sector who can prioritise higher needs individuals in financial distress; and
- Improved access to financial advice by lowering its overall cost.

21 Average Annual Advice fee as quoted in the Adviser Ratings 'The Average Annual Adviser' infographic 2019.

22 Rainmaker analysis reported in the Financial Standard on 23 April 2020 that nearly 500 advisers have exited the industry between February and April this year.

23 ASIC press release, ASIC grants relief to industry to provide affordable and timely financial advice during the COVID-19 pandemic, 14 April 2020.

24 KPMG Research, 'Value Proposition of Financial Advisory Networks – Update and Extension', January 2011.

Life Insurance

Permit early intervention by life insurers

The longer an individual is away from work due to a disability from an illness or injury, the lower their likelihood of returning to work. If a person is off work for 70 days their probability of returning to work reduces to 35 per cent.[25]

Current legislative arrangements prevent life insurers from funding medical treatment which requires a health insurance license.

The FSC recommends removing regulatory barriers to enable life insurers to offer targeted rehabilitation payments. This would allow life insurers to use more effective early intervention practices and would increase successful rehabilitation.

25 The Australasian Faculty of Occupational & Environmental Medicine and The Royal College of Physicians – Australian and New Zealand Consensus Statement on the Health Benefits of Work – first published in 2011.

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