



2014-15 Pre-Budget Submission

January 2014

AIST Submission

## AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose mission is to promote and protect the interests of Australia's \$600 billion not-for-profit superannuation sector. AIST's membership includes the trustee directors and staff of industry, corporate and public-sector funds, who manage the superannuation accounts of nearly two-thirds of the Australian workforce.

As the principal advocate and peak representative body for the not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

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As the peak industry body in the not-for-profit superannuation sector, AIST is focused on outcomes that improve financial retirement sustainability, adequacy and security for all Australians.

Whilst we understand that the Government's superannuation reform agenda is detailed and far-reaching; there are a range of other policies that are in the public interest. AIST advocates these additional policies in this submission. These proposals are affordable and provide far-reaching economic benefits.

### 1.1 Measures to reduce red tape

AIST proposes these measures as measures to improve efficiency in the superannuation sector as well as the public sector, and reduce red tape:

- Remove the \$450 per month superannuation guarantee (SG) threshold;
- Remove age-based restrictions on contributions for superannuation fund members aged 65 and over;
- Remove the work test requirement on contributions for superannuation fund members aged 65 and over;
- Allow for the mandatory provision of salary sacrifice for all employees;
- Link the superannuation guarantee to a gross remuneration measure; and
- Increase funding for indigenous identification schemes.

### 1.2 Measures to reduce inequity

AIST proposes these as measures to reduce inequities that remain present in Australia's superannuation system:

- Maintain the Low Income Earner's Contribution (LISC);
- Allow for the mandatory provision of salary sacrifice for all employees;
- Remove the \$450 per month superannuation guarantee (SG) threshold;
- Abolish the loophole that allows a reduction of SG amounts due to salary sacrifice; and
- Retain age 60 as the preservation age.

## 1.3 Measures to improve sustainability and adequacy

AIST recommends re-consideration of a review to Centrelink means testing to the age pension, to ensure that the age pension is better targeted.

Finally, AIST recommends consideration of measures to better improve the mix of sustainability and adequacy in the superannuation system, such as:

- Implement a limit on the amount that can be taken as a lump sum; and
- Implement a lifetime limit on non-concessional contributions.

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## 2 Recommendations

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### 2.1 Measures to reduce red tape

#### 2.1.1 Removal of the \$450 per month superannuation guarantee (SG) threshold

AIST recommends the removal of the \$450 per month income threshold on the superannuation guarantee as a measure to remove red tape. We note that at current SG rates, anyone earning just under the threshold would be eligible for only \$41.63 per month, yet the administering of this measure could cost more than this.

Access Economics<sup>1</sup> modelling showed in 2010 that while the aggregate impact of removing the \$450 monthly threshold would be small, industry experience suggests it is likely to be quite concentrated, resulting in significant improvements for those individual workers who are most disadvantaged by the current exemption. Access Economics has estimated that the cost to government of removing the exemption would be minimal (0.003 per cent of GDP in 2041).

AIST also notes that the removal of this threshold will act to reduce inequity. We have addressed this argument later in this submission.

#### 2.1.2 Removal of age-based restrictions on contributions for superannuation fund members aged 65 and over

AIST believes that it is a good time to recommence discussions on why superannuation contribution restrictions are in place. However, we are also mindful that Australians are living and working longer.

Based upon that, AIST recommends the removal of all age-based restrictions on contributions. Although we primarily support this for equitable reasons, that is, that we cannot support age-based discrimination, we also wish to draw attention to the issues present in the restrictions themselves.

In accepting contributions, a trustee must be mindful of whether a member is in a position to make a contribution, based upon their age. And although age-based restrictions on superannuation guarantee (SG) contributions ended last year, we note that there still remain a plethora of regulations making it difficult or even impossible, for older working Australians to contribute to their retirement savings. The following is a list of some age-based restrictions presently in force with regards to contributions into superannuation:

- A work test (of gainful employment on at least a part-time basis) must be satisfied from the age of 65, if a member is making a personal contribution;

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<sup>1</sup> Access Economics Pty Ltd. 2009. *Retirement Incomes Policy Simulations Paper*. [pdf] Melbourne: Australian Institute of Superannuation Trustees and Industry Superannuation Network. <http://tinyurl.com/l4g33n6> [Accessed: 30 Jan 2014]

- If a member is making a contribution on behalf of an eligible spouse, the eligible spouse must satisfy the work test from age 65 onwards;
- The 'bring forward rule' which allows members making non-concessional contributions to bring forward two additional years of non-concessional contributions is no longer able to be used from age 65 onwards;
- Contributions on behalf of eligible spouses may no longer be made once the eligible spouse has turned 70;
- Eligibility for the government co-contribution ceases for financial years which end in the taxpayer being 71; and
- Personal contributions may no longer be contributed to superannuation, once a member turns 75.

AIST is concerned that these appear both discriminatory and arbitrary and recommend their removal.

### **2.1.3 Removal of the work test requirement on contributions for superannuation fund members aged 65 and over**

In the process of removing age-based restrictions on superannuation contributions, AIST recommends removal of the work test.

The work test was designed for an earlier period, where superannuation benefits were subject to a reasonable benefit limit imposed through use of taxation, and the use of such disincentives tacitly noted that one's life expectancy was shorter.

We view the imposition of this requirement to be unnecessary, as well as being unable to be enforced. The removal of this limitation will enable all Australians to contribute as well as allow superannuation funds to get on with their job of processing contributions, unencumbered by this layer of regulation.

### **2.1.4 Allow for the mandatory provision of salary sacrifice for all employees**

Salary sacrificing into superannuation is a sensible means for employees to supplement their provision for retirement. Yet despite the tax advantages, it is not available to all employees, as it is generally dependent on the terms of modern awards, EBAs and individual contracts of employment. AIST recommends that the Government legislate to provide all workers with the ability to make pre-tax salary sacrifice contributions to their superannuation fund. Greater access to salary sacrifice should increase the effectiveness of superannuation as a long-term investment vehicle.

One of the reasons that this is not made available to employees is due to the perceived cost of implementation and processing, especially for small business. AIST points out that implementation of initiatives such as this on a large scale provides wholesale cost savings that are not apparent in a voluntary system, as payroll systems are required *en masse* to change over to support the new rules.

In addition to the lowered business costs from implementing this change, we point to the estimated low cost associated with this measure: Assuming that even a larger number of additional employees, such as 50,000 immediately took advantage of salary sacrificed superannuation contributions and sacrificed at a rate of about 5%, assuming an average wage of approximately \$50,000 per annum, then this would result in an overall tax cost of \$37.5 million nationally.

AIST also notes that the provision of salary sacrifice to all employees will act to reduce inequity. We have addressed this argument later in this submission.

### 2.1.5 Link the superannuation guarantee to a gross remuneration measure

The SG is presently linked to ordinary time earnings, or OTE. OTE unfortunately only captures some of the many payments that can be paid to employees as part of their work.

Determining whether a payment forms part of OTE is presently indecipherable. In Superannuation Guarantee Ruling SGR 2009/2<sup>2</sup>, the Commissioner of Taxation considered the following payments and only concluded in 14 cases that these formed part of OTE:

Payment no.	Payments to an employee in relation to...	Salary or wages?	OTE?
<b>Awards and agreements</b>			
1	A simple overtime situation	Yes	No
2	Overtime hours - agreement prevailing over award	Yes	No
3	Agreement supplanting award removes distinction between ordinary hours and other hours	Yes	Yes
4	No ordinary hours of work stipulated	Yes	Yes
5	Casual employee - <i>shift-loadings</i>	Yes	Yes
	<i>overtime payments</i>	Yes	No
6	Casual employee whose hours are paid at overtime rates due to a 'bandwidth' clause	Yes	No
7	Piece-rates - no ordinary hours of work stipulated	Yes	Yes

<sup>2</sup> Australian Taxation Office, *Superannuation guarantee: meaning of the terms 'ordinary time earnings' and 'salary or wages'*, SGR 2009/2, 13 May 2009.

8	Overtime component of earnings based on 'hourly driving rate' formula stipulated in award	Yes	No
<b>Allowances</b>			
9	Allowance by way of unconditional extra payment	Yes	Yes
10	Expense allowance expected to be fully expended	No	No
11	Danger allowance	Yes	Yes
12	Retention allowance	Yes	Yes
13	Hourly on-call allowance in relation to ordinary hours of work for doctors	Yes	Yes
<b>Payment of expenses</b>			
14	Reimbursement	No	No
15	Petty cash	No	No
16	Reimbursement of travel costs	No	No
17	Payments for unfair dismissal	No	No
18	Workers' compensation -		
	Returned to work	Yes	Yes
	Not working	No	No
<b>Leave payments</b>			
19	Annual leave	Yes	Yes
<b>Termination payments</b>			
20	Termination payments -		
	In lieu of notice	Yes	Yes
	Unused annual leave	Yes	No
<b>Bonuses</b>			
21	Performance bonus	Yes	Yes
22	Bonus labelled as ex-gratia but in respect of ordinary hours of work	Yes	Yes
23	Christmas bonus	Yes	Yes
24	Bonus in respect of overtime only	Yes	No

Table 1

Although SGR 2009/2 forms guidance and is not binding upon the Commissioner of Taxation, the confusion that this creates is unnecessary. In addition, we are concerned that these payments are capable of being gamed by employers or employees in order to reduce an employer's SG liability, or inflate an employee's take-home pay at the expense of their retirement savings.

AIST proposes that SG be linked to an employee's gross remuneration rather than OTE to reduce confusion, red tape, and manipulation.

## 2.1.6 Increase funding for indigenous identification schemes

AIST notes that in many aboriginal communities, a significant number of individuals do not possess sufficient identification documentation to claim their superannuation benefits.

We are aware of two notable schemes which exist in the Northern Territory where individuals are verified by tribal elders and provided with photographic identification, however we are aware that funding to these schemes is uncertain.

AIST recommends that funding for these schemes should be assured, in order to ensure that fraud and mistakes are minimised, and so that superannuation funds can best serve their indigenous members without the roadblocks caused by a lack of documentation.

## 2.2 Measures to reduce inequity

### 2.2.1 Maintain the Low Income Earner's Contribution (LISC)

AIST strongly recommends the maintenance of the Low Income Superannuation Contribution scheme as it is sound and equitable policy. Whilst we understand that the LISC is presently being repealed as part of the Minerals Resource Rents Tax repeal bills, AIST believes that the LISC is important enough to be considered on its own.

At the time, AIST opposed the linking of the LISC to the MRRT. We recognised that in ordinary circumstances, the revenue from a taxation measure contributes to consolidated revenue, and expenditure measures are rarely included as part of a package with a revenue measure. In our submissions, we pointed to the issues associated with an unlinked item of government expenditure, the age pension, which is affected by insufficient retirement savings<sup>3</sup>.

AIST supports the LISC as a key to Australia's retirement policy, and points to this scheme as the most efficient method that we presently have to reduce inequity in superannuation.

We therefore offer the following comments in support of the LISC.

#### 1. The LISC scheme provides support to the Government's commitment to Australia's three-pillar retirement system

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<sup>3</sup> O'Connor, D. 2010. *AIST briefing paper November 2010: The benefits of an SG rate of 12 per cent.* [pdf] Melbourne: Australian Institute of Superannuation Trustees. <http://tinyurl.com/lvv5em8> [Accessed: 29 Oct 2013].

Compulsory superannuation is an essential component of Australia's three pillar retirement system and provides a sound foundation for the Government in addressing retirement income needs and the financial risks associated with an ageing population.

The bedrock of retirement savings can be witnessed by the growing superannuation coverage of the Australian workforce. According to the Australian Bureau of Statistics, the proportion of employees covered by superannuation has grown from 32% in 1974 to 94% in 2007<sup>4</sup>.

Given this solid foundation of retirement savings, it is even more pressing that highly visible taxation inequities - which affect millions of Australians within the compulsory superannuation system - be addressed. The compulsory superannuation pillar of the Australian superannuation system is a core priority.

## **2. The LISC scheme redresses fundamental inequities in the Australian taxation system**

Estimates from the end of the 2012-13 financial year considered that over 3.6 million workers benefit from the Low Income Superannuation Contribution scheme. This is just over 30% of the Australian workforce. Unfairly taxing superannuation guarantee contributions reduces the level of superannuation guarantee contributions in a member's superannuation account. In turn, this reduces the effectiveness of superannuation guarantee contributions in a way which is especially inequitable for low income earners.

The LISC scheme overcomes a fundamental inequity within the compulsory superannuation system where low income earners without the LISC are paying the same rate of tax on compulsory superannuation contributions as other income earners, even though they may not even be subject to income tax.

## **3. The LISC scheme incentivises investors to save for their future**

Economic theory has long held that individuals should be rewarded for the decision to forgo spending in the short term, in return for putting money aside for the future. Tax without the LISC on the contributions of low income earners at the same rate breaks this rule.

Given that superannuation guarantee contributions are taxed at a flat 15%, this gives rise to a tax benefit that is larger for higher income earners with higher marginal tax rates.

## **4. The LISC scheme helps to redress the retirement income savings gap of women – over 50 per cent of all women employees would benefit**

Estimates from the end of the 2012-13 financial year note that of the 3.6 million workers who would benefit from the scheme, approximately two-thirds are women. This means that the scheme would

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<sup>4</sup> ABS. 2009. *Australian Social Trends, March 2009*. Cat. No. 4102.0 Canberra: Australian Bureau of Statistics.

benefit over 50 percent of all women employed in Australia. Both the average accumulation scheme and retirement savings balances of women are slightly more than half that of men.

Given that more women than men work part time (and this trend is continuing) AIST submits that the LISC scheme would continue to help redress lower retirement savings of women.

## 5. The LISC scheme helps further increase confidence in the superannuation system

The LISC scheme, which addresses a fundamental inequity, coupled with a lack of a further change to the superannuation system, would help further increase member confidence.

Member surveys consistently find that the top retirement issue for members is whether they will have an adequate retirement benefit. Confidence in the superannuation system is assisted through addressing such inequities.

## 6. Better recognises the changing nature of Australia's workforce, where there is a growing number of part time and casual workers

The LISC scheme better targets the growing trend to part time and casual work through redressing a major tax inequity affecting lower income earners without such a scheme being in place. Part time work has become an ever increasing and important form of employment.

According to a 2008 report from the Productivity Commission<sup>5</sup>:

	Total employment	Men	Women
1966	10%	4%	24%
2007	29%	15%	45%
From ABS <sup>6</sup>			
2011	30%	16%	47%

<sup>5</sup> Abhayaratna, J., Andrews, L., Nuch, H. and Podbury, T. 2008. *Part Time Employment: the Australian experience*. [report] Canberra: Productivity Commission.

<sup>6</sup> ABS. 2011. *Employee Earnings, Benefits and Trade Union Membership, Australia, August 2011*. Cat. No. 6310.0 Canberra: Australian Bureau of Statistics.

## 2.2.2 Allow for the mandatory provision of salary sacrifice for all employees

In addition to the reasons referred to above, AIST sees the provision of salary sacrifice to all employees as a means to address inequity.

Salary sacrifice arrangements are not available to all Australian workers on an equitable basis. The ability to salary sacrifice is provided either through agreement among industrial parties or by direct agreement between an employee and their employer. In many cases, information about this arrangement is only available to employees when they proactively seek the information from the employer. A significant number of Australian workers do not have access to salary sacrifice arrangements.

AIST recommends that the ability to salary sacrifice into superannuation be provided to all employees as an equity measure.

## 2.2.3 Removal of the \$450 per month superannuation guarantee (SG) threshold

In addition to the reasons referred to above, AIST sees the removal of this threshold as a means to address inequity.

We note that the high concentration of females working part-time is a contributing factor to their relatively low superannuation balances. Women comprise over 67 per cent of the part-time workforce and have almost the same number of full time and part-time workers<sup>7</sup> (over twice as many full time workers are men as compared to part time). AIST has long argued that abolishing the exemption on compulsory superannuation contributions for those earning less than \$450 per month would benefit many women – as well as males – on low incomes, working on casual or part-time bases. In female-dominated industries where working for several employers is common (such as retail, hospitality and nursing), many employees are excluded from the SG system because the \$450 threshold applies only to a single employer, and not on a combined income level. Australia ranks 5<sup>th</sup> in the OECD for incidence of women in part time work at 38.5%.<sup>8</sup>

AIST recommends that this threshold be abandoned for gender inequity reasons.

## 2.2.4 Abolish the loophole that allows a reduction of SG amounts due to salary sacrifice.

Additionally, the Government should legislate that where employees partake in a salary sacrifice arrangement, their employer cannot base their SG obligations on the reduced 'take-home' salary amount.

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<sup>7</sup> ABS, *Employee Earnings and Hours*, Australia, May 2010 (6306.0)- [Accessed 27 January 2012]

<sup>8</sup> OECD, <http://www.oecd.org/statistics/#d.en.199456>, Chart LMF1.6.A: Incidence of part-time employment, 2011, Sourced 04/01/13

AIST has long proposed the abolition of this loophole, as it allows employers to profit from diligent employees who are proactively contributing towards their retirement, and short changes employees, who in many cases are not even aware that their contributions are less than what they think.

### **2.2.5 Retain age 60 as the preservation age**

Much has been written about the need to improve superannuation's sustainability, including moving the preservation age from 60 years of age. Despite the implementation of SG in 1992, Government figures suggest that outlays on aged services, pensions and health will make up almost half of all government expenditure in 2050.

In yet to be published AIST research, a gradual shift in the Official Retirement Age from 60-65 for females, announced in 1994 found that an increase in the eligibility age of one year resulted in a decline in retirement probability each year by approximately 10 percent. This was seen to support increasing the Official Retirement Age (ORA) at the time.

However, in the same study, it was noted that almost three-quarters of males and more than 40% of females that retire before the age of 55 do so involuntarily. Health reasons are the biggest driver however retrenchment and inability to find work also play a role. When the broader definition of involuntary retirement (which includes retiring to care for others) is used, the proportion of females who retire involuntarily before 55 increases to almost 60%.

Although longevity is a problem facing retirees, we note that there is still a significantly large number of Australians, for whom the reality of finding work at this age is not realistic. The unpublished study notes that almost one half of super balances accrue in the last decade of employment so people who have to leave work (but involuntarily - health, caring, redundant, unable to find other work) miss out.

The same study noted that in other countries, race is a key determinant of involuntary retirement. The Australian data is less conclusive with only minor differences between those born here and overseas. However, a more telling determinant is English language proficiency and that this is even more critical for females.

In the case of indigenous Australians, the average life expectancy is significantly less than the national average. We point to well documented problems with indigenous health as evidence that, for these Australians, their working days are behind them.

In another case, where Australians who have been working in more physical occupations are normally unable to participate in the workforce far beyond age 60.

We would submit that that for all these Australians, they are already into their retirement and therefore should continue to be able to draw on their retirement benefits at age 60.

## 2.2.6 Tax superannuation contributions more equitably

AIST considers that the question of how superannuation contributions are taxed is a significant equity issue, and that further community discussion should take place within the context of the overall taxation system, with a view to ensuring a more equitable tax system.

This was a view that was canvassed in the Henry Review, and has been further discussed by ACOSS and others. This is a discussion that needs to continue and AIST fully supports a comprehensive discussion around the equity of taxation of superannuation contributions within the context of the tax review that will follow the Financial System Inquiry.

In the meantime, and notwithstanding the current pressures on the budgetary situation, we submit that the government should resist the introduction of ad hoc measures that can diminish public confidence in the superannuation system, and create uncertainty and confusion.

## 2.3 Measures to improve sustainability and adequacy

Our proposals to improve the sustainability and adequacy of the superannuation system call for a reform of the limits that exist with regards to superannuation. In addition, we point to Centrelink means testing.

### 2.3.1 Reform Centrelink means testing to ensure better targeting of age pension benefits

A veritable cottage industry examining shortfalls and problems with post-retirement in Australia has arisen in recent times. Numerous white papers and research reports have been released detailing the issues Australia faces with regard to increasing longevity, adequacy and financial sustainability of the system.

As a result of this study, a considerable number of problems have been identified, which will need to be addressed in the near future. Although these are legion, we have chosen in this submission to focus on one – potentially the elephant in the centre of the room: Centrelink means testing.

Much has been written about this subject, however the savings are evident. RiceWarner Actuaries<sup>9</sup>, for example, estimated that between 5-10% of Australia's age pension expenditure could be saved, through a careful needs-based age pension dispensation regime. Based on calculations from the Grattan Institute<sup>10</sup>, this cost savings is therefore as much as \$3.6 billion dollars per year, currently, however as future costs of

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<sup>9</sup> Ricewarner Actuaries. 2014. 'Reforming the Age Pension'. *Touchstone* [online] August 2012. Available at: <http://tinyurl.com/m3k7vwp> [Accessed: 30 Jan 2014].

<sup>10</sup> McGannon, C. 2014. 'Aged pension reform needed to fix Budget'. *MacroBusiness*, [blog] 29 January, Available at: <http://tinyurl.com/l32typr> [Accessed: 30 Jan 2014].

the age pension has been estimated to be as high as \$96 billion dollars<sup>11</sup>, the savings would correspondingly soar.

Whilst we realise that the Minister for Social Services, the Hon. Kevin Andrews MP, has recently announced that the age pension will be excluded from a review into social security sustainability, we point to the government's drive to reduce red tape and improve productivity in the public service. Consequently, we believe that not considering means testing for the age pension has the potential to create different means testing regimes for different government payments, and that this may therefore create additional productivity bottlenecks. We therefore recommend that consideration be re-extended to the age pension.

### **2.3.2 Implement a limit on the amount that can be taken as a lump sum**

Compulsory superannuation in Australia is still very young. Consequently, the amount that Australians can take as lump sums must be questioned, as experience shows that Australians are still exhausting their superannuation early into their retirement.

To ensure that Australians are able to enjoy a realistic retirement, AIST recommends that a limit be placed on lump sum withdrawals. AIST believes that a suitable amount should still be set relatively high, to allow for one off expenses such as travel at the start of retirement. The remaining part of one's superannuation benefit would ideally be only available via a superannuation income stream.

### **2.3.3 Implement a lifetime limit in non-concessional contributions**

The present system allows for members of superannuation funds to contribute large amounts non-concessional – presently \$150,000 each year, or \$450,000 over three years if the bring forward rule is utilised.

To ensure that superannuation as a concessional taxed environment is not misused, and to simplify the rules regarding contributions, it is recommended that the non-concessional annual cap be replaced with a lifetime cap.

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<sup>11</sup> Main, A. 2013. 'Future pension costs much higher than official forecasts'. *The Australian* [online] 4 June. Available at: <http://tinyurl.com/lyauspp> [Accessed: 30 Jan 2014].