



5 March 2009

By email: AFTSretirement@treasury.gov.au

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Australia's Future Tax System – Retirement Income Consultation Paper

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Federal Government's Retirement Income Consultation Paper as part of its review of the Australian tax system.

Consumer Action supports the Federal Government's broad approach to reforming the retirement income system to ensure a fair, less complex and efficient regime. We focus on Section 3 of the consultation paper, 'An acceptable retirement income system' which largely deals with the issue of tax concessions in superannuation. It is our view that currently, the various tax concessions on superannuation are unfair and inequitable, favouring higher income earners over those on lower incomes. Furthermore, it also accentuates a generational inequality between those of pre-retirement and retirement ages. This is particularly highlighted by an issue not addressed in the consultation paper, the 21.5% tax on early release of superannuation benefits. Any future reforms to superannuation must focus on closing these gaps to ensure a more equitable retirement income system.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Low income earners and contributions tax rate

For many consumers, contributions to a superannuation fund such as 'superannuation guarantee' payments and 'salary sacrifice' amounts are not taxed at the same rate as an employee's personal income but at a rate of 15% when paid into a complying superannuation fund. Such contributions are taxed at a concessional rate to essentially encourage savings and to assist in allowing a person's retirement savings to grow.

However, as acknowledged in Treasury's 'Architecture of Australia's tax and transfer system August 2008', the changes to personal income tax rates since 2000 have severely impacted on low income earners including part-time employees.¹ Based on the 2008/09 tax rates, it is estimated that around 1.2 million people will not receive a personal income tax benefit from the tax rate applied to their concessional superannuation contributions. In addition to the number

¹ The Australian Government, Architecture of Australia's tax and transfer system, August 2008 pp 244 -245.

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without any concession on contributions, an estimated 1.2 million people only have a concession equivalent to 1.5% points (the Medicare levy). Indeed, the consultation paper notes that, from 2010-11, a person earning a third of Average Weekly Ordinary Time Earnings (**AWOTE**) will receive a concession of 1.5 percentage points on their concessional superannuation contributions. This compares to a concession of 16.5 percentage points for a person earning AWOTE (approximately \$58,000) and 31.5 percentage points for someone earning three times AWOTE. In other words, tax concessions are inequitable benefiting those on higher incomes by giving them more incentive to contribute to their superannuation and build their retirement savings.

Furthermore, the Minister for Superannuation and Corporate Law, Senator Nick Sherry, has also confirmed that the Federal Government will look into a further anomaly in the superannuation system. Low income earners who do not pay personal income tax are still required to pay 15% for contributions into their superannuation, hence removing any incentive to make contributions to superannuation.² We support removing this anomaly.

Recommendation: For consumers not receiving tax concessions from superannuation contributions, the current 15% flat tax on contributions should be replaced by a more progressive tax rate to benefit lower income earners. Furthermore, contributions made by consumers who do not pay income tax should be tax free and a government funded rebate should also be introduced to ensure that such consumers are benefiting rather than being disadvantaged by making contributions into superannuation as is the case now.

Differential take up of incentives

The different tax treatment of certain contributions also causes inequity between higher and lower paid consumers. The previous Government sought to make superannuation more attractive to low income earners by introducing the co-contributions scheme. In the scheme, the federal government either fully or partly matches superannuation contributions made by eligible individuals on incomes of up to \$60,342 for the 2008-09. Those on \$30,342 or less are eligible to receive the maximum co-contribution of \$1.50 for every \$1 contributed to super up to \$1,000. The maximum co-contribution is \$1,500. Although this is designed as an incentive for lower income earners to invest in superannuation, it is less likely that lower income earners on \$30,342 or less will be able to make such a contribution into their superannuation, given normal day to day cost of living issues. According to the consultation paper it is estimated that in 2008/09 approximately 1.4 million people will take advantage of the co-contribution scheme and \$1.1 billion of co-contributions will be paid. However, this only represents 20% of people who would be eligible for the scheme, highlighting that there is not a high take up of the scheme.

A tax offset may also apply if contributions are made on behalf of a consumer's spouse. This applies to contributions made on behalf of non-working or low income-earning spouses, whether married or de facto. A consumer may be able to claim an 18% tax offset on super contributions of up to \$3,000 made on behalf of a non-working or low income-earning spouse. Again it is difficult to envisage how someone on a low income will be able to afford to make contributions in order to claim the tax offset. This scheme is likely to benefit households with one high earning individual.

Other concessions such as salary sacrifice also benefit those on higher incomes allowing them to reduce their incomes and with it their personal income tax while at the same time receive a tax concession for salary sacrifice contributions into their superannuation. Again such contributions are more difficult for those on lower incomes who, as mentioned, are more burdened with the day to day cost of living. This form of contributions is geared at those on higher incomes and is

² Maiden S, 'Nick Sherry flags superannuation reform for low income earners', The Australian 11 December 2008

another example of the concessions, in practice, benefitting the 'haves' over the 'have nots. Such discrepancies are obvious and the system is unfair and inequitable.

Recommendation: Schemes such as co-contributions and spouse contributions require examination and perhaps should be replaced by the introduction of a government funded rebate for low income earners, particularly those that do not pay income tax as mentioned earlier. In order to fund such rebates further examination may also be required in tightening super tax breaks for higher income earners such as lowering the caps for the amount an individual can salary sacrifice per financial year.

Generational inequity – early release of superannuation benefits

Taxation in the current superannuation system also enforces a generational inequity, particularly between those of retirement age and non retirement age. This was entrenched in 2007 with the removal of taxation on retirement benefits paid to people over the age of 60. The Federal Government has made it clear that it will not consider re-introducing this tax as part of the current tax review. Nevertheless, this generational inequity is accentuated when considering the issue of taxation on the early release of superannuation benefits, an issue which is not considered in the Retirement Income Consultation Paper.

According to the Superannuation Industry (Supervision) Act 1994 (**the Act**), the early release of an individual's superannuation benefit is permitted under certain circumstances subject to the rules of the fund or Retirement Savings Account (**RSA**). A consumer can access their superannuation benefit before retirement age if they meet certain criteria such as financial hardship, specified or have compassionate grounds, permanent departure from Australia, permanent incapacity, terminal illness and a minimum of \$200 in the superannuation account.

The two main criteria for early withdrawal are financial hardship and specified grounds. In short the Act allows a consumer to access their superannuation under financial hardship if they are in receipt of a Commonwealth income support payment, and have been so, continuously, for the last 26 weeks; and if they satisfy the trustee/RSA provider that they are unable to meet reasonable and immediate family living expenses. (There are guidelines that Australian Prudential Regulation Authority (**APRA**) has produced to assist trustees in assessing claims, including a definition of 'unable to meet reasonable and immediate family living expenses.')

If unable to claim under financial hardship the most common means to access superannuation benefits is through specified grounds. Obtaining funds under specified grounds is administered by APRA and are as follows;

- medical treatment or transport for the member or his/her dependant where the treatment is necessary to treat a life threatening illness or injury, or to alleviate acute or chronic pain or acute or chronic mental disturbance, and where such treatment is not readily available through the public health system;
- to prevent foreclosure of a mortgage, or exercise of a power of sale over the member's principal place of residence;
- modifications to the family home and/or vehicle to meet the special needs of a disabled member or his/her disabled dependant; or
- palliative care or death, funeral, or burial expenses for a member or his/her dependant.

The taxed element of early release of superannuation benefits to individuals under the age of 55 is taxed at 21.5% (which includes the 1.5% Medicare levy). The purpose of the tax is to remove any tax concessions on the superannuation benefits and more significantly as an incentive for

consumers to not access their superannuation savings until retirement age. However, given that the nature of most claims for early release of benefits will be for severe financial hardship and specified grounds, the tax imposes an extra burden on people who are already in financial distress.

It is also difficult to determine whether the 'withdrawal tax' on superannuation acts as a disincentive to consumers. It can be assumed that if a person meets the criteria for financial hardship and specified grounds that they are desperate enough to bear the tax. According to a report by the Consumer Law Centre of the Australian Capital Territory (CLCACT) and the Australian National University, most individuals that accessed their superannuation due to specified grounds did so to prevent foreclosure of a mortgage.³ It tried to access data from APRA that would highlight, among other things, the number of ACT applications from 2000 until the end of 2006 for early releases of superannuation funds made for the purpose of preventing foreclosure or sale. APRA does not have such data but were able to provide CCL: the number of applications received and approved for early release of superannuation for specified grounds.

Total Claims Received by APRA 2001-2006

Year	Claims Received
2001	11,763
2002	11,186
2003	11,732
2004	11,300
2005	12,779
2006	16,500

Total Claims Approved by APRA 2001-2006

Year	Claims Approved
2001	6,331
2002	6,788
2003	7,775
2004	9,212
2005	10,459
2006	13,871

CLCACT noted a marked increase in applications received and approved, particularly between 2005 and 2006 where application numbers received went up 29% and approved went up 33%.

Equally notable was the increase in total amount of funds released. According to the CLCACT;

Total Amount of Funds Approved for Release by APRA 2001-2006

Year	Funds Approved for Release
2001	\$31,607,258.97
2002	\$37,828,316.13
2003	\$48,381,407.92
2004	\$64,548,847.99
2005	\$76,661,728.27
2006	\$135,328,742.13

³ The Consumer Law Centre of the ACT and the Centre for Commercial Law, The Australian National University, They still want to take our house: A further investigation into house repossessions in the ACT Supreme Court, December 2007. Much of this report focuses on the level of people who have experienced mortgage foreclosure despite getting early access to their superannuation. It resulted in them losing both their house and retirement savings.

CLCACT surmise the overall amount of funds released in 2005 and 2006, combined with nationwide evidence that mortgage default rates are increasing, suggests that the increase in applications to APRA for early release of superannuation may be related to mortgage defaults.⁴ We also believe that the 21.5% tax does not act as a disincentive for early release of superannuation benefits given the recent increase in applications and approvals for early release as highlighted by these figures. For that reason, given that individuals who access their superannuation under financial hardship and specified grounds are often desperate for the funds, many of whom, according to the CLCACT, in an attempt to prevent foreclosure on their mortgage, it is also unfair to tax this early withdrawal of superannuation at 21.5%.

This tax highlights a huge gap between those who access their superannuation early and those who receive a tax free benefit at retirement. It should be noted that the federal government's recent decision to remove the 21.5% tax on payouts for early withdrawal due to terminal medical conditions is welcomed but more is needed to assist those who access their superannuation on financial hardship and specified grounds.

Recommendation: A review is required of the tax treatment of the taxed amounts of the lump sum payments of early released superannuation benefits, particularly for financial hardship and specified grounds, as there does not appear to be much research in this area. Rather than punishing consumers for claiming their superannuation early with a 21.5% on the taxed element of their fund, more regulation is required in assessing a consumer's eligibility for early withdrawal, such as not releasing superannuation if a consumer's mortgage is likely to foreclose even if they were able to access their retirement savings. This may assist in reducing the levels of early release of benefits rather than an unfair tax which is currently not impacting on the levels of early release of funds.

Conclusion

Consumer Action has focussed on the section related to tax concessions of superannuation contributions in its submission regarding the Retirement Income Consultation Paper. We welcome the Federal Government's attempts to reform the retirement income system and the overall Australian taxation system. We believe that there are important elements of the retirement system which should be referred such as the tax on the early release of superannuation and the lack of incentive for low income earners to contribute into superannuation which need to be considered in ensuring a fairer and more efficient retirement income system.

Please contact Sean Carroll on 03 9670 5088 or at sean@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

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⁴ Consumer Law Centre of the Australian Capital Territory and the Centre for Commercial Law, The Australian National University, "They still want to take our house": A further investigations into house repossessions in the ACT Supreme Court.