FINANCIAL ADVICE ASSOCIATION AUSTRALIA

17 April 2023

Director
Tax and Transfers Branch
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuation@treasury.gov.au

Dear Sir/Madam

Better targeted superannuation concessions

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to provide feedback on Treasury's *Better targeted super concessions consultation* paper.

In principle, our association supports the intent of the government announcement to ensure the superannuation tax concessions available to all Australians are fair, reasonable and equitable. The superannuation tax concessions are fundamental provisions of the system that incentivise and help individuals to save for a self-funded retirement and alleviate demand for government support in later years. The FAAA believes that those with very substantial superannuation balances should not have unlimited access to the tax concessions on superannuation earnings.

We are supportive of a higher tax rate applying to the investment earnings of very large superannuation account balances, however we have reservations with respect to what is the most appropriate threshold and tax rate, the ongoing indexing of this threshold and how the additional tax might be calculated. We also note that in reality, this measure will result in much more than a doubling of the tax rate that applies to these larger balances.

The FAAA provide the following feedback on the proposal:

<u>Complexity</u>

The scale of the different rules, requirements, caps, restrictions and exemptions in the superannuation laws make it an extremely complex system. This impacts the workability, fairness and reasonableness of new measures, such as the proposed changes to superannuation tax concessions, as well as consumers' confidence in and engagement with the system. The proposal will introduce a new separate set of laws to the system with a new complex formula for calculating an individual's earnings that will be subject to the additional tax rate and tax liability.

Consideration should be given to aligning the new measure to existing superannuation and taxation laws as much as possible.

[1] The Financial Advice Association of Australia (FAAA) was formed in April 2023 from a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest standing associations of financial planners and advisers. (See attachment 1 – About the FAAA.)

The FAAA appreciates the difficulty in designing a calculation based on the information available to the ATO so as not to impose unreasonable additional reporting requirements on funds, the cost of which would be borne by consumers (the members). We appreciate the limitations that this may impose.

<u>Threshold</u>

The superannuation system will not reach maturity until approximately the mid-2030's. Incomes increase each year, which means the superannuation guarantee and potentially member contributions will also increase each year. Therefore, superannuation account balances will grow, resulting in a larger percentage of individuals exceeding this threshold over-time. While $3m seems like a large super balance today, it may not be by the time the system reaches maturity and beyond. Australians may need that much in super to support themselves in retirement in the future. Thus, this measure might be counterproductive in terms of alleviating the pressure on government funded benefits that will arise as a result of an aging population.

To ensure the equity of the system is maintained over time, the threshold should increase to keep pace with wage increases. Applying indexation to the threshold is consistent with other measures in the superannuation system, most relevantly, the Transfer Balance Cap (TBC). "*The general transfer balance cap is reviewed each financial year and indexation occurs in line with the consumer price index in $100,000 increments.*"[1]

The TBC is expected to increase to the level of the proposed $3 million threshold over the next 10 to 15 years, which will impact a significantly larger cohort of Australians given the rise in wages and increasing maturity of the super system at that point in time. We would consider the situation where the TBC exceeded the threshold for a higher tax rate on superannuation to be highly problematic.

The FAAA notes the government's reluctance to apply indexation at this time and the Treasurer's public statements that this should be a decision for future governments. However, given the long-term nature of superannuation, consumers need certainty as to what will happen when the indexed transfer balance cap increases to the proposed $3 million threshold for the additional tax rate. The proposal should be future-proofed and have surety to enhance confidence in the system.

In the context of the uncertainty about reaching this threshold in the future, particularly when it is not indexed, this proposal may have a material impact upon the willingness of younger Australians to salary sacrifice into super. It is our view that this would be a very negative outcome for Australians.

The FAAA recommends the proposed superannuation earnings concessional tax threshold be higher than $3 million and indexed in line with increases in the CPI to provide greater certainty for consumers over the long-term. We note that other key superannuation industry stakeholders have previously proposed a cap of $5 million for superannuation account balances.

<u>The real increase in the tax rate</u>

Whilst we note that the consultation paper refers to this reform bringing the headline tax rate from 15% to 30%, the reality is that the increase will be substantially more than a doubling of the tax rate. This is as result of the following factors:

- The taxing of unrealised gains (including the timing of the payment of tax).

- The lack of access to the one third Capital Gains Tax discount that applies to super funds.
- The lack of access to the benefit of franking credits that would otherwise be available to super funds.

We further note that this proposal creates a substantial differential in the treatment of capital gains between money invested inside superannuation and outside. Australians will have access to a 50% reduction in the taxable capital gain outside super, where it is not recognised until the investment is sold, whereas it will be taxed before it is realised and without any discount within super, for those Australians who have an account balance of greater than $3m.

In this context, we recommend that the increased tax rate be reduced to a level materially below 30%, to avoid creating a significant disincentive for Australians to invest in their superannuation in their earlier years in the workforce. We believe that this is necessary to ensure an outcome that is fair, equitable and reasonable for the many Australians who might ultimately be impacted.

Unrealised gains

The proposed formula effectively includes unrealised gains in the year's earnings. This results in many circumstances where assets held inside super may incur a higher effective tax rate than assets held outside of super, along with unequal treatment of the discounting for capital gains. The timing of the payment of tax is also an important consideration, in that a large tax may be payable in a year of very strong investment returns, whereas the following years could see market declines with no cash refund resulting. The design of this measure is without precedent and raises the question of fairness.

The FAAA suggests consideration be given to investigating this issue further to improve the fairness in the formula and certainty for consumers. This could include consideration of exempting unrealised gains from the calculation, and changes to the preservation rules to allow individuals to make a one-off withdrawal to remove excess funds from the super system to avoid this issue. Otherwise, we fear that the outcome would be that Australians would be required to keep their money invested in what might be a higher tax environment than is optimal, and losing the many benefits of deferred consumption that the superannuation system encourages.

Insurance benefits

The FAAA supports the inclusion of 'insurance benefit payments for policies owned inside super' in the net contributions subtracted from the calculated earnings under the proposal. As stated in the consultation paper, such payments would not be classified as earnings in the year of receipt.

Conclusion

The FAAA supports fairness and equity in the superannuation system and suggests that consideration be given to identifying solutions to the above issues raised, to improve the short and long-term certainty for consumers regarding proposed changes to the superannuation tax concessions. Improving surety in the proposal will raise consumer trust and investment in the superannuation system and increase Australians' preparedness for self-funded retirement.

We would welcome the opportunity to discuss with the Treasury any matters raised in our submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

Phil Anderson
Interim General Manager Policy and Advocacy
Financial Advice Association of Australia

Attachment 1 - About the FAAA

The Financial Advice Association of Australia (FAAA) was formed in April 2023, from a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest standing associations of financial planners and advisers.

The FPA was a professional association formed in 1992 as a merger between The Australian Society of Investment and Financial Advisers and the International Association of Financial Planning. In 1999 the CFP Professional Education Program was launched. As Australia's largest professional association for financial planners, the FPA represented the interests of the public and (at the time of the merger) almost 11,000 members. Since its formation, the FPA worked towards changing the face of financial planning, from an industry to a profession that earned consumer confidence and trust, and advocated that better financial advice would positively influence the financial wellbeing of all Australians.

The AFA was a professional association for financial advisers that dated back to 1946 (existing in various forms and under various names). The AFA was a national membership entity that operated in each state of Australia and across the full spectrum of advice types. The AFA had a long history of advocating for the best interests of financial advisers and their clients, through working with the government, regulators and other stakeholders. The AFA had a long legacy of operating in the life insurance sector, however substantially broadened its member base over a number of decades. The AFA had a strong focus on promoting the value of advice and recognising award winning advisers over many years. The AFA had strong foundations in believing in advocacy for members and creating events and other opportunities to enable members to grow and share best practice.