2010 Federal Budget and the Henry Tax Review — the super tinkering continues

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The financial services industry is bracing itself for what is aptly described as an avalanche of reforms which have been announced in recent months. They include the Henry Review into Australia's Future Tax System (Henry Review), the future of financial advice changes, the proposed changes to superannuation in the 2010 Federal Budget, the new regime for the taxation of managed investment trusts, the government's response to the Johnson Report, and the impending report of the Super Review by Jeremy Cooper, to name but a few.

This article provides a summary of the government's response to the retirement incomes recommendations of the Henry Review, and the subsequent Budget announcements concerning superannuation, coupled with some high level commentary on the proposed changes. In general, the superannuation reforms are to be applauded as a genuine attempt by the government to improve retirement incomes for Australians. However, one notable exception is the proposed changes to the co-contribution scheme.

It will be important for the government to be mindful of the risks associated with unnecessary regulation in the legislation supporting the reforms. Unnecessary regulation and complexity in the system do not assist the trustees and other service providers who are responsible for managing the system, nor do the costs involved serve the interests of Australians and their retirement savings.

The Henry Review and retirement incomes

On 2 May 2010, the federal government released its response to the Henry Review. The Henry Review made 138 recommendations in its final report, seven of which relate to retirement incomes. A large part of the government's response to date has focused on these recommendations concerning retirement incomes. Table 1 provides an extract of the retirement incomes recommendations from the report of the Henry Review. The extracts are coupled with the government's response, an indicative timeline for their introduction and some brief commentary.

Table 1: Retirement incomes recommendations and responses

Henry Review recommendations on retirement incomes	**Government response, indicative timeline and comments**
Taxation of superannuation	
Recommendation 18 The tax on superannuation contributions in the fund should be abolished. Employer superannuation contributions should be treated as income in the hands of the individual, should be taxed at marginal personal income tax rates, and should receive a flat-rate refundable tax offset. An offset should be provided for all superannuation contributions, up to an annual cap of $25,000 (indexed). The offset should be set so the majority of taxpayers do not pay more than 15% tax on their contributions. The cap should be doubled for people aged 50 or older. An annual cap on total contributions should continue to apply.	No direct government response. ***Government contribution for low income earners*** The government will provide a superannuation contribution of up to $500 annually for individuals who have an adjusted taxable income of up to $37,000. *Indicative timeline* Concessional superannuation contributions made from 2012–13 will be eligible with the first government contribution paid in 2013–14. ***Comments***

The offset should replace the superannuation co-contribution and superannuation spouse contribution tax offset. Compulsory superannuation contributions made by employers should not reduce eligibility for income support or family assistance payments. They should also not form part of the calculation for child support.	Although it did not respond directly to this recommendation, the government was motivated by a desire to make superannuation concessions fairer — hence the introduction of the $500 government contribution for low income earners. It is anticipated that this initiative will benefit 3.5 million individuals. It is unclear whether a more wholesale review of the taxation of superannuation will form part of the government's long-term plans if it is re-elected. It is noteworthy that the joint press release from the Treasurer and the Prime Minister expressly states the following: *"The Government also reaffirms that it will never remove tax free superannuation payments for the over 60s."* Further, the 2010 Federal Budget did not include any wholesale changes to the tax treatment of superannuation. Some would argue that the industry has witnessed enough in the way of tax reforms since the introduction of the Simpler Super (later renamed Better Super) changes introduced by the Howard government.
Recommendation 19 The rate of tax on superannuation fund earnings should be halved to 7.5%. Superannuation funds should retain their access to imputation credits. The 7.5% tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.	No government response. See our comments above in respect of recommendation 18.
Superannuation contributions	
Recommendation 20 The restriction on people aged 75 and over from making contributions should be removed. However, a work test should still apply for people aged 65 and over. There should be no restrictions on people wanting to purchase longevity insurance products from a prudentially regulated entity.	No government response, but three reform items for superannuation contributions were announced. ***Increasing the SG rate to 12%*** The government has rejected the recommendation in the Henry Review's preliminary report in May 2009 that the superannuation guarantee (SG) rate remain at 9%. Instead, the government proposes to increase the SG rate incrementally to 12% by 2020, as set out below. *Indicative timeline* Year SG rate (%) 2013–14 9.25 2014–15 9.5 2015–16 10 2016–17 10.5 2017–18 11 2018–19 11.5 2019–20 12 ***Raising the SG age limit from 70 to 75*** The government recommends raising the SG age limit from 70 to 75. This will mean that workers aged 70–74 will be eligible to have SG contributions made on their behalf. The new SG age limit will also now match the age limit for voluntary and self-employed contributions.

	Indicative timeline This recommendation will commence from 1 July 2013. ***Older workers and concessional contributions cap*** The government recommends a separate higher concessional contributions cap of $50,000 (indexed) for those aged 50 or over who have total superannuation balances of less than $500,000. *Indicative timeline* This recommendation will take effect from 1 July 2012, when the existing transitional concessional contributions cap was due to fall to $25,000. The government will consult with the superannuation industry on the operation of the $500,000 threshold. ***Comments*** Although the government has not specifically responded to this recommendation, it has announced three significant initiatives described above which will be warmly received by the superannuation industry. In terms of addressing issues surrounding adequacy of retirement incomes and equity in the system, the proposals are a step in the right direction. The staggered introduction of the increase in the SG rate is desirable in terms of allowing employers and unions the opportunity to factor the reforms into any future salary and wage negotiations. However, subject to union and government efforts to minimise it, there is a clear risk that employers may undermine this aspect of the reforms by simply reducing salary and wage increases to offset the impact of the additional 3% in SG contributions. While the increase in the SG age limit from 70 to 75 will only impact a small number or workers (approximately 33,000), it will address a current inequity in the system and a serious issue for mature age workers. Finally, it is critical to note that the window has been left open for the prospect of more changes. In the joint press release of the Treasurer and the Prime Minister, the following statement is made: *"In the coming months we will have more to say on a number of other areas considered by the review, especially making tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system. This would represent a full second term agenda."*
Longevity risk and annuities	
Recommendation 21	
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.	No government response. ***Comments*** Given the findings of the Intergenerational Report and much of what has been occupying the minds of industry experts, it is disappointing that this aspect of the Henry Review was not embraced by the government.

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 (Cth) 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.	
Recommendation 22 The government should consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income. This should be subject to a business case that ensures the accurate pricing of the risks being taken on by the government. To limit the government's exposure to longevity risk, it should consider placing limits on how much income a person can purchase from the government.	The government has rejected this recommendation and confirmed that it will not offer a government annuity product. See the comments above in respect of recommendation 21.
Financial literacy and superannuation administration	
Recommendation 23 The government should help make people more aware of the retirement income system, and therefore better able to manage their superannuation, by increasing the regularity of superannuation guarantee contributions, making it easier for people to manage their superannuation and providing people with a single point of contact for government agencies. Superannuation guarantee contributions should be paid at the same time as wages. This should be introduced over time so businesses can adjust their cash flows. As a first step, larger businesses (that is, businesses required to lodge their business activity statements on a monthly basis) should be required to pay superannuation guarantee contributions at least monthly. Employers should report superannuation contributions to their employees when a contribution is made. There should be a method of linking superannuation records, such as client identifiers like the tax file number, to make it easier for people to manage their superannuation. A superannuation portal where people can interact with government agencies and get information on retirement incomes should be developed. Over time, this portal should evolve, subject to suitable safeguards, so that people can manage all their superannuation through one channel.	No government response. ***Comments*** It is important to note that the Super System Review chaired by Jeremy Cooper published a preliminary report dated 22 March 2010 which introduced the notion of "SuperStream". SuperStream is the name the Review Panel has chosen to describe how to enhance the administration of superannuation in Australia. It is possible the government will revisit this issue once the Cooper Review finalises its recommendations and submits its report to the government. Further, the Financial Literacy Board has been established by the government to provide advice to the government and ASIC on financial literacy issues. We also understand that industry associations in the superannuation sector are working closely with government and the regulators to address issues such as those highlighted by the Henry Review in terms of awareness and understanding of the retirement incomes system.

2010 Federal Budget — confirmation of super changes and additional tinkering

On 11 May 2010, Treasurer Wayne Swan delivered the 2010 Federal Budget. Despite many references in the media commentary to a "no-frills" Budget with a focus on fiscal responsibility, there are many aspects of the Budget which impact on the financial services industry — in particular, superannuation. In many respects, the superannuation aspects of the Budget were a confirmation of what the government had already announced in the context of its response to the Henry Review, as discussed above.

As part of the Budget, the government confirmed its previously announced superannuation proposals, including:

- a government contribution of $500 annually for low income earners (from 1 July 2012);
- increasing the superannuation guarantee (SG) rate from 9% to 12% (gradually until the SG reaches 12% by 2019–20);
- raising the SG age limit from 70–75, meaning that workers aged 70–74 are eligible for SG contributions (from 1 July 2013); and
- workers aged 50 and over with superannuation balances below $500,000 will be able to make up to $50,000 in annual concessional superannuation contributions (from 1 July 2012).

Additional superannuation measures in the 2010 Budget

In addition to confirming its response to the Henry Review, the government also announced the following superannuation measures as part of the Budget:

- *$5.9 million over four years to cover the increased workload of the Superannuation Complaints Tribunal (SCT)*

  This funding increase for the SCT is designed to address what the government refers to as a 30% increase in the SCT's workload since 2004. In terms of helping the SCT achieve its statutory objectives of resolving superannuation complaints in a manner that is fair, economical, informal and quick, this will be a welcome initiative for the SCT.
- *The transfer of state and territory unclaimed superannuation monies to the Australian Taxation Office (ATO) (from the date of Royal Assent of the enabling legislation).*

  This is a sensible attempt by the government to streamline the administration of unclaimed superannuation monies. It will allow the states and territories to transfer unclaimed monies from public sector schemes to the ATO.
- *The ability for superannuation funds to deduct the cost of providing benefits for terminal medical conditions (TMC) (from 16 February 2008, the date when the TMC condition of release was introduced).*

  This is a positive step by the government and will address an anomaly in the existing tax laws regarding deductibility by superannuation funds and RSA providers of the costs of providing TMC benefits.
- *Permanently setting the matching rate for the government co-contribution at 100% and the maximum co-contribution that is payable at $1000 (this will continue on from the so-called "temporary" measures announced in last year's Budget, which reduced the matching rate to 100%). Further, the government has announced that it will freeze for 2010–11 and 2011–12 the indexation applied on the income thresholds which apply to the government co-contribution.*

  The permanent setting of the matching rate at 100% is a significant announcement that will adversely impact low and middle income earners who currently benefit from the superannuation co-contribution scheme. It means that the previously legislated increase in the matching rate to 125% in the 2012–13 and 2013–14 income years, and ultimately 150% in 2014–15 and later years, will not apply if the government's Budget announcement is adopted. The government currently provides a matching contribution for contributions made into superannuation from post-tax income. The matching contribution is up to $1000 for individuals with incomes up to $31,920 in 2009–10 and phases down for incomes up to $61,920, at which point the scheme does not apply. The proposed freezing of any indexation means that these thresholds will remain at $31,920 and $61,920 for the next two income years. Not surprisingly, these measures are designed to save the government $350 million over the forward estimates.
- *Various minor amendments to improve the administration of superannuation legislation for excess contributions tax and employer contributions (from the 2010–11 income year). The amendments include:*
  - — allowing the Commissioner to exercise a discretion in terms of excess contributions tax before an assessment is issued;
  - — clarifying the due date of the shortfall interest charge associated with excess contributions tax;

- — permanently allowing a claim for a deduction for eligible contributions to be made to successor superannuation funds; and
- — permanently allowing a claim for a deduction for eligible contributions to be made to successor superannuation funds; and

These amendments are designed to commence from 1 July 2010 and in large part will be welcomed by the industry. In particular, self managed superannuation funds will be pleased with a discretion being made available to the Commissioner as the issue of excess contributions tax has been significant for them and somewhat exacerbated by the penalties which are imposed under the current regime. What is less desirable is the fact that the discretion will only apply from 1 July 2010. This means that any earlier breaches of the concessional contributions caps are unlikely to be excused by the ATO.

Devil in the detail and avoiding complexity

There is no doubt that the superannuation changes are significant and, in some cases, long overdue. For example, the time-honoured debate about adequacy of retirement incomes has often led to a push for an increase in the SG rate beyond the existing 9%. While the proposed increase to 12% has not been embraced by all, it is a step in the right direction. Time will tell what the true impact will be on employers and their employees and retirement savings in Australia.

Notwithstanding the merits of the proposed reforms, it is important to acknowledge that some aspects of the reforms and their merit will be driven by the detail associated in the legislation which introduces the changes. The superannuation sector is no stranger to reform and tinkering with the system. It will be a refreshing change if the reforms do not create unnecessary complexity in the system for those whom they are designed to benefit, as well as for those trustees and service providers who are charged with the responsibility of managing the system.

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