2015-16 FEDERAL BUDGET SUBMISSION

About FSC

The Financial Services Council represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.4 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

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Executive Summary

This submission is provided to the Treasury at a time when our population is ageing, welfare costs are increasing, the tax base is shrinking and our competitiveness is under threat.

These are challenging times but we remain in control of our destiny if we make the necessary policy and budget changes.

We must both manage our demographic changes and ensure that we are backing our comparative advantages.

Accordingly, the Financial Services Council's submission to the 2015-16 budget process proposes short and long term budget policy changes to:

1. Increase private provision of welfare and pensions through insurance and superannuation to reduce Commonwealth outlays; and
2. Enhance the export capability of the $2.4 trillion funds management industry by implementing the recommendations of Mark Johnson AO.

Both of these objectives require budget decisions. There are many other medium and long term issues impacting the budget. However this year we will focus on these two matters and address broader superannuation and taxation issues through the forthcoming Tax White Paper.

Enhance the export potential of the $2.4 trillion funds management industry

The recent Financial System Inquiry (FS) reminded us that there remains much work to be done to enable our funds management industry to compete in our region.

The FSI again outlined a failure to capitalise on our comparative advantage.

The financial services industry recommends finishing an opportunity identified in Mark Johnson's 2009 review – exporting Australian managed funds.

As Johnson concluded, a combination of out-dated regulation and taxation settings has prevented Australia from exporting these skills for managing foreign capital.

For example, 60 per cent of the assets managed in Hong Kong belong to foreign investors, in Singapore; the number is 80 per cent.[3] In contrast, our pool of $2.4 trillion under management, less than five per cent is foreign sourced.[4]

Countries such as Luxembourg, Ireland, Singapore and Hong Kong have been successful in promoting and attracting financial services through targeted regulatory and taxation settings.

As Australia is not managing large amounts of foreign money, we do not receive the flow-on benefits from higher economic activity, employment and tax collection.

Instead, we are losing this business to Hong Kong, Singapore and others in our region. We urge the government to complete the Johnson recommendations.

In this budget submission, we specifically recommend widening the range of vehicles available to Australian fund managers and putting in place a competitive taxation regime.

The FSI clearly supported both objectives by stating: "policy makers should avoid adopting unique Australian regulatory approaches that are inconsistent with international practice." This is a reference to the archaic trust law vehicle to which fund managers have been limited.

The FSI also stated: "withholding tax increases the required rate of return for non-residents, which reduces the attractiveness of Australia as an investment destination." Accordingly, competitive withholding tax rates must be provided to Australian managed funds if they are to win investment mandates in dynamic markets.

Both of these changes are essential to realising the goal of increasing our competitiveness in funds management. We commend this submission to the Treasury.

Increased private provision of welfare and disability pensions

Our proposals are made in the shadow of the Intergenerational Report, this will be the fourth edition since 2002. We expect it will again show us that Australia is failing to properly manage the costs associated with demographic change.

The private sector must take on a larger portion of the cost associated with demographic change. The Commonwealth no longer has the taxation base to maintain the expenditure associated with welfare and pension payments.

However recent policy changes have embedded significant costs. For example the National Disability Insurance Scheme (NDIS) expense rate grows at 46.2% over the decade while the Disability Support Pension (DSP) and age pensions also increase at four and six per cent each.

This submission makes a case for reducing the cost of the NDIS by deploying policy to encourage Australians to take out disability insurance.

[1] Research commissioned by the FSC completed by Deloitte Access Economics, Expanding the coverage of private disability insurance to reduce the economic burden of social disability insurance, March 2014, p. ii

Private disability life insurance that protects against the economic risks of disability is an underused policy device in Australia, which could reduce Commonwealth budget pressure arising from increasing disability-related welfare costs. Just as superannuation is the private sector solution to the costs of an ageing population and private health insurance is a private sector solution to managing health care costs, so too life insurance can be the private sector solution to the increasing budget costs of disability.

Policymakers have failed to consider relaxing impediments to private sector solutions, instead opting for large and unfunded social insurance programs.

The Commonwealth has committed $19.3 billion over seven years from 2012-13 to fund 53 per cent of the cost of the NDIS with the states and territories to fund the remaining cost. Eligibility for the NDIS will not be means tested and financial support will be available to those who are born with or acquire a permanent disability.

To demonstrate the costs that could be saved by privatising a portion of the NDIS and DSP, FSC engaged Deloitte Access Economics to construct an alternative policy design which utilised private disability insurance.[1]

By using incentives and disincentives, the modelling shows that improving the level of private disability coverage could generate net savings over five years to 2019, to the NDIS of $10.3 billion and to the DSP $3.4 billion.

This includes combined savings from both programs of $3.7 billion for the Commonwealth Government (after accounting for the incentive expenditure $5.2 billion) and $4.8 billion for state and territory governments.

The figure below demonstrates the potential savings that could be achieved through improved levels of private disability insurance coverage alongside the NDIS.

Parameters	Savings/(Expenditure) (billion)
Savings to the governments programs	
National Disability Insurance Scheme	$10.3
Disability Support Pensions	$3.4
Gross Savings	**$13.7**
Commonwealth Rebates	**($5.2)**
Net Savings to governments	
Commonwealth	$3.7
States and Territories	$4.8
Total net savings	**$8.5**

[2] Research commissioned by the FSC completed by Deloitte Access Economics, Expanding the coverage of private disability insurance to reduce the economic burden of social disability insurance, March 2014, p. ii
[3] Address by Alexa Lam Hong Kong SFC Deputy CEO - December 2013
[4] ABS Catalogue 5655.0 ($77bn foreign sourced from the pool of $2.4 trillion)

The Deloitte Access Economics research also concluded:

> *From a policy perspective, private disability insurance, supported by a broader base of consumers, would potentially provide a more equitable distribution of the financial burden of disability insurance across people who can afford to pay and need not fall back on the safety net provided by the NDIS. It would also avoid the crowding out of private expenditure among those who can afford to pay, and reduce financial risk to the Australian government (and by extension, taxpayers).*[2]

Proposals to involve the private sector in the NDIS policy design phase were quickly dismissed. We believe they must now be reconsidered.

SALLY LOANE
Chief Executive Officer
Financial Services Council

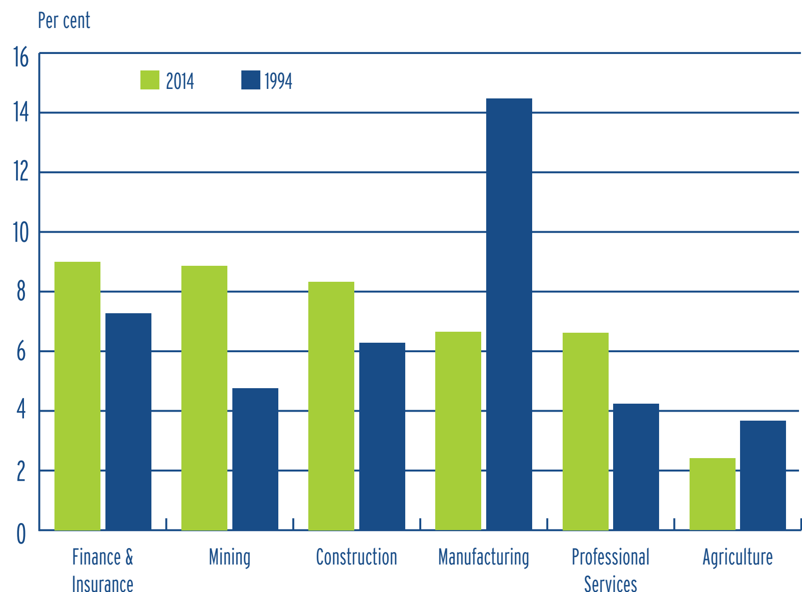
Introduction

The financial services industry is the largest industry in the Australian economy. The industry contributes 9.0 per cent to Australia's GDP and, as demonstrated in Chart A, is larger than the mining, manufacturing and construction industries. The sector also grew strongly in the past year, growing by 6.1 per cent in the twelve months to September 2014 making a significant contribution to Australia's GDP growth.[5]

The Australian financial services industry manages $2.4 trillion, the third largest pool of contestable funds in the world. This is larger than the capitalisation of the Australian Securities Exchange and larger than Australia's GDP. Over 80 per cent ($1.8 trillion) is managed by superannuation funds.[6]

Financial services has also grown strongly over the past two decades and, in spite of the global financial crisis, has not suffered the same level of cyclical instability experienced by mining and construction, or the gradual decline experienced by manufacturing.

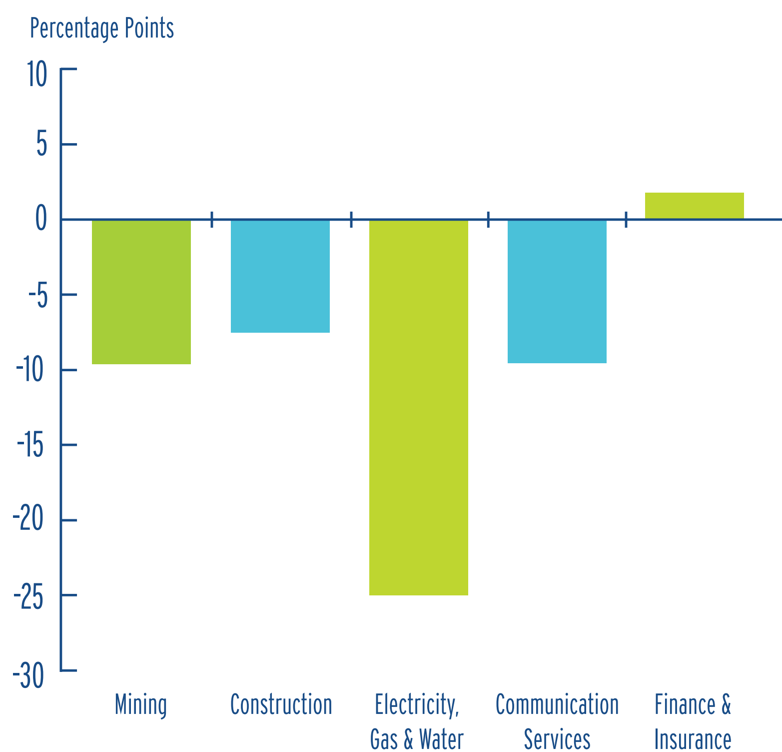
Chart A, Industry Gross Value Added to GDP[7]



The financial services industry pays a disproportionately large level of corporate tax compared to its contribution to GDP. The average tax rate of financial services is higher than most other major sectors of the economy, and continued to be so even during the global financial crisis, as demonstrated in Chart B.

[5] ABS 5204
[6] ABS 5655
[7] ABS 5204

Chart B. Average Tax Rate Deviations from Mean by Industry – 2006-07 to 2008-09[8]



Treasury's 2011 Economic Roundup confirmed that the average tax rate for the financial services sector has been higher than most other industries for at least the past six years.

Given the size of the financial services industry in the Australian economy and the significant additional contribution the industry makes through the investment of the nation's savings, the FSC urges the Government to adopt its policy recommendations.

[8] Treasury Economic Roundup Issue 2, 2011

Exporting Financial Services

The 2015-16 Budget will be the final Budget before the Asia Region Funds Passport commences in January 2016. It is therefore essential that budget decisions are made on these items well in advance of this date.

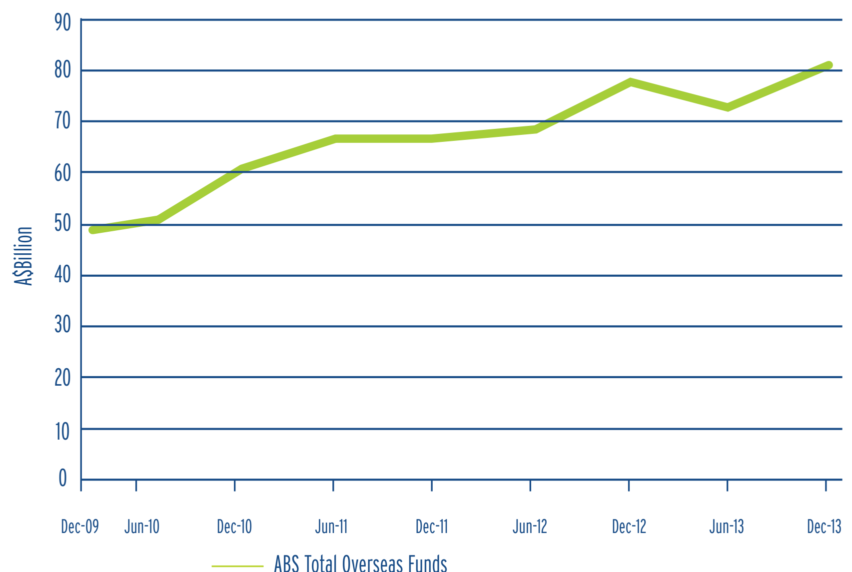
Background

Currently, the proportion of funds sourced from overseas represents less than 5% of the $2.4 trillion in assets managed in Australia.[9]

Research by Deloitte Access Economics shows that an increase in foreign sourced money managed by Australian managers can have a significant positive impact on the economy. Foreign fund flows contributed $434 million in total value added to the Australian economy in 2012-13.[10] A doubling of annual funds management export revenue is expected to result in an increase in GDP of approximately $330 million per annum by 2029/30.[11]

Over the four year period from 1 January 2010 to 31 December 2013 Australian Bureau of Statistics ("ABS") data shows the amount of foreign sourced money managed by Australian managers rose from $49 billion to $81 billion. Research by the FSC and Perpetual shows that the amount invested into Managed Investments Trusts (MITs) doubled over the same period, increasing from $20.3 billion to $40.4 billion.[12]

Chart C – Total Funds Managed by Australian Managers for Foreign Investors, 1 Jan 2010-31 Dec 2013 (Australian Bureau of Statistics)



[9] ABS Catalogue 5655.0 ($77bn foreign sourced from the pool of $2.4 trillion)
[10] Deloitte Access Economics, "The economic impact of increasing Australian funds management exports", report prepared for the Financial Services Council, May 2014. http://www.fsc.org.au/downloads/file/ResearchReportsFile/2014_0806_EconomicimpactofincreasingAustralianfundsmanagementexports_e64a.pdf
[11] Ibid
[12] FSC and Perpetual, "2014 Australian Investment Managers Cross Border Flows Report" http://www.fsc.org.au/downloads/file/ResearchReportsFile/FSCPerpetualAustnFundMgrsCrossBorderFlowsReport2014.pdf Source: ABS 5655.0 Managed Funds Australia Jun 2014, Table 1. Summary Managed Funds Industry

This doubling of investment has occurred following a reduction in the Managed Investment Trust Withholding Tax (MIT WHT) rate for foreign investors. The MIT WHT rate was progressively decreased from 30% in 2008, with a rate of 7.5% applying from 1 July 2010. As can be seen in Chart C, a noticeable increase in funds occurred from July 2010 onward and anecdotal evidence suggests this increase was as a direct result of the decreased withholding tax rate.

The withholding tax rate decrease was reversed with effect from 1 July 2012 and the rate was doubled to 15%. Again, a noticeable drop off in funds can be seen from December 2012, a direct result of the increased rate.

There is the potential for an exponential increase in foreign sourced funds under management if the right policy settings are implemented. The ABS data shows that changes in fund inflows are sensitive to changes in the withholding tax rate.

A further doubling of fund inflows is an achievable target. If the 7.5% rate had remained in place, the original growth trajectory from July 2010 could have been maintained instead of the step-drop in funds that occurred from December 2012.

The outstanding Johnson recommendations are an opportunity to create a step-change increase in fund flows to fuel growth in this sector; growth which in turn will have a meaningful impact on the Australian economy.

Asia Region Funds Passport – ensuring Australia's success

The Asia Region Funds Passport (the "Passport") provides a regulatory framework for the mutual recognition of fund operators and investment funds between participating jurisdictions. Australia's participation in a mutual recognition framework within the Asian region was recommended by the Johnson Review as a part of a package of reforms aimed at leveraging Australia's significant funds management expertise.

Whilst progress on the Passport has been significant, a number of related recommendations have not yet been progressed by the government. Five critical recommendations of the Johnson Review are:

1. Implementation of an Investment Manager Regime;
2. Broadening the range of allowable Collective Investment Vehicles;
3. Ensuring ongoing competitiveness of the Offshore Banking Unit regime;
4. Removing tax uncertainty; and
5. Competitive tax settings

The Passport represents a significant opportunity to offer the industry a clean slate – one that has not been contaminated by these uncertainties.

The Australian funds management industry's ability to capitalise on the Passport will be hampered if these changes are not in place prior to the Passport's commencement.

Investment Manager Regime

Foreign investors must have certainty about tax treatment when engaging an Australian fund manager.

On 18 December, Finance Minister Mathias Cormann announced policy to "provide greater tax certainty to foreign investors and ensure that Australian fund managers can actively market their financial services globally, promoting Australia as a regional financial services centre."

This policy now requires legislation so investors know exactly what to expect when investing with an Australian fund manager.

The Investment Manager Regime ("IMR") will remove tax impediments to foreign investment through or into Australia by foreign investors.

We appreciate the government's intention to implement a practical IMR through or into Australia by foreign investors and release exposure draft legislation in 2015. The FSC fully supports an approach which mirrors that used in the United Kingdom as it is well regarded by Australian industry and generally considered a 'world-class' regime.

There is currently uncertainty as to whether the benefits of the IMR will apply to foreign investors investing in Australian Passport funds. It is the FSC's position that foreign investors accessing an Australian "home" (i.e. Australian domiciled) Passport fund should receive the same certainty of taxation treatment that the IMR will provide for other foreign investors.

Consideration should be given to how to include Passport investors when the IMR exposure draft legislation is developed.

RECOMMENDATION: The IMR be constructed to ensure Passport fund investors receive the same benefits that the IMR affords other foreign investors and this certainty be provided to industry by 1 July 2015.

EXPECTED BUDGET IMPACT: Nil. Foreign investors should not be taxed on foreign assets. To the extent that Passport investors have exposure to Australian-sourced income they should be taxed at appropriate rates and with the same certainty afforded to other foreign investors through the IMR.

Collective Investment Vehicles ("CIVs")

Australian fund managers cannot deploy legal vehicles for investment that our neighbours understand. For example, many Asian nations do not operate under a trust law system and refuse to use it for foreign investment. Unfortunately, trusts are the only legal vehicles for Australian fund managers. This must be deregulated.

A broader range of tax flow-through Collective Investment Vehicles ("CIVs") is important for attracting investors from foreign jurisdictions. Australian unit trusts are unique and complex vehicles. The underlying legal interest that investors are purchasing is inherently different from that in all other jurisdictions. Even those markets offering a 'trust' vehicle by name are not offering a vehicle with an equivalent underlying legal structure.

It will be essential for Australian fund managers to have a suite of vehicle types to choose from when developing Passport funds.

The Johnson Report recommended a CIV regime be developed so that Australia could develop as a fund formation centre. A CIV regime will also have broader benefits outside the Passport. It will allow Australian managers to better market Australian domiciled funds offshore.

The FSC maintains that appropriate policy constraints can be developed such that a CIV regime does not result in lost government revenue, 'flipping', or other integrity concerns. A well-designed CIV regime should be seen as an opportunity to grow the pie and increase the number of funds currently domiciled in Australia.

This will in turn result in increased economic activity through the necessary fund formation services which must be provided by the jurisdiction in which the fund is domiciled.

It is anticipated that most fund flows into the new vehicle types will be new money from offshore investors. Whilst there will be some natural transfer of investment from existing MIT structures into new CIVs we expect this would be minimal and no greater than the transfers which occur between MIT structures currently. This is due to MITs being predominantly domestic vehicles targeted at attracting domestic investors.

The creation of a new of CIVs will allow fund managers to attract new money from offshore investors. The increased activity will not significantly impact the existing MIT base because this activity is not currently undertaken in Australia. Fund managers seeking to attract offshore investment develop vehicles in Luxembourg, the UK, Ireland and Hong Kong. It is these markets that the new CIV regime will target. It is also important to note that whilst this may suggest that any new CIVs should be limited to foreign investors, no such policy constraint should be placed on the new CIVs.

New CIVs should be open to both Australian and foreign investors. Fund managers already separate the income and gains earned by foreign investors within their fund accounts so appropriate withholding tax rates can be applied. There is no policy rationale for creating additional limitations on which investors can access the new vehicle types.

Appropriate policy constraints will need to be placed on the new CIVs however the existing MIT rules provide a strong framework from which to start. The following principles should form the basis of the new regime:

- Formed for eligible investment business only;
- Passive investment, no active business, not controlling a trading entity; and
- Widely held.

We seek to assist Treasury to develop the regime in a way that will be simple, effective and workable.

RECOMMENDATION: A CIV regime is legislated by November 2015 which offers a suite of alternative tax flow-through collective investment vehicle structures open to both domestic and foreign investors.

EXPECTED BUDGET IMPACT: Nil. Broadening the allowable CIVs will generate new activity.

The appropriate policy constraints for a CIV regime will result in:

- additional new vehicles being domiciled in Australia that are currently being domiciled offshore; and
- opportunities for managers who are not currently offering products to offshore investors.

Further, we would welcome the opportunity to assist the government by providing relevant industry data to demonstrate a nil cost to revenue.

Ensuring competitiveness of the Offshore Banking Unit regime ("OBU regime")

Recommendation 3.2 of the Johnson Review was to update the list of eligible OBU activities to make the OBU regime more useable and to ensure that the OBU continues to remain internationally competitive.

Fund management activities by their nature are highly mobile and the market is highly competitive. Managers will locate their businesses in the jurisdiction with the most desirable features. The OBU tax concession was viewed as a key policy to establish Australia as an attractive regional financial centre and to facilitate greater non-bank competition for offshore business.

The use of the OBU concession to achieve these policy objectives is long standing and bipartisan government policy. In 1999 the OBU concession was extended by the Coalition Government to specifically include funds management and insurance companies in OBU activities, so that the Australian regime would be competitive with those in other countries, such as Singapore. This policy position has been further endorsed by the Johnson Report and again supported by the Labor Government in its response to the Johnson Report in 2010.

In 2013 the Coalition Government again provided its support for allowing Australian industry to compete by offering a competitive tax rate to attract activity to the Australian operations of OBUs.

> **RECOMMENDATION:** Update eligible OBU activities to ensure the OBU regime remains globally competitive.

EXPECTED BUDGET IMPACT: Unquantifiable theoretical budget impact. Whilst concessional treatment provided by the OBU regime has a notional budget cost, increased use of the regime will result in more actual government revenue being collected, as these activities are being undertaken in foreign jurisdictions (such as Singapore) or are simply not occurring at all.

Removing taxation uncertainty

The following items are critical to ensuring Australian fund managers can capitalise on the Passport initiative. Items are presented in order of priority and those in bold are essential to be legislated prior to the Passport's commencement.

Item	Description	Comments	Priority
Multi currency class hedging treatment	Removal of existing restrictive taxation implications of operating multiple fund classes in different currencies	This will allow existing unit trusts to utilise their scale and offer additional currency classes. Whilst many fund operators have expressed a preference for new vehicles some larger funds have also expressed a demand for being able to offer currency overlays for their existing products. This is expected to attract both domestic and foreign investors.	Before 1 Jan 2016
Receive benefits of IMR	Foreign investors using Passport vehicles must receive the same benefits as other foreign investors under the IMR	Certainty of treatment must be provided	Before 1 Jan 2016
FX hedging treatment	Passport vehicles must receive appropriate treatment under TOFA subdivision 230E in relation to portfolio FX hedging	We are aware of the government's TOFA deregulation consultation but note that this item must be fixed for Passport funds to operate effectively	Before 1 Jan 2016
FX hedging treatment	Passport vehicles must receive appropriate treatment under TOFA subdivision 230E in relation to portfolio FX hedging	We are aware of the government's TOFA deregulation consultation but note that this item must be fixed for Passport funds to operate effectively	Before 1 Jan 2016

We believe these changes can be developed in a way which meets industry's objectives and results in no cost to government revenue.

RECOMMENDATION: Various taxation uncertainties be rectified in a Passport-specific package of taxation law amendments.

EXPECTED BUDGET IMPACT: Unquantifiable. We anticipate that there may be some cost to government revenue on FX hedging items due to timing differences, however we do not expect that there would be a net cost over the forward estimates period.

Increasing taxation competitiveness

Tax certainty must be coupled with competitive tax rates for foreign investors. David Murray's FSI said: "…withholding tax increases the required rate of return for non-residents, which reduces the attractiveness of Australia as an investment destination."

Australia's taxation regime for foreign investors is also complicated, with different rates of withholding tax applying depending on the character of the income received by the investors.

There are individual rates of withholding tax for dividends, interest and royalties which are separate to the Managed Investment Trusts withholding tax (MIT WHT) rate for fund payments. Each of these rates can be different depending on whether the country in question has a double taxation treaty or exchange of information agreement with Australia.

Previous changes to the MIT WHT from 30% to 7.5% were welcomed by industry. The subsequent increase to 15% damaged Australia's reputation as a competitive funds management centre.

For Australia to compete effectively it will be necessary to better align the MIT WHT with the comparable withholding tax rates charged by other jurisdictions (see Appendix A for a comparison of rates from Passport jurisdictions). It will also be necessary to send a clear message to the global market place that Australia is open for business.

This measure should be limited to Passport funds only.

> **RECOMMENDATION:** The withholding tax rate for all receipts by foreign investors from Australian Passport funds be reduced from 15% to 5%

EXPECTED BUDGET IMPACT: There will be some budget impact due to the lowering of the fund payment and other withholding tax rates for Passport funds to 5%. We expect this would result in an unquantifiable but small and theoretical decrease in revenue. This revenue decrease would be purely theoretical as the Passport is a new regime which provides access to markets that Australian managers cannot currently directly enter. No withholding tax revenue is currently being collected from Passport investors, so the baseline comparison is zero. Future revenue resulting from the Passport regime would be collected at the 5% rate instead of 15%.

Conclusions

Substantial increases in GDP, government tax revenue and jobs can be achieved if funds management exports are improved.

Key Results[13]

	GDP	Tax Revenue ($2012-13 million)	GOS	Employment FTE
Doubling of FM exports	325.7	105.5	185	776
2 bps reduction in cost of capital	2,260.9	618.9	877	7,737
Hong Kong level of FUM	4,223.1	1,252.3	1,355	9,982

We believe this package of budget measures has the potential over time to significantly increase the amount of foreign fund inflows received by Australian managers. The Deloitte research shows the potential for a considerable increase in contribution to GDP as a result of increasing foreign fund flows is high.

The changes in fund inflows experienced in July 2010 and December 2012 show that the market has been sensitive to previous policy changes. We see no reason why additional, positive policy changes would not result in marked increases in fund inflows from foreign investors.

Further, it is essential that the remaining tax changes recommended in the Johnson Review are implemented so that Australian fund managers can take full advantage of the trade opportunities arising from the recent free trade agreements with Korea and Japan. Without these changes Australian fund managers will continue to be at a disadvantage despite the hard work that has gone into negotiating promising financial services terms in these agreements.

These changes will require budget, policy and legislative changes. Collectively, this plan will unshackle a major export prospect as Asia's demand for services increases.

[13] Source: Deloitte Access Economics

Life Insurance

The National Disability Insurance Scheme (NDIS) and the Disability Support Pension (DSP) both represent significant and well intentioned government interventions to provide public insurance for the wellbeing of Australians.

However, their design and implementation has a number of unintended consequences that may lead to perverse outcomes for individuals and the overall Commonwealth budget. There are four main questions that are worth considering:

1. Do these programs set the right incentives for individuals who can afford to self insure against the risk of disability?
2. Do these programs crowd-out existing life insurance products, such as income protection?
3. Is the level of service provided in these programs sustainable on an inter-generational basis, given the projected increase in expenditure on the DSP and NDIS?
4. Are there other more effective mechanisms to address the market failure that government is attempting to address by providing public insurance through the DSP and NDIS?

The FSC believes that little attention has been paid to these questions, and that considering them now provides the rationale for reducing the strain on the Commonwealth budget before costs get locked in.

Significant savings of $8.5 billion can be achieved through the government providing a tax incentive to have life insurance (i.e. rebates), complimented by a minimum level of insurance required to avoid extra taxation (i.e. additional charges). This would work much like the current arrangements for the Private Health Insurance Rebate, and the Medicare Surcharge Level, but for income protection life insurance products.

With the increase in costs around the National Disability Insurance Scheme (NDIS) and the ongoing strain on the government budget of the Disability Support Pension (DSP), the ability of private life insurance products to ameliorate the budget deficit is becoming more apparent.

According to research conducted for the FSC by KPMG, roughly 9.5 million Australians, or 44% of the population, could mitigate the economic risks of disability through private disability insurance.[14]

From a policy perspective, private disability insurance supported by a broader base of consumers would potentially provide a more equitable distribution of the financial burden of disability insurance across people who can afford to pay and need not fall back on the safety net provided by the NDIS.[15]

[14] KPMG, Underinsurance – Disability Insurance Protection Gap in Australia, 2014
[15] Research commissioned by the FSC completed by Deloitte Access Economics, Expanding the coverage of private disability insurance to reduce the economic burden of social disability insurance, March 20154, pp. ii

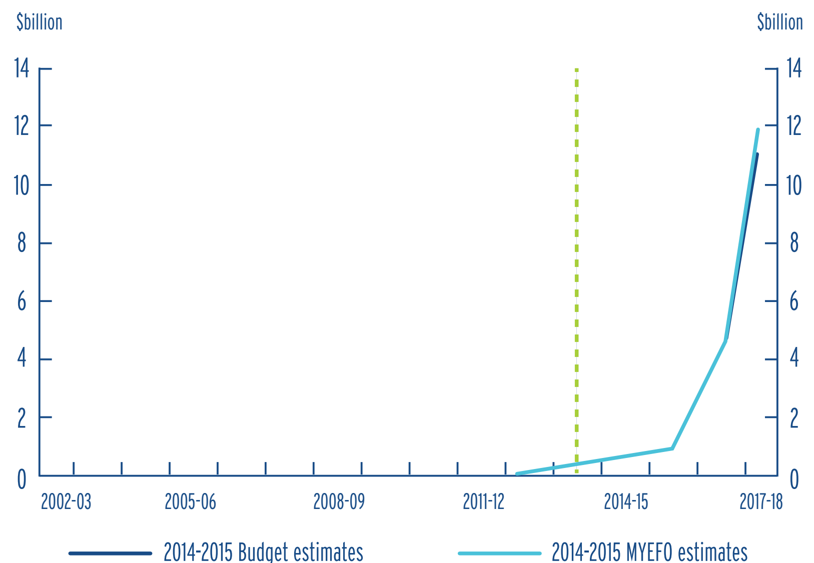
It would also avoid the crowding out of private expenditure among those who can afford to pay, and reduce financial risk to the Australian Government and by extension, taxpayers.

National Disability Insurance Scheme

The Australian Government has committed $19.3 billion over seven years from 2012-13 to fund 53 per cent of the cost of the NDIS with the States and territories to fund the remaining cost. Eligibility for the NDIS will not be means tested and financial support will be available to those who are born with or acquire a permanent disability.

The FSC supports the establishment of the NDIS and the NIIS. However, we submit that the existing funding model is likely to be unsustainable and may ultimately place pressure on the Scheme's long-term viability. In fact, modelling released in the 2014-15 Mid-year Economic and Fiscal Outlook shows that parameter and other variations are expected to increase NDIS expenses by $800 million over the four years to 2017-18, relative to the 2014-15 budget[16] (see Chart D below).

Chart D: NDIS - change from 2014-15 Budget to 2014-15 MYEFO estimates by measures and other variations



We note that the development of the NDIS and NIIS has not placed any emphasis on the role of life insurance or addressing insurance penetration and adequacy generally.

[16] Parliamentary Budget Office, 2014-15 Mid-year Economic and Fiscal Outlook, Figure 26

The NDIS and NIIS will not provide an ongoing income replacement benefit where a disability is acquired as provided under adequate disability insurance. Such benefits enable an individual to maintain his or her standard of living and continue to meet financial obligations such as mortgage payments, rent, daily living expenses and education costs for children in the family.

Deloitte Access Economics modelling study

To consider ways in which to address insurance penetration and adequacy and reduce the public sector costs of disability, the FSC engaged Deloitte Access Economics to undertake modelling on expanding the coverage of private disability insurance to reduce the burden of the Disability Support Pension and the National Disability Insurance Scheme.

The study demonstrates the potential savings that could be achieved by government if NDIS eligibility for those who acquire a disability was means tested and, by extension, reduced eligibility for DSP benefits, while ensuring social policy objectives of the Scheme and other disability-related welfare programs would continue to be achieved through privatisation of risk.

The research was undertaken based on the principle of the historical role of private health insurance in Australia which has reduced public healthcare expenditure.

The private health insurance rebate (originally at a standard 30% rate) and MLS were introduced in the late 1990s, along with the introduction of differential private health insurance premiums for those taking out and maintaining private health insurance cover before the age of 30 years (see Table 1 below).

Table 1: Private health insurance rebate levels

Singles	<$88,000	$88,001-102,000	$102,001-136,000	>$136,001
Families	**<$176,000**	**$176,001-204,000**	**$204,001-272,000**	**>$272,001**
Rebate				
< age 65	30%	20%	10%	0%
Age 65-69	35%	25%	15%	0%
Age 70+	40%	40%	20%	0%
Medicare Levy Surcharge				
All ages	0.0%	1.0%	1.25%	1.5%

The effect on private health insurance coverage in Australia was to increase rates of cover from around 30% in 1997 to around 45% by 2001. In December 2013, 47 per cent of Australians held private hospital cover and almost 55 per cent held general treatment cover.

The study uses the principles of existing policy mechanisms that operate for Australian taxpayers for private health insurance as the basis for considering private disability take up through a range tax incentives (i.e. rebates) and disincentives (i.e. additional surcharges).

In consumer polling recently completed by GfK those surveyed without disability insurance were asked to indicate the most persuasive messages to act in relation to taking out income protection cover.

The most motivating message was the government providing a tax incentive to have insurance (i.e. rebates), while the second most motivating message was a minimum level of insurance required to avoid extra taxation (i.e. additional charges).[17]

Disincentives

Deloitte research suggested that the introduction of a "Disability Levy Surcharge" (DLS) would perhaps be the strongest insurance penetration and adequacy policy lever to 'push' individuals to take up private disability cover.

A DLS would be a disincentive or a 'stick' for those earning over a specified income, in the base case over $88,000, to take out private disability insurance cover.

In the new modelling, the DLS was based on current policy for the MLS which includes a surcharge of up to 1.5% on taxable income (in addition to the 2.0% Medicare Levy) for those without the appropriate level of cover.

Deloitte's base case models the potential savings for government with an assumption that 10 per cent of the total population was covered by adequate insurance.

That represents an assumption that all taxpayers earning above the income threshold and therefore subject to the DLS would take out cover to avoid the "stick".

[17] GfK, A review of consumer attitudes and behaviour in relation to financial protection: Instilling behavioural change to counter under-insurance in the Australian life insurance category, February 2014

Incentives

The introduction of rebates similar to those for private health insurance is assumed to be necessary to avoid underinsurance and to assist with the affordability of cover.

Deloitte's modelling assumed a rebate level the same as with private health insurance. That is, between a ten per cent and 30 per cent rebate for those aged less than 65 with annual taxable income less than $136,000 for individuals and $272,000 for households.

The modelling shows that through these incentives and disincentives improving the level of private disability coverage could generate net savings over five years to 2019, for the NDIS of $10.3 billion and to the DSP $3.4 billion.

This includes combined savings from both programs of $3.7 billion for the Commonwealth Government (after accounting for the incentive expenditure of $5.2 billion) and $4.8 billion for state and territory governments.

Table 2 demonstrates the potential savings that could be achieved through improved levels of private disability insurance coverage alongside the NDIS.

Table 2: Savings to government programs

Parameters	Savings / (Expenditure) (billion)
Savings to government programs	**$**
National Disability Insurance Scheme	$10.3
Disability Support Pension	$3.4
Gross Savings	$13.7
Commonwealth Rebates	($5.2)
Net savings to governments	
Commonwealth	$3.7
States and Territories	$4.8
Total net savings	**$8.5**

Disability Support Pension

There is a direct link between the Commonwealth outlays associated with disability payments and insurance penetration and adequacy. Social security and welfare spending is the most significant federal budget expense accounting for 35%, or around $138 billion of government expenses in 2013-14.[18] DSP accounts for around 11% of this expenditure or $15.5 billion.

DSP expenditure is projected to increase by 15% to almost $18 billion by 2016-17.[19] In excess of 800,000 people receive DSP benefits and over the past 20 years, DSP recipient numbers have grown more than recipient numbers in any other government income support program.[20]

In 2012-13 there were 51,418 new DSP claims were granted.[21] The FSC is concerned about the sustainability of growing DSP expenditure at a time of increased budget pressure. We believe there are options available to the government, which may not have been previously considered, to transfer risk and the associated budget expense to the private insurance sector.

With more employed Australians adequately insured against the economic risks of disability, fewer would need to rely on the DSP as a safety net should they suffer an illness or injury and be unable to work. Social outcomes could be expected to improve as income replacement from insurance would enable the standard of living (in economic terms) to be broadly maintained.

Based on current DSP means-testing, every dollar of income received from private insurance can be expected to reduce the DSP by 50 cents through reduced eligibility if all employed Australians were adequately insured.

This translates to a government cost saving in the first year, if Australians are adequately insured, of at least $340 million for each cohort of new disability pensioners even before the tax revenue foregone is taken into account.

According to the FSC's research, the cumulative annual savings effect of adequate disability insurance is estimated to be $2.5 billion per annum in the 10th year, as measured by lower DSP payments.

> **RECOMMENDATION:** Public policy settings governing welfare and disability payments contribute to poor insurance penetration and inadequacy. There is significant scope for the life insurance industry to reduce the costs associated with the Disability Support Pension and National Disability Insurance Scheme.

[18] Australian Government, 2013-2014 Budget Paper No. 1, Statement 6: Expenses and Net Capital Investment
[19] Australian Government, 2013-2014 Budget Paper No. 1, Statement 6: Expenses and Net Capital Investment, Table 3.1
[20] Australian Government, 2011-12 Budget Review, Disability support pension reforms
[21] Australian Government, 2012-13 Annual Report, Department of Human Services

Abolition of Inefficient State Taxes

The FSC supports the abolition of inefficient State taxes. This will be a core component of the FSC's response to the Federal Government's Tax White Paper, Federation White Paper and Inter-generational Review processes in 2015.

To the extent that changes are made to Australia's taxation system, we encourage the Commonwealth to ensure the States commit to their promise to abolish inefficient taxes. Importantly this commitment should be a focus of any agreement to make changes to the GST.

Backtracking of States on prior commitments has resulted in a patchwork of inefficient, distortionary tax outcomes. These are in turn impacting on areas of the economy with undesirable consequences.

The different treatment of stamp duty on life insurance is an example. We acknowledge this issue is beyond the scope of the Federal Budget, however we make the following observations:

- Each jurisdiction has a different regime for the collection of stamp duty on life insurance policies.
- Individual members of different group insurance products residing in different States must be accounted for by insurers when calculating each member's stamp duty liability, thus creating a substantial and costly administrative burden.
- Each jurisdiction applies different stamp duty rates to life insurance 'policy riders', such as such as trauma and disability cover, despite the fact it is virtually impossible to purchase these 'policy riders' as a stand alone product.
- The cost to collect the tax (cost to insurers and government) in most jurisdictions would comprehensively exceed taxes raised.

Stamp Duty on Life Insurance

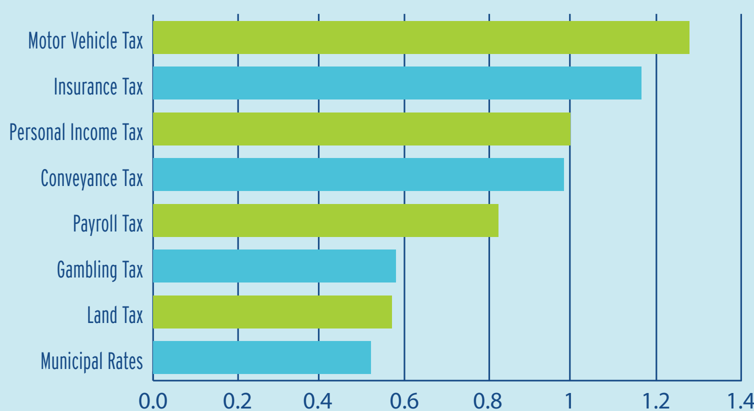
The cost of collecting stamp duty on life insurance, including the systems and administration practices required for FSC member companies and State Revenue Offices is likely to comprehensively exceed the amount of tax revenue raised.

Most States and territories have a different rate and basis for levying taxes collected. Some are sum insured based; some are premium based; some have a combination; some have no duty on life insurance but loaded duties on rider benefits; the percentage of rates levied on life rider benefits vary from State to State and product to product.

This creates a productivity drag on life insurers because it necessitates complex assessment processes, legal fees and systems reconfiguration all of which would be simplified under a harmonised system, or not necessary at all if stamp duty was abolished.

According to research by Deloitte Access Economics for the Finance Industry Council of Australia, insurance taxes rank as the second most inefficient of taxes levied by State governments[22] (see Chart E below).

Chart E: General efficiency rankings of State/Federal taxes



Attempts to have a 'uniform' methodology for the raising of the state tax have failed on a number of occasions and Australia is one of the few mature economies that taxes life insurance and life riders instead of giving a tax deduction. Appendix 1 provides a summary of the various stamp duty levies applying to life insurance and associated products in each Australian jurisdiction.

RECOMMENDATION:
Stamp duty on life insurance is an inefficient tax that creates a productivity drag for the life insurance industry. **Inefficient stamp duties should be addressed in the Federal Government's Tax White Paper process.**

[22] Deloitte Access Economics, 2011 Analysis of State Tax Report, pp. 2

Superannuation

Superannuation and Government Finances

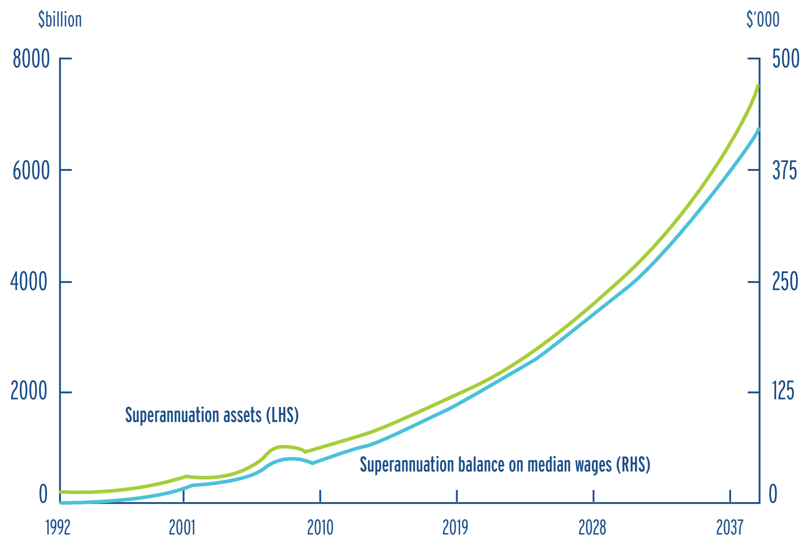
The superannuation system is an important long-term policy designed to alleviate age-related costs that threaten the stability of Government finances. It also has a significant impact on the immediate Budget forecasts, in terms of both the tax concessions afforded to contributions and fund earnings.

Through managing over $1.8 trillion in retirement savings the superannuation system is making a significant contribution to Government revenue. As demonstrated in the Budget, $7.68 billion in tax is forecast to be paid by superannuation funds in 2014-15, increasing to over $11 billion by 2016-17.[23]

As markets have continued to return to growth after the financial crisis and European debt crisis, current taxation settings will result in Government revenue benefiting from strong receipts from earnings tax.

Treasury forecasts that within 25 years superannuation savings will reach $7 trillion, or 130 per cent of forecast GDP, and individual balances will continue to grow as demonstrated in Chart F.

Chart F. Superannuation assets and superannuation accumulator[24]



Earnings tax receipts on a large pool of savings could, on average be expected to increase in proportion to the size of the pool across the cycle.

[23] 2014-15 Commonwealth Budget, Paper 1
[24] 2012-13 Commonwealth Budget, Statement 4

Table 3. 2012-13 Government revenue projections[25]

Australian Government general government (cash) receipts

	Actual		Estimates		Projections	
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	$m	$m	$m	$m	$m	$m
Individuals & other withholding taxes						
Gross income tax withholding	149,807	156,700	169,400	181,500	193,400	206,700
Gross other individuals	33,294	34,200	37,100	40,700	44,700	48,800
less: Refunds	26,801	27,100	27,700	28,600	29,800	31,800
Total individuals & other withholding tax	156,300	163,800	178,800	193,600	208,300	223,700
Fringe benefits tax	3,922	4,090	4,360	4,930	5,210	5,100
Company tax	66,911	68,000	71,600	75,400	80,000	84,700
Superannuation fund taxes	7,661	6,530	7,680	10,380	11,280	11,810
Minerals resource rent tax(a)	310	170	0	0	0	0
Petroleum resource rent tax	1,507	1,400	1,950	1,900	1,900	1,900

Earnings tax levied on a pool of domestic savings as large as 130 per cent of GDP clearly offers a strong source of Government revenue under current tax policy settings, underpinning the long-term fiscal sustainability of the superannuation system.

Earnings tax from superannuation would not be available without the mandatory superannuation system being in existence. The system is necessary as Australians do not otherwise saving for their own retirement without the correct mix of compulsion and incentives in the form of tax concessions.

RECOMMENDATION: The Government recognise that the superannuation system has created a taxable pool of capital that would not have otherwise existed and is increasingly contributing to Government revenue over the cycle in line with the growth in that pool.

[25] 2014-15 Commonwealth Budget, Paper 1

Sustainability of Super Tax Concessions

In contrast to the $8.5 billion in revenue the Government will receive from superannuation funds, the Budget estimates show that superannuation funds are also provided tax concessions in return for Australian workers agreeing to compulsorily save their income for up to 40 years.

The revenue cost of tax concessions afforded to superannuation in 2013-14 totalled $39.70 billion:[26]

Superannuation – concessional taxation of employer contributions	$16.3 billion
Superannuation – concessional taxation of superannuation entity earnings	$13.4 billion

The FSC will consider these two concessions discretely in this submission, and is concerned that they are regularly reported in aggregate.

Earnings tax

The Tax Expenditures Statement is misleading in classifying the taxation of superannuation entity earnings as a 'concession'. Without compulsory superannuation Australians would change their behaviour and the $1.7 trillion in retirement savings would be spent and invested elsewhere.

The Tax Expenditures Statement assumption that behaviour would not change, which is the basis of the revenue cost, is highly improbable. Instead, it is far more likely that, in lieu of superannuation existing, a significant portion of the revenue would be 'lost' as individuals would 'save' via the tax free family home, or spend a portion of their income on the 40 per cent of goods and services that escape the GST, reducing the overall size of the taxable pool of national savings.

The FSC recognises and appreciates that Treasury is testing alternatives to the comprehensive income tax benchmark as included in Appendix A in the 2013 Tax Expenditures Statement. Under this alternative the tax expenditure on superannuation entity earnings, previously estimated to be worth $16.1 billion in 2013 14 is revised to negative $5.8 billion.[27]

The FSC appreciates that these models are experimental and that Treasury has published these numbers to assist debate around proper account of the concessions afforded superannuation savings. The FSC welcomes exploration of better measures of the concessions afforded different forms of saving in Australia.

[26] 2013-14 Tax Expenditures Statement
[27] Appendix A, Tax Expenditures Statement 2013

The FSC submits that further analysis around the appropriate accounting of the concessional treatment of savings is necessary for a mature debate on the Tax White Paper. Addressing common misconceptions around the impact of superannuation earnings tax concessions to the Commonwealth's fiscal position is critical.

The FSC notes that Treasury itself has conceded the flaw in classifying the current arrangement as a concession:

> *The revenue forgone approach - this approach measures the difference in tax paid by taxpayers who receive a particular concession relative to similar taxpayers who do not receive that concession. It compares the current/prospective treatment to the benchmark treatment, assuming taxpayer behaviour is unchanged. Accordingly, revenue forgone tax expenditures measure the impact of a concession in terms of the benefit taxpayers derive from the concession given their behaviour once it is in place.*[28]
>
> *Care should be taken when interpreting the tax expenditure estimates presented in this document. The estimates of reported tax expenditures are not necessarily reliable indicators of the budgetary impact of removing particular tax concessions.*[29]

The rationale for classifying the forgone revenue from earnings tax as a concession is weakened by the Senior Australians and Pensioners Tax Offset (SAPTO). Under SAPTO individual retirees can receive an annual income of $32 279 tax free, and couples $57 948 tax free. This effectively allows a retiree to hold approximately $600 000 in cash ($1.16 million for couples) outside of superannuation without paying tax.

If superannuation funds were to be required to pay tax when the account holder is in retirement, retirees would simply move their savings outside of super and retain their tax free status. This would result in no revenue gain for the Government, and undermine the stability of the retirement system.

> **RECOMMENDATION:** The Tax White Paper process address misconceptions around the impact of earnings tax concessions on the Commonwealth's fiscal position.

[28] Tax Expenditures Statement 2012 at 16
[29] Ibid at 19

Contributions tax

The $16.3 billion tax concession on contributions is significant in the context of the Budget. However, the concessional taxation of contributions equates to only 22 per cent of the $75 billion in total mandatory contributions in that year. The tax concession is a modest but necessary Government contribution for compelling individuals to save 9.5 per cent of their income for up to 40 years.

The concession also assisted in attracting a further $21 billion in discretionary contributions in that year, a second important contributor to national savings.

> **RECOMMENDATION:** The Government recognise that a tax concession is a necessary precondition to requiring employees to contribute to their superannuation from their income and boosts national savings by encouraging Australians to save for their retirement.

Future savings

The fiscal impact of tax concessions afforded to superannuation earnings and contributions in the Budget do not take into account the reduced expenditure on the age pension, or other age-related health care costs, which results from more people becoming self funded retirees.

By definition, the superannuation system is needed to meet these long-term costs. Australians would not otherwise adequately save for their own retirement.

Research by NATSEM concluded that in 2013-14 government age pension expenditure was $5.7 billion lower than it would otherwise have been as a result of the superannuation system.[30] This is achieved in spite of the system not being mature.

NATSEM forecast for increasing age pension savings by 2030:

Year	Annual Age Pension Savings (2013 dollars)
2013	$5.7 billion
2020	$7.6 billion
2030	$11.1 billion

Whilst the immediate revenue costs of the tax concessions afforded superannuation appear in the current Budget, the offsetting benefits do not. These will materialise in Budgets in 20, 30 or 50 years from now.

[30] NATSEM 2014

The Budget also neglects the significant improvements in quality of life for retired Australians who have private savings to fund their retirement. Whilst only a portion of every dollar saved reduces age pension reliance, a larger, unquantified quality of life improvement is achieved through superannuation.

> **RECOMMENDATION:** Long-term savings in age pension, health care and aged care, as well as improvements in quality of life that will be delivered as a result of the superannuation system should be considered in the debate around the value of the system.

Superannuation and national savings

Australia's superannuation system has created a pool of funds valued at $1.8 trillion that underpins our national savings.

After historical lows in Australia's national savings at the start of the 1990s, before the superannuation system was established, Australia's national savings were significantly above the advanced economy average by 2011. It is also above the world average, which includes high saving East Asian countries, as shown in Chart G below.

Chart G. International comparison of gross national saving[31]

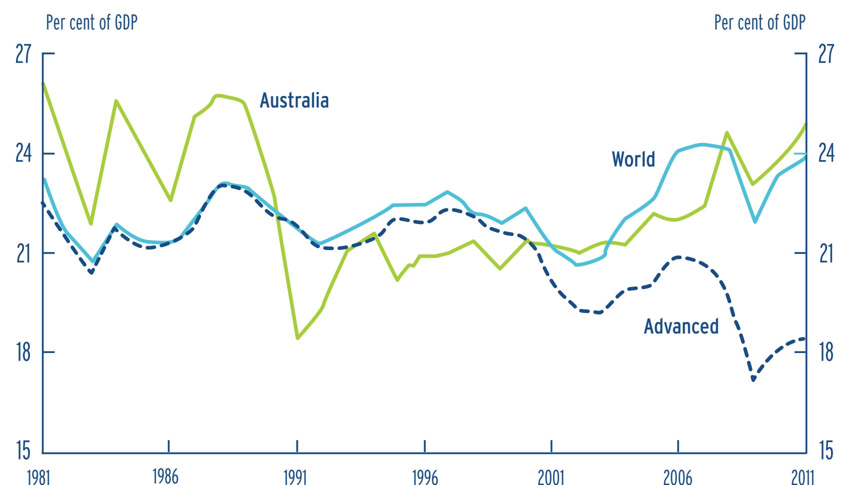


Chart G shows that Australia's national savings relative to the rest of the world has grown steadily since the introduction of the SGC in 1992. When compared to the impact on national savings of the 1990-92 recession, the global financial crisis and the Asian financial crisis were relatively modest. From a macroeconomic perspective, the benefits to the Australian economy of this stable growth in national savings in a manner that is resilient to international shocks cannot be understated.

[31] 2012-13 Commonwealth Budget, Statement 4

The 2012-13 Budget detailed the importance of a higher level of national savings[32]:

- It moderates price pressures, providing scope for monetary policy to respond to economic developments;
- It is prudent for a portion of national income, which is temporarily elevated by the mining boom, to be saved for the future;
- Borrowing less and saving more makes Australian companies more resilient to external shocks by having access to a pool of domestic capital; and
- The ageing of Australia's population means that more should be saved now in order to support a progressively older population.

Growth in national savings, which has been driven by the superannuation system, acts as a stabilising force for the Australian economy.

RECOMMENDATION: The Budget should include a calculation of the economic benefit delivered by higher national savings as a result of the superannuation system in order to determine the impact on GDP and tax revenue.

Preservation Age

Increasing mature age workforce participation is a key way in which the Government can improve output in the Australian economy and strengthen Government finances over the long-term in the face of an ageing population.

An effective measure to boost participation is to increase the preservation age, the age at which Australian can access their superannuation savings, to increase retirement savings and reduce Age Pension reliance.

The preservation age is currently transitioning from 55-60 years based on an individual's date of birth as outlined in Table 4.

Table 4. Transitional arrangements for preservation age[33]

Date of Birth	Preservation age (years)
Before 1 July 1960	55
1 July 1960 - 30 June 1961	56
1 July 1961 - 30 June 1962	57
1 July 1962 - 30 June 1963	58
1 July 1963 - 30 June 1964	59
After 30 June 1964	60

[32] 2012-13 Commonwealth Budget, Statement 4
[33] http://www.ato.gov.au/Super/Self-managed-super-funds/Accessing-your-super/Preservation-age/

The FSC recommends that the superannuation preservation age be increased to 65 years to better align with the age pension eligibility age.

For every year the preservation age is increased the retirement savings gap decreases by approximately $200 billion, significantly reducing reliance of government age related programs and improving quality of life for Australian retirees.

Table 5. Total Retirement Savings Gap – delaying retirement age ($billion)[34]

As at 30 June 2011	Males	Females	Total
Retire at age 60	1,333	993	2,326
Retire at age 61	1,248	889	2,137
Retire at age 62	1,111	794	1,905
Retire at age 63	1,000	722	1,722
Retire at age 64	878	641	1,519
Retire at age 65	701	588	1,289
Retire at age 66	573	494	1,067
Retire at age 67	453	383	836

There would also be a significant positive Budget outcome from increasing the preservation age which has been broadly supported by the Productivity Commission and Commission of Audit.[35]

For instance, the Grattan Institute has also recently modelled increasing both the preservation age and the Age Pension eligibility to 70 years by 2035. The estimated saving would be $12 billion by 2023 and $15 billion in 2035 (today's dollars).[36]

Government finances would be improved by an increase in the preservation age, as fewer future retirees would be eligible for the age pension as they would have higher personal savings and spend less time in retirement. Mature age workers would also pay additional income and contributions tax whilst they continued to work.

Further, those who work beyond the age of 60 years are also likely to receive lower total age pension payments as they will draw down less of their savings during the critical years between superannuation eligibility and age pension eligibility.

[34] FSC & Rice Warner Actuaries, Longevity Savings Gap Report, 2012
[35] Productivity Commission, An Aging Australia: Preparing for the Future, November 2013 at 201 http://www.pc.gov.au/__data/assets/pdf_file/0003/129747/ageing-australia-overview.pdf
[36] Grattan Institute, Balancing Budgets: Tough Choices We Need, November 2013 at 30 http://grattan.edu.au/static/files/assets/ceacf10a/801_Balancing_Budgets.pdf

Higher levels of mature age workforce participation would also have significant benefits for the broader economy. The first report from the Advisory Panel on the Economic Potential of Senior Australians concluded that using the existing skills and experience of older Australians would bring a windfall for the Australian economy of $10.8 billion a year. [37] The report also found that engagement in the workforce has significant mental and physical health benefits for older Australians.

The possible burden for some mature workers of a higher preservation age is reduced by the availability of transition to retirement arrangements, which allow mature workers to reduce the number of hours they work whilst continuing to make superannuation contributions. It could be further alleviated through an early release scheme for those unable to work to 65 years due to health or caring responsibilities.

RECOMMENDATION: Phase in an increase in the preservation age to 65 years without impacting current or near-term retirees.

Intergenerational Report

The Government has previously published Intergenerational Reports in 2002, 2007 and 2010. These reports have proved invaluable in informing and focusing debate on the long-term challenges facing Australia and have assisted the Government and stakeholders in designing policy responses to these challenges.

RECOMMENDATION: The Government is required to issue a new Intergenerational Report every five years. The next Report should be released as soon as possible to inform debate around the fiscal challenge facing the Government.

The next report would appropriately update previous reports based on policy changes announced by this, and the previous, Governments, including:

- The impact of tax changes on retirement savings;
- The staged increase in the superannuation guarantee from 9 per cent to 12 per cent; and
- The impact of MySuper on retirement savings.

[37] Advisory Panel on the Economic Potential of Senior Australians, First Report - http://epsa.treasury.gov.au/EPSA/content/publications/changing_face_of_society/default.asp

The Intergenerational Report 2015 would also allow the Government to publish modelling on current, significant issues. For example, the 2010 report concluded that lower projected age pension spending was partially as a result of:

- A decline in the proportion of pensioners receiving a full age pension, because of the increased value of individuals' superannuation and other private asset income; and
- The proportion of people with a part age pension is projected to increase significantly [by 2050] whilst the proportion of the eligible age group not receiving any age pension is projected to rise [only] slightly.[38]

No further analysis was provided in the 2010 report on the role of superannuation in taking age-related cost pressures off future Budgets by reducing the number of retirees eligible for the age pension.

The FSC is of the view that public misunderstanding around the role that superannuation plays in improving the Government's fiscal position over the long-term undermines the stability of the retirement system. The Intergenerational Report should be used to clarify the importance of superannuation to the long term national accounts.

RECOMMENDATION: The next IGR should provide detailed modelling on:

- The expected growth of funds in the superannuation system;
- The projected size of individuals' superannuation balances once the system is mature;
- The size of balances of Australians who will be fully or partially reliant on the age pension;
- The fiscal contributions superannuation makes in moving retirees from the full age pension to the part pension, or the part pension to no age pension;
- The extent to which superannuation savings will fund other age-related expenses, such as health and aged-care costs, reducing individuals' overall reliance on the Government in retirement.

[38] Intergenerational Report 2010 at 61

Age Pension

The Government should consider whether the correct people are receiving the age pension based on their personal wealth. Appropriate targeting of public benefits is becoming increasing important as a factor of budget sustainability.

The FSC is concerned that the stability of the retirement system is being undermined by loose eligibility rules that enable individuals to receive pension payments whilst still owning substantial assets.

RiceWarner Actuaries research has demonstrated in 2012 that there are over 850,000 retirees receiving the part age pension, or 36 per cent of the total retiree population.[39] This rate was significantly increased when the Government reduced the taper rates for the asset test for the age pension.[40]

When retirees become eligible for the part pension varies depending on the income test and asset test formulas. By way of example, it is unsustainable for a retired couple who own their own home, hold over an additional $1 million in assets and receive an income of over $60 000 per year to still be eligible to receive a part age pension.[41] This is in spite of the previous government's positive move in the 2009-10 Budget to increase the pension income test taper rate for income in excess of the income test free area.[42]

Table 6 reflects different levels of pension receipt by individuals and couples with varying levels of asset ownership and income.

Table 6. Aged pension benefit impact of income and asset tests[43]

Category	Assets	$0	$100,000	$200,000	$300,000	$400,000	$500,000	$600,000	$1,000,000
	Income	$0	$6,000	$12,000	$18,000	$24,000	$30,000	$45,000	$60,000
Home Owner	Individual	19,643	18,593	15,593	12,593	9,593	6,593	-	-
	Couple	29,614	29,614	23,330	26,830	24,349	20,449	10,699	949
Non Home Owner	Individual	19,643	18,593	15,593	12,593	9,593	6,593	-	-
	Couple	29,614	29,614	23,330	26,830	25,330	23,830	15,964	6,214

Table 6 demonstrates that individuals and couples, regardless of whether they own their own home or rent, are eligible to receive the partial age pension even where they have incomes and hold assets that the broader community would consider inappropriately high.

FSC has been supportive of the government's move to include earnings from account based pensions in the assets test in legislation which is presently before Parliament.

RECOMMENDATION: The Government conduct a review on whether the income and asset tests for the age pension are too generous and whether the long-term cost of the pension is sustainable.

[39] RiceWarner, Super Revolution, Focusing on the Retirement Years, August 2012, page 12
[40] 2006-07 Commonwealth Budget http://www.budget.gov.au/2006-07/ministerial/html/treasury-03.htm
[41] This analsysis is based on 2012 modelling by RiceWarner Actuaries
[42] 2009-10 Commonwealth Budget http://www.humanservices.gov.au/customer/enablers/income-test-pensions
[43] RiceWarner, Super Revolution, Focusing on the Retirement Years, August 2012, page 11

Appendix A – Comparison of Tax Rates in Passport Jurisdictions

Investors into Australian Domiciled MITs

Location	WHT – Fund Payments	Capital gains tax on sale of units
Korea	15	only on taxable Australian property
Phillipines*	30	only on taxable Australian property
Malaysia	15	only on taxable Australian property
Singapore	15	only on taxable Australian property
New Zealand	15	only on taxable Australian property

*EY report – Phillipines is not in EOI country list, despite having DTA – EOI country list determines rate see
https://www.ato.gov.au/General/International-tax/in-detail/investing-in-Australia/Withholding-tax-arrangements-for-managed-investment-trust-fund-payments/
Regulation: http://www.austlii.edu.au/au/legis/cth/consol_reg/tar1976378/s44e.html
EY – http://www.ey.com/Publication/vwLUAssets/Worldwide_corporate_tax_guide_2014/$FILE/Worldwide%20Corporate%20Tax%20Guide%202014.pdf

Investors into Korean Domiciled Vehicles

	WHT – Fund Payments – Dividends		
Location	Controlling parent	Other shareholders	Capital gains
Australia	15	15	Korean sourced capital gains derived by a non-resident are taxed at the lesser of 11% of the sales proceeds received or 22% of the gains realised. Progressive tax rates (of up to 22%) apply depending on the level of taxable income. A local surtax of 10% of the corporate income tax due applies.
Phillipines	11	27.5	
Malaysia	10	15	
Singapore	10	15	
New Zealand	15	15	

Investors into Singapore Domiciled Vehicles

Location	WHT – Fund Payments – Dividends	Capital gains
Australia	0	Capital gains are not taxed in Singapore. However, some exceptions apply. Corporate income tax rate is 17% at fund leve.
Korea	0	
Phillipines	0	
Malaysia	0	
New Zealand	0	

Note, considerable corporate tax concessions and incentives exist for companies domiciling their business activities in Singapore.
These are not being compared
Example includes financial sector incentive, p1216 EY report – 5% or 12% concessional tax rate

Appendix B - Stamp Duty Rates October 2014

Life Plan	ACT	NSW	NT	QLD	SA	TAS	VIC	WA
Life other than Term/ Temp	From 1/07/14 if Sum insured is $2,000 or less, $0.40 for each contract. From 1/07/14 if Sum insured > $2,000, 0.04% of total Sum insured	For first $2,000 or part thereof of Sum insured $1, where Sum insured >$2,000, $1 plus 20 cents for every $200 or part of $200 in excess of $2,000	10 cents for every $100 or part thereof of the sum insured	For a sum insured up to $2000 - 0.05% of the sum insured. Where Sum insured >$ 2,000, 0.05% of first $2,000 & 0.1% of the balance of sum insured	1.5% of the annual premium	For first $2,000 or part thereof of Sum insured, $0.10 for every $200 or part thereof. If Sum insured > $2,000, $1 plus 20 cents for every $200 or part of Sum insured in excess of $2,000	No duty after 1/07/14	No duty after 1 July 2004
Term	01/07/14 - 2% of first year's premium	5% of first year's premium	5% of first year's premium	5% of first year's premium	1.5% of annual premium	5% of first year's premium	No duty after 1/07/14. Pre 1/07/14 contracts/ policies - 5% first year's premium	No duty after 1 July 2004
Life Plan + Riders	**ACT**	**NSW**	**NT**	**QLD**	**SA**	**TAS**	**VIC**	**WA**
TPD/Trauma/Terminal illness which reduce a death benefit	01/07/14 - 2% of first year's premium	5% of first year's premium	5% of first year's premium	5% of first year's premium	11% of the annual premium	5% of first year's premium	Contracts entered into on/after 1/07/14 the rate is 10% annually. Contracts entrered into pre 1/7/14 5% first year's premium. This rate applies until novation of contract or creation of new contract	10% of annual premium
TPD which do not reduce a death benefit	01/07/14 - 2% of first year's premium	5% of first year's premium	5% of first year's premium	Contracts entered into before 01/08/13 duty is 5% of premium annually. This rate applies until novation/ creation of new contract. Contracts entered into on/after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Trauma/Crisis which do not reduce a death benefit	01/07/14 - 2% of first year's premium	5% of first year's premium	5% of first year's premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Accidental Death Benefit (ADB)- reduces the death benefit	01/07/14 - 2% of first year's premium	5% of first year's premium	5% of first year's premium	5% of first years premium	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Waiver of premium	01/07/14 - 2% of first year's premium	5% of first year's premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Double TPD Option	01/07/14 - 2% of first year's premium	5% of first year's premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium

Stand Alone	ACT	NSW	NT	QLD	SA	TAS	VIC	WA
TPD	01/07/14 - 4% of annual premium	5% of annual premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Crisis/Trauma	01/07/14 - 4% of annual premium	5% of annual premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Waiver of premium with TPD or Crisis/trauma	01/07/14 - 4% of annual premium	9% of the annual premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation/ creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Income Protection	01/07/14 - 4% of annual premium	5% of the annual premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation or creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Accidental Death Benefit (ADB)	01/07/14 - 2% of first year's premium if duration of contract is more than 1 year	5% of first year's premium if duration of contract is more than 1 year	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation or creation of new contract. Contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Mortgage insurance duty - where entire premium received upfront	**ACT**	**NSW**	**NT**	**QLD**	**SA**	**TAS**	**VIC**	**WA**
Life cover only - where entire premium received upfront	01/07/14 - 2% of first year's premium	5% of the premium for the entire policy	5% of first year's premium	5% of first year's premium	1.5% of the annual premium	2% of the premium for the policy	No duty after 01/07/14 Pre 01/07/14 - 5% first year's premium	No duty after 1 Jul 04
Riders that reduce death benefit - where entire premium received upfront	01/07/14 - 2% of first year's premium	5% of the premium for the entire policy	5% of first year's premium	5% of first year's premium	11% of the annual premium	2% of the premium for the policy	Contracts entrered into pre 01/7/14 5% first year's premium. This rate applies until novation of contract or creation of new contract. Contracts entered into on/after 01/07/14 the rate is 10% annually	10% of annual premium

Group Policies	ACT	NSW	NT	QLD	SA	TAS	VIC	WA
Term	01 /07/14 - 2% of first year's premium. Duty is calculated on new members' premium	5% of first year's premium. Duty can be calculated on new members' premium or net annual premium	5% of first year's premium. Duty is calculated on new members' premium	5% of first year's premium. Duty is calculated on new members' premium	1.5% of annual premium	5% of first year's premium. Duty is calculated on new members' premium	No duty after 01/07/14 Pre 01/07/14 - 5% first year's premium. Duty is calculated on new members' premium	No duty after 1 Jul 2004
Salary Continuance/ Income protection	01/07/14 - 4% of annual premium	5% of annual premium	10% of annual premium	Contracts entered into before 1/08/13 duty is 7.5% p.a. This rate applies until novation or creation of new contract. This includes new members that joined the policy after 01/08/13. Group contracts entered into after 1/08/13 is 9%	11% of the annual premium	10% of annual premium Pre 1 Oct 2012 - 8%	10% of annual premium	10% of annual premium
Riders which reduce a death benefit/don't provide an additional benefit	01/07/14 - 2% of first year's premium. Duty is calculated on new members' premium	5% of first year's premium. Duty can be calculated on new members's premium or net annual premium	5% of first year's premium. Duty is calculated on new members' premium	5% of first year's premium. Duty is calculated on new members' premium	11% of the annual premium	5% of first year's premium. Duty is calculated on new members' premium	Contracts entered into on/after 1/07/14, 10% of annual premium. Pre 01/07/14 contracts/ policies was 5% first year's premium. Grandfathering rules will apply to pre-existing life policies, with riders. Any increases in premiums for old members for those linked riders occurring post 1 July 2014 will not be subject to the new rules. If new riders or additional rider cover is added to a pre-1/7/14 policy refer to Tax Policy document. New members post 1 July 2014 – the premiums for the linked riders will be subject to stamp duty at 10% annually	10% of annual premium

HISTORY

ACT: General insurance rates reduction over five year period – 01/10/12 – 8%; 01/7/13 – 6%; 01/07/14 – 4%; 01/04/15 – 2%; 01/07/16 – 0%. (Prior to 01/10/12 – 10%).

ACT: Life insurance rates reduction over five year period – 01/10/12 – 4%; 01/7/13 – 3%; 01/07/14 – 2%; 01/04/15 – 1%; 01/07/16 – 0%. (Prior to 01/10/12 – 5%).

ACT: Duty on life insurance contracts is 0.08% of the total sum insured where the sum insured is greater than $2,000, and $0.80 for each contract where the sum insured is $2,000 or less. Effective 01/07/12 (Reduction of 2%/0.20c each year 2013 – 2016).

QLD: Post 01/08/13 new contracts for general insurance stamp duty payable 9% of annual premium. Grandfathering provision apply pre 01/08/13 where 7.5% stamp duty rate applicable.

TAS: From 1 July 2007 sickness, trauma and disability riders will be treated as general insurance insurance rate, where a rider attached to a life insurance policy provides an additional financial benefit over and above the life insurance.

TAS: Effective 01/10/12 – General Insurance rate increase from 8% to 10%.

VIC: Effective 01/07/14 – Life insurance – stamp duty is nil. Life insurance riders post 01/07/14 – stamp duty payable 10% annually.

VIC: Pre 01/07/14 – 5% first year's premium. Grandfathering rules will apply to pre-existing life policies, with riders that do not provide an additional benefit or that reduce the death benefit, provided a new contract is not entered into.

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