

# Henry Tax Review

The Russell Perspective  
2 May 2010

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## What are the key superannuation recommendations?

The main policy initiatives outlined by the Henry Tax Review relating to Superannuation were:

### **Increase in the Superannuation Guarantee from 9% to 12%**

From 1 July 2013 to 1 July 2019 the Government has announced it will increase the Superannuation Guarantee rate from 9 per cent to 12 per cent by small annual increments.

### **Increase in the Superannuation Guarantee age from 70 to 75**

We have seen a commitment to provide mature workers an extra incentive to remain in the workforce by raising the superannuation guarantee age limit from 70 to 75 from 1 July 2013.

### **Introduction of Government contributions for low income earners**

The Government will pay an extra contribution for low-income earners to offset contributions tax on concessional contributions, from 1 July 2012 (although the first contribution from the Government, in relation to the 2012-2013 year, will not be paid until 2013-2014). The contribution will be 15 per cent of concessional contributions made by or for individuals on adjusted taxable incomes of up to \$37,000, aiming to match the 15 per cent contributions tax on those contributions, subject to a maximum contribution of \$500 pa (not indexed). This contribution will be on top of the current Government co-contribution scheme, which remains unchanged after today's response.


### **Higher Concessional Contributions cap for certain groups**

Individuals aged 50 or over with total superannuation balances of less than \$500,000 will be eligible for a higher concessional contributions cap of \$50,000 (indexed) from 30 June 2012. This extends the current concessional contributions cap of \$50,000 (which is not indexed) for those aged 50 or over, which is due to expire on 30 June 2012. The higher cap will allow those with lower superannuation balances to "catch up", and particularly benefit those who have had periods outside the workforce.

These proposals are all good news for the superannuation industry - some will require administration system changes but all are designed to increase retirement savings. None of the proposals will have immediate effect, with the earliest effective date being 1 July 2012.

## What are some other considerations?

The Government has stated it will not implement some of the Review's recommendations, notably:

- A gradual increase in the preservation age to 67 years to be aligned with the new age pension eligibility age of 67 years.
  - The ability to purchase a lifetime annuity product from the Government.
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A number of recommendations impacting on superannuation made in the Henry Review were not specifically addressed by the Government. These remaining recommendations will presumably be the subject of further consideration and consultation and so could be introduced by the Government at a later stage.

### **Other Henry recommendations the Government could consider introducing**

- Abolishing tax on employer superannuation contributions in the fund, and instead taxing them as part of an individual's income, at his marginal income tax rate, with a flat –rate refundable tax offset to apply. This offset, which would apply to all superannuation contributions up to an annual cap, would replace the superannuation co-contribution and the spouse contribution tax offset.
- Reducing the 15% tax on investment income of a fund in the accumulation phase to a 7.5% tax, but applying this to income earned during both accumulation and pension phases – i.e. remove the current exemption for tax on pension income.
- Including superannuation balances in Age Pension means tests on the same basis as other savings.
- Removing the restriction on people aged 75 and over from making superannuation contributions. It is not clear how this would work, given that a work test would still apply at age 65 and over and SG contributions would cease to be compulsory at age 75.

The review also provides detailed analysis of a range of options to assist Australians to manage longevity risk. In particular it considers issues such as:

- should annuities be compulsory or voluntary (they recommend voluntary);
- should they be provided by the Government or the private sector (the Review says the Government should consider issuing annuities, subject to certain limits, but the Government has ruled out this option); and
- should annuities be guaranteed (the Review does not recommend restrictions on the types of products which can be sold).

The Review considers the barriers to the development of an effective private sector market in longevity insurance and recommends the Government consider issuing long-term securities, providing data for a longevity index to assist providers to hedge longevity risk and removing rules in the SIS legislation restricting product innovation.

The Report also acknowledges the importance of making people more aware of the retirement income system and recommends a number of measures.

- Requiring Superannuation Guarantee contributions to be paid at the same time as wages and at least monthly.
- Requiring employers to report superannuation contributions to employees when a contribution is made.
- Developing a method of linking superannuation records with a client identifier, to make it easier for people to manage their superannuation.

- Developing a superannuation portal where people can interact with Government agencies and get information on retirement incomes - this portal would eventually evolve to allow people to manage all their superannuation through one channel.

## **It should be relatively easy for defined benefit funds to be updated for the changes**

In most respects it will be relatively easy to update defined benefit funds to incorporate the changes announced by the Government. However, inevitably there will be some additional complexity.

For defined benefit funds perhaps the biggest relief is that the Government has not adopted the Henry Review's recommendation that "The tax on superannuation contributions should be abolished. Employer superannuation contributions should be treated as income in the hands of individuals taxed at marginal personal income tax rates and receive a flat-rate refundable tax offset." Imagine a defined benefit plan design that tried to incorporate members' marginal tax rates!

The implications of each of the four changes the Government hopes to adopt in respect of superannuation are discussed below.

### **Low Income Earners Government Contribution**

Defined Benefit funds will not generally be able to incorporate the low income earners' Government contribution into their benefit structures. However, like co-contributions the additional contribution should be able to be added to an accumulation account maintained in parallel with the defined benefit.

### **Concessional Contribution Caps**

Special grandfathering rules generally apply to members of defined benefit funds as at 12 May 2009. This means that their Concessional Contributions to the defined benefit fund are capped at the limit applicable to them. For some high paid employees this is a significant advantage of remaining in the defined benefit fund.

The Concessional Contribution limit was to become \$25,000 (indexed) for all members from 1 July 2012. The Government has now announced it will maintain the Concessional Contribution limit at \$50,000 (but now indexed) beyond 1 July 2012 for members over age 50 and with balances below \$500,000. Even where the grandfathering applies, this will allow relevant members with defined benefit Concessional Contributions between \$25,000 and \$50,000 to make additional salary sacrifice contributions. This is good news.

It will also assist new members who have joined defined benefit funds since 12 May 2009 and do not have the grandfathering applying, but only if they are over age 50 and their balances are below the limit.

### **Superannuation Guarantee age from 70 to 75**

It should also usually be reasonably straight forward to extend Superannuation Guarantee (SG) coverage from age 70 to age 75 for defined benefit funds.

### **Increase in Superannuation Guarantee to 12%**

The stepped increase in the Superannuation Guarantee (SG) Charge reaching 12% from 1 July 2019 will have a few implications but should generally be able to be implemented without significant additional complexity.

For many defined benefit funds that provide more generous benefits than the 9% currently required this will narrow, and in some cases even eliminate, the gap. In the very long term this is likely to assist employers who are encouraging members to transfer from defined benefit funds. It also means that funds have the potential to become Technically Insolvent more easily.

Depending upon how a defined benefit fund provides its minimum SG benefit (known as a Minimum Requisite Benefit) the annual stepped increases in the Charge may require significant administration system upgrades each year.

## The impacts on your investment portfolio

### Company tax and dividend imputation

Australian equity investors could benefit from a possible “bounce” in equity prices (excluding resources stocks) based on the Government’s announced reductions in the company tax rate. The rate will be reduced in stages from the current 30% to 29% in 2013-14 and 28% in 2014-15, though the low 28% rate will apply from 2012-13 for small cap stocks (small businesses). This reduction is more modest than the 25% company tax rate recommended in the Henry Report. However, it will be offset by proposed increases to compulsory employer superannuation contributions

Despite being rare by international standards, Australia’s imputation system is to be retained, at least in the short and medium term. Companies will continue to be able to pay franked dividends, with investors using the franking credits to offset tax on dividends and other income. There is also good news for those using franking credits as a yield enhancement strategy - no changes will be made to the rules which allow individuals, superannuation funds and charities to claim back excess franking credits from the Tax Office.

### Capital gains tax (CGT)

Despite speculation, the Government has not announced changes to the CGT rules, so investors can still access the CGT discount tax concessions whether investing directly or through managed funds. The Henry Report recommends changes to the CGT discounting rules as part of a change to a broader 40% tax discount applicable to a range of income streams and gains from savings, including capital gains discussed below. The Government, however, has explicitly rejected reducing CGT discounting “at any stage”. Investors with very old (pre-1985) investments will be interested in the Government’s rejection of the Henry recommendation to bring these investments, currently exempt from CGT, into the CGT net.

Investors will no doubt echo the Henry Report’s recommendation that the CGT rules be rewritten in a principles-based style to remove complexity. The Government’s response is silent on this matter.

### Broad tax discount on savings

The Government has not commented on the Henry recommendation to replace the CGT discount with a broad 40% tax discount applicable to a range of income streams and gains from savings, such as bank deposit interest, bond coupon interest, rental income and capital gains. If accepted, this would have significant implications for investors choosing between different types of savings vehicles who are currently favoring CGT assets (or investing in non-CGT assets via their superannuation funds) because of their tax-preferred status. The breadth of this recommendation means the Government may want to take more time to consider its response.

## Next steps

To implement the proposed reforms will require legislative change. Add to this a Federal Election, due to occur in the second half of the year, making the changes may prove difficult, leading to a lengthy reform process and possible future uncertainty.

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