Association of Independent Retirees (A.I.R.) Limited
ACN 102 164 385

Australia's Future Tax System

Response to the Tax Review Consultation Paper

February 2009

12 February 2009

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

Association of Independent Retirees (A.I.R.) Limited
Response to the Tax Review Consultation Paper

The attached response to the Tax Review Consultation Paper addresses the questions raised that are appropriate for self-funded retirees and which affect their lives and living standards.

They are submitted by A.I.R. in the sincere hope that the Government will accept the need for a more equitable recognition of the current needs of self-funded retirees, in the context of their past and ongoing contributions to the economic and social development of Australia.

The responses outlined in this Submission have been developed in consultation with A.I.R. members across all States and Territories. They are intended to assist the Review Panel in reviewing Australia's Future Tax System.

I hope that this Submission will be accepted as positive and supportive of Government policy objectives. Should you require any further information, please contact the following:

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Yours sincerely

Theresa Kot

Theresa Kot
National President

Executive Summary

The Association of Independent Retirees (A.I.R.) Limited is the peak body representing the interests of retirees who are wholly or partly self-funded in retirement. A.I.R.'s members include full self-funded retirees, part-pensioners, and superannuants.

Formed in 1990, A.I.R. is a not-for-profit, non-political, volunteer organisation that is focused on matters affecting the standard of living, health and welfare of retired and partly-retired people.

As well as carrying out research and gathering information that will assist its members in maximising their life opportunities, A.I.R. is committed to educating the wider community (including political parties at all levels of Government) regarding the views and concerns of self-funded retirees.

This submission is in response to the Tax Review Consultation Paper. An answer is provided to each of the questions raised in that paper.

The submission reflects the views of partly and fully self funded retirees who have experience in managing their affairs during retirement. They have a clear understanding of the issues that affect their capacity to live a fulfilling retirement. A.I.R. believes that the views of people who are actually living their retirement provides a pragmatic and realistic input to the Review, and this input is important in achieving an acceptable and reasonable retirement income system in Australia.

Responses to the questions are summarised below.

Question 1.1

> *In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?*

- AIR supports the objectives set out in the Consultation Paper but suggests that there are anomalies and inequities in the application of the retirement income system that are unnecessary, inequitable, and add to complexity. There should be greater emphasis on:
  - Recognition of the contribution made to retirement income from the voluntary savings held by three quarters of retirees;
  - Tax structures that sustain private assets through a retiree's life span, including recognition of the need to withdraw lump sums to meet unforeseen circumstances;
  - Removal of tax discrimination between those with taxed fund superannuation, those with untaxed superannuation, and those with private assets outside superannuation;
  - Identification, registration, and regulation of financial products suitable for retirement income investment;
  - Flexibility to meet the different interests of retirees in managing their retirement income;

- Removal of tax churn for part age pensioners by removing the need to pay income tax;
- Changing the concept of a retirement age to one where individuals can access retirement income while encouraging them to continue to contribute to the Australian economy.

Question 2.1

As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?

- The retirement income system should continue to cater for these vulnerable groups through the Age Pension provisions;
- A statutory authority, or similar, tied to APRA should be established to receive and consolidate small individual superannuation amounts to prevent the loss of these assets through administrative charges greater than interest earned. Cost of administering the authority should be met through an initial capital grant from government.

Question 2.2

Noting that the adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?

- The Age Pension should be set at a safety net level to sustain a reasonable standard of living for those members of the community who have insufficient private savings (including the SG) to sustain a standard of living greater than the safety net level;
- The part Age Pension concept should be continued as an incentive to members of the community to sustain a standard of living above the safety net level supported by their private savings;
- The upper threshold for part Age Pension support should be set at least at the after-tax rate of AWOTE.
- Retirees above the upper income threshold for the part Age Pension should receive a phased level of tax relief up to the upper income threshold of the 30 cents in the dollar marginal tax rate and, as a consequence, the CSHC should be returned to its original purpose of providing relief for pharmaceutical benefits and other health costs.

Question 2.3

What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

- Regulatory policies and procedures should be simplified for a majority of retirees by removing the requirement for part age pensioners to pay income tax;,
- The great majority of retirees do not have sufficient assets to justify the government establishing complex superannuation regulations to prevent misuse of government incentives for estate planning purposes. Age and minimum withdrawal restrictions should be removed from taxed superannuation funds.

Question 3.1

Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?

- A.I.R. makes no response to this question.

Question 3.2

Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, how should they be reformed?

- A.I.R. does not have any comment on superannuation concessions during the accumulation phase;
- Income tax provisions for taxed superannuation funds during the drawdown phase are appropriate.

Question 4.1

At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

- The concept of the retirement age should be changed to one where the retirement age is the age at which people may gain access to retirement income benefits;
- The retirement age should be set at 65.

Question 4.2

What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

- A superannuation authority, or similar, tied to APRA should be established:
    - to approve financial products to minimise investment risk,
    - to carry the investment risk associated with approved financial products,
    - to collect, integrate and invest small compulsory superannuation sums (see Section 2.1).

Question 5.1

In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?

- Part age pensioners should be exempt from paying income tax. This could be achieved by restructuring SATO to commence from the taxable income at which the part Age Pension ceases and made equal to the marginal tax payable on that income. SATO should then be phased out linearly to cease at the upper income threshold of the 30 cents in the dollar marginal tax rate. As a result:
    - the retirement income tax system would be significantly simplified, both for government and retirees,
    - tax churn would be removed from partly self-funded retirees,
    - the incentive for retirees in this group to work beyond the age of 65 would be significantly increased;
- The CSHC upper income threshold for singles should be changed to the upper income threshold of the 30 cents in the dollar marginal tax rate; the present ratio between singles and couples should be maintained. Further, if the restructuring model proposed above for SATO is adopted, the CSHC could be returned to its original purpose—providing pharmaceutical benefits and certain other health concessions;
- Retirees should be exempt from capital gains tax on the drawdown of private capital assets held outside superannuation for retirement income purposes up to the upper income threshold of the 40 cents in the dollar marginal tax rate;
- Existing regulations requiring a minimum amount to be withdrawn from superannuation should be removed entirely. Alternatively, if the Government wishes to retain such a regulation, the percentage should be set at the real return on assets of retail superannuation funds based on the index used for indexing the Age Pension;
- Age related regulations for persons 65 and over applying to superannuation should be removed;
- Superannuation income streams from both taxed and untaxed funds should be assessed separately from other assessable income as recommended by the Senate Economics Report February 2007.

Question 6.1

> *The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?*

- Retirees with a part Age Pension should pay no income tax;
- Introduction of ‘Simpler Super’ removing the requirement to pay income tax on pensions and earnings in taxed superannuation funds during the drawdown phase means that the loss of revenue to government from exempting part age pensioners from payment of income tax would be small.

Question 6.2

In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?

- The retirement income system has only a small bearing on workforce decisions.

Question 6.3

What impact could financial intermediation have on the effectiveness of retirement income policy?

- Investment and longevity risks should not be transferred to individual retirees provided they invest in APRA approved products;
- A statutory authority, or similar, tied to APRA should be established to act as insurer for APRA approved financial products. Its terms of reference should include:
    - o to receive and consolidate small superannuation holdings and to manage these without charging an administrative fee so that the assets do not decline in value for the individual,
    - o to act as the insurer against longevity risk as a means of improving returns on annuitv type products for those retirees who do not wish to manage their retirement income,
    - o to act as the insurer against loss of individuals superannuation assets through investing in APRA approved investment products. This term of reference would provide an incentive for APRA to ensure that products are sound and ensure that retirees understand investments that are APRA approved.
- Education should be focused on improving understanding of the management of private assets across a retiree's retirement life span. It should be included in secondary school curriculum.

Question 6.4

The cost of providing health and aged care to older Australians is currently met by government through the health sectors. Should retirement income policy take into account projected increases in health costs for older Australians? If so, what would be the most effective mechanism and how might the transition to such a system be achieved?

- Pharmaceutical costs increasing with age should continue to met through the CSHC,
- The CSHC should be recognised as a proper concession and suitable indexation should be incorporated (See Question 5.1).

Detailed Responses to Questions

Response to Q1.1

In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?

1.1.1 Australia's retirement income system

Australia's retirement income system is based on private assets generated by individuals and couples prior to retirement. Of the 2.8 million individuals 65 and over, 1.5 million (over half) fully or partly support themselves from their private assets. These private assets may have been generated by saving and direct investment from after-tax income, and/or through company and public service superannuation.

Many members of the community have an innate imperative to try to build adequate assets to maintain their lifestyle during retirement. They recognise that relying solely on government support will not provide them with a lifestyle approaching that of their pre-retirement. They built their assets without the compulsion of the superannuation guarantee (SG), introduced because many employees did not have sufficient resources to meet their perceived future needs.

A.I.R. suggests that the three-pillar retirement income system set out in the Consultation Paper does not adequately reflect the importance of private assets built voluntarily by members of the community outside the government controlled component of the retirement system. It suggests the following description is more appropriate.

Australia's retirement income system is based on private assets generated by individuals and couples prior to retirement. Government supports and regulates the retirement income system through:

- a government provided Age Pension system with associated concessions and allowances for those with insufficient private savings to maintain a reasonable living standard,
- taxation relief for low income retirees, and
- a superannuation system available to all that:
    - supports compulsory minimum savings for employees enforced through the superannuation guarantee (SG), and
    - provides incentives for individuals to build their private savings within superannuation.

AIR supports the objectives set out in the Consultation Paper. Each of these is discussed in the following sections.

1.1.2 A broad and adequate retirement income system

The amount of retirement income provided from retirees' private savings and earnings is significant and is essential to sustain the retirement income system. It is of the same order of magnitude as Government assistance to the aged[1]. Introduction of the SG is intended to increase the proportion of the members of the community with superannuation and will increase the proportion of retirement income from private sources as the SG matures.

In the financial year 2006/2007, about one quarter of retirees supported themselves totally from their private resources[2]. About one-third of retirees partly supported themselves and received a part Age Pension or equivalent averaging about 10% of their total income. The remaining 40% received the full Age Pension and had little private income.

Government incentives to encourage private saving for retirement have been focused on superannuation[3]. However, many retirees have been unable to access superannuation because of workplace policies–examples include women forced to retire upon marriage and self-employed people. Many have been unable to build significant assets within superannuation because of their age when superannuation became more generally available, or because of age restrictions on contributions. This latter restriction has also led to retirees with smaller superannuation funds supplementing their portfolios with private investment. However, many have chosen not to use superannuation because of its investment and withdrawal restrictions–examples include ownership of property, and minimum withdrawal requirements.

1.1.3 An acceptable retirement income system

The future retirement income system should encourage individuals to build their own assets to the maximum extent possible prior to retirement, whether in superannuation or privately. Many individuals will choose to build their assets in a flexible manner and differently at different stages in their career. There is now evidence that younger people will choose to build the majority of their assets outside superannuation including through property acquisition. They are concerned over employment risk and do not wish to lock their assets away. As people approach retirement there is a greater emphasis on contributions to superannuation from after-tax earnings to gain the benefits of superannuation.

An individual's assets, whether in superannuation or outside superannuation, need to last the individual's lifetime, even if the individual relies completely on the Age Pension. Private assets provide dignity and choice.

An individual's assets provide, or support, normal living requirements and lump sum requirements to meet unforeseen circumstances (uncertainty risk). Individuals wish to maintain their assets to preserve a regular income sufficient to maintain their lifestyle during their retirement, which can cover over thirty years. They also wish to maintain sufficient assets to meet unforeseen capital maintenance needs and health costs as they move through retirement. Policies which do not allow assets to be sustained to maintain income at real levels force a decline in living standards and an increasing recourse to government pensions and allowances. In this respect, policies based on statistical life expectancies have no meaning to a retiree trying to manage his/her individual life.

[1] See Appendix 1
[2] See Appendix 1
[3] Tax Review Consultation Paper 2008 Appendix B

1.1.4 A robust retirement income system

Investment by large superannuation funds should be conservative and transparent. Recent financial turbulence has made it clear that this has not been the case. Close scrutiny and transparency of the performance of all funds is necessary, including retail funds. The latter supports a large number of employees in small to medium size businesses who have minimum SG.

The Self Managed Superannuation system (SMSF) provides an alternative for retirees interested in closely managing their retirement assets. However, there are significant differences in the types of investment allowed between SMSFs and large superannuation providers. There should be greater consistency between the investments allowed in the two systems. Many retirees have little confidence in the proposition that large superannuation funds have greater expertise and exercise greater professional responsibility than Trustees of SMSFs. SMSFs also act as a competitive force against large superannuation funds as evidenced by recent transfers from large superannuation funds to SMSFs.

There is need for greater incentive for government regulatory bodies to properly exercise their responsibilities in controlling products developed by financial intermediaries

The different levels of interest that individual retirees have in their superannuation assets should be recognised. The superannuation system provides the ability for a retiree disinterested in managing their assets to receive a regular pension. Provision of alternative investment strategies allow more interested retirees to have a degree of choice in the type of investment that meets their investment risk profile. The Self Managed Superannuation system meets the needs of retirees who are interested in closely managing their investments. These varied provisions should be encouraged to provide a degree of peer control over the behaviour of the different segments within the industry.

1.1.5 A simple and approachable retirement income system

In the 2005/2006 Financial Year approximately 87% of retirees reporting taxable incomes have retirement income less than the upper income threshold of the 30 cents in the dollar marginal tax rate[4].

This percentage will change significantly from the 2007/2008 financial year when no income tax will be paid on pensions and on earnings in taxed superannuation funds supporting those pensions. Recognising that the group of retirees with incomes less than the upper income threshold of the 30 cents in the dollar marginal tax rate has low assets, income tax paid on income where assets are held privately is unreasonable and inequitable. Payment of income tax, including capital gains tax, distorts the effective use of assets, leads to poor investment decisions, and downgrades income from assets. Discrimination in income tax in the drawdown phase serves no useful purpose at these taxable income levels, but distorts flexibility of choice and optimal investment decisions.

Nothing in the above comments suggests that superannuation serves no useful purpose in encouraging the accumulation of assets to meet retirement income needs. Superannuation as an incentive to encourage building of assets in superannuation in the accumulation phase makes sense.

[4] See Appendix 1

1.1.6 A <u>sustainable</u> retirement income system

The retirement income system should reflect changes in the work/leisure pattern of Australian individuals. The concept of moving from work to retirement at a defined age is no longer relevant and removes flexibility from the retirement income system. A retirement age should be seen as the age at which access to government benefits such as the Age Pension, superannuation, and income tax concessions should become available. Continuing to work beyond this retirement access age or to move between part or full time work and leisure at different periods during retirement should be encouraged.

1.1.7 Summary of the response to Question 1.1

- AIR supports the objectives set out in the Consultation Paper but suggests that there are anomalies and inequities in the application of the retirement income system that are unnecessary, inequitable, and add to complexity. There should be greater emphasis on:
    - Recognition of the contribution made to retirement income from the voluntary savings held by three quarters of retirees;
    - Tax structures that sustain private assets through a retiree's life span, including recognition of the need to withdraw lump sums to meet unforeseen circumstances;
    - Removal of tax discrimination between those with taxed fund superannuation, those with untaxed superannuation, and those with private assets outside superannuation;
    - Identification, registration, and regulation of financial products suitable for retirement income investment;
    - Flexibility to meet the different interests of retirees in managing their retirement income;
    - Removal of tax churn for part age pensioners by removing the need to pay income tax;
    - Changing the concept of a retirement age to one where individuals can access retirement income while encouraging them to continue to contribute to the Australian economy.

Response to Q 2.1

> *As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?*

2.1.1 Meeting the retirement income needs of vulnerable groups

The structure of the Australian community and the work pattern of its members is complex. The SG cannot meet all needs and the Age Pension must remain as the fallback retirement income system for members of the community who cannot build sufficient assets through the SG or private means.

Government policy should aim to minimise the number of members of the community who need to use the Age pension as their primary retirement income. Vulnerable groups include:

- casual workers, where the administrative charge is greater than the interest earned on small superannuation contributions and the superannuation amount disappears over time. The present policy of allowing cashing of small amounts does not work because people do not see the amount as sufficient to overcome the initiative required to recover it. A mechanism to consolidate contributions below a threshold amount and to remove the administrative charge as a fixed monetary amount through a statutory authority, or similar body, tied to APRA would make sense.
- Couples where partners separate or the partner providing most of the income support dies.
- Self-employed people. Self-employed people who do not earn sufficient to build assets, or who choose not to, are vulnerable[5]. Many self-employed people are able to build retirement assets from their business from after-tax income. There is some relief from capital gains tax arising from the sale of their business for self-employed people who have maintained their business for 15 years or more. Payment of income tax, even with capital gains tax relief is discriminatory against those who have generated their assets in taxed superannuation funds.

The retirement income system should continue to cater for these vulnerable groups through the Age Pension provisions. Any policy that tries to modify superannuation legislation to include these groups will have negative economic consequences. Alternative solutions should be sought. As an example, small contributions, which decline to zero over time because of administrative charges greater than interest received, should be transferred to a statutory authority, which consolidates small contributions and provides some growth to the capital.

Summary of the Response to Question 2.1

- The retirement income system should continue to cater for these vulnerable groups through the Age Pension provisions,

- A statutory authority, or similar, tied to APRA should be established to receive and consolidate small individual superannuation amounts to prevent the loss of these assets through administrative charges greater than interest earned. Cost of administering the authority should be met through an initial capital grant from government.

Response to Question 2.2

> *Noting that the adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?*

[5] Consultation Paper Section 'The Self-Employed'

2.2.1 Concept of adequacy

The appropriate concept of adequacy should recognise the social and economic pattern in Australian society. It should not be structured in a way that forces people into a common standard of living and a standard of living markedly less than they enjoyed during their pre-retirement.

The Age Pension should be set at a safety net level to sustain a reasonable standard of living for those members of the community who have insufficient private savings (including the SG) to sustain a standard of living greater than the safety net level;

The part Age Pension concept should be continued as an incentive to members of the community to sustain an improved standard of living above the safety net level supported by their private savings. Removal of tax on part age pensioner income would remove tax churn, improve adequacy, and simplify administration for government and retirees.

The upper threshold of the part age pension is presently set by phasing out the full Age Pension at a fixed linear rate. Subject to the recommendations of the Pension Review, AIR believes that it is more appropriate to link the upper threshold for part Age Pension support to a community standard. It believes that the after-tax rate for average weekly ordinary time earnings represents a reasonable measure of average living standards in the Australian community. The phasing out rate of the full Age Pension should remain linear but the rate should be adjusted to maintain the after-tax rate for average weekly ordinary time earnings.

Retirees with moderate incomes above the upper threshold of the Age Pension presently receive concessions through the Commonwealth Seniors Health Card (CSHC). They should receive a phased level of tax relief related to their taxable income above the upper income threshold of the part Age Pension and phasing out at the upper income threshold of the 30 cents in the dollar marginal tax rate. This would allow the CSHC to be returned to its original purpose of providing relief for pharmaceutical benefits and certain other health costs.

Summary of the comments to Question 2.2

- The Age Pension should be set at a safety net level to sustain a reasonable standard of living for those members of the community who have insufficient private savings (including the SG) to sustain a standard of living greater than the safety net level;
- The part Age Pension concept should be continued as an incentive to members of the community to sustain a standard of living above the safety net level supported by their private savings;
- The upper threshold for part Age Pension support should be set at least at the after-tax rate of AWOTE.
- Retirees above the upper income threshold for the part Age Pension should receive a phased level of tax relief up to the upper income threshold of the 30 cents in the dollar marginal tax rate and, as a consequence, the CSHC should be returned to its original purpose of providing relief for pharmaceutical benefits and other health costs.

Response to Question 2.3

> *What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?*

2.3.1 Maintaining retirement assets to generate retirement income during retirement

Retirement living needs are generally higher early in retirement when retirees are generally more active, healthy, and looking to enjoy their free time. Whilst, the level of activity and basic food needs tend to decline later in retirement, these needs tend to be replaced by higher medical costs. Thus, the level of income needs to be sustained across the full retirement life span.

Partly self-funded retirees make up about 40% of all age pensioners[6]. However, only about 22% receive a weekly income greater than $100 per week, compared with the 'free' income, which full age pensioners are permitted of $69 per week for single pensioners and $60 per week for each partner of a couple. A.I.R.'s 2006 National Survey[7] (with 4,500 respondents, approximately one quarter of total membership), showed that approximately 50% of its members received some form of pension or assistance. The average annual income of all respondents to the Survey was approximately $53,000, about equal to the before-tax MTAWE at the time of the Survey. Hence, effective management of the tax transfer system is very important to the great majority of retirees and will be a major challenge facing Australia as the number of retirees increases in the future.

The need to replace capital items such as cars and washing machines increases with time. Even accepting that a car can be kept for ten years (well above the average age of cars in Australia), a car requires at least one replacement during the average retirees' life span of 17.7 years (the A.I.R. National Survey, 2006 showed that over 90% of respondents continued to own a car between 75 and 84 years of age, with 77% continuing to own a car over the age of 85). The availability of a car remains essential if a retiree is to remain independent in later life, e.g. to access shopping centres and to remain active. Activity in retirement is identified as essential to maintain health and minimise medical costs later in life.

Most retirees own their own home throughout most of their retirement. Household items such as washing machines also have a life less than the average retirees' life span of 17.7 years. To maintain a home over 17.7 years to a reasonable standard requires some capital expenditure (painting, plumbing repairs, etc.). Maintaining the capital value of a house is important to allow downsizing or other accommodation changes to meet retiree needs later in life.

Partly self-funded retirees do not, and will not, have sufficient assets to pay significant tax or build assets for estate planning purposes. Retirees in this category currently represent approximately 30% of all retirees over 65 years of age.

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[6] See Appendix 1

[7] A.I.R. National Survey 2006 www.independentretirees.com.au

Note also that Age Pension or related support is received by over 80% of male retirees between the ages of 70 and 90 and over 85% of female retirees between the ages of 70 and 100[8].

A.I.R. recognises that income tax and other concessions are undoubtedly an incentive for people to build assets in superannuation. However, from the point of view of those retirees who have untaxed superannuation funds or who do not have assets in superannuation the present structure is discriminatory. The requirement to pay income tax should be consistent with the requirements for taxed superannuation funds.

Overall tax revenue from retirees will decline in the foreseeable future because of declining proportions of retiree groups who do not have taxed superannuation funds against those with taxed superannuation funds. Consequently, the cost in foregone tax revenue from removal of inequities between retirees with private assets held in different ways will not be unreasonable against the benefit of removing the inequities.

Only a small percentage of retirees (4%), about 24,000 individuals[9], have a taxable income above the upper threshold of the 40 cents in the dollar marginal tax rate, the category where government regulations might require measures to prevent estate planning from government support incentives. The cost of administering regulations for the great majority or retirees to control estate planning, when this applies only to a few, far outweighs the benefit to government. Complexity and inequities arising from minimum withdrawal regulations and retiree age barriers in taxed fund superannuation provide little effective control compared to the costs incurred. However, they impact negatively on community perceptions by adding administrative complexity. A.I.R. takes the view that regulatory policies should be simplified for the majority of retirees, and that exception type policies should, if deemed necessary, be put in place to meet any governmental concerns about the small percentage of retirees with very high incomes and assets.

Summary of the response to Question 2.3

- Regulatory policies and procedures should be simplified for a majority of retirees by removing the requirement for part age pensioners to pay income tax;,
- The great majority of retirees do not have sufficient assets to justify the government establishing complex superannuation regulations to prevent misuse of government incentives for estate planning purposes. Age and minimum withdrawal restrictions should be removed from taxed superannuation funds.

Response to Question 3.1

> *Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?*

A.I.R. is primarily concerned with the interests of retirees during their retirement life span. It is inappropriate for it to make any comment on the level of the SG.

Summary of the response to Question 3.1

- A.I.R. makes no response to this question.

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[8] Pension Review Background Paper August 2008 Dr Jeff Harmer.Chart 20
[9] See Appendix 1

Response to Question 3.2

Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, how should they be reformed?

3.2.1 Superannuation concessions during the accumulation phase

A.I.R. does not have a view on the whether the current level of superannuation concessions during the accumulation phase is appropriate.

3.2.2 Superannuation concessions during the drawdown phase

As discussed in the response to Question 5.1, A.I.R. believes that the income tax structure applying to taxed fund superannuation in the drawdown phase is appropriate.

A prime factor in the retirement income system is the need to sustain private assets during the retirement life span to meet income needs and one-off extraordinary maintenance and health needs. It is not appropriate to have a system that runs down private assets through the imposition of income tax during the early years of retirement, steadily forcing people to reduce their standard of living until they are on the full Age Pension. Longevity risk and its associated uncertainty risk places a priority for retirees on sustaining their assets across their retirement life span. The great majority of retirees do not have sufficient assets to enable the use of government concessions for estate planning purposes–that is of secondary concern compared with meeting the retiree’s needs (see the response to Question 2.3).

Summary of the response to Question 3.2

- AIR does not have any comment on superannuation concessions during the accumulation phase;
- Income tax provisions for taxed superannuation funds during the drawdown phase are appropriate.

Response to Question 4.1

At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

4.1.1 Access to Superannuation and the Age Pension

Present transition to retirement arrangements are generally appropriate. The age at which people become eligible for the Age Pension, of 65, should be the same for males and females, and is appropriate. Incentives should be available to encourage people to remain in the workforce after the age of 65.

There are conflicting issues in setting a retirement age. Many people remain valuable and flexible members of the workforce. They have the right to retire when they wish. Incentives to encourage them to continue to work allow them to build further assets for retirement, assist the organisation to maintain a skilled workforce, and assist in reducing government costs associated with retirement. The retirement bonus scheme recognises these issues.

On the other hand, as some people move through their working life they become more resistant to change and can no longer meet the needs of an organisation for which they work. The retirement age provides a method for managing this issue with dignity.

Any proposal to raise the retirement age above 65 takes away the choice of individuals to leave work. It can force organisations to retain employees who are no longer appropriate members. Also, as fully or partly retired people provide a substantial amount of the many millions of hours of volunteer work across Australia any proposal to raise the present retirement age will severely impact volunteer availability. For these reasons AIR believes that the present retirement age of 65 provides the best balance and is appropriate.

Summary of the response to Question 4.1

- The concept of the retirement age should be changed to one where the retirement age is the age at which people may gain access to retirement income benefits;
- The retirement age should be set at 65.

Response to Question 4.2

> *What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?*

4.2.1 Investment risk

Self-funded retirees managing their own retirement assets should bear the responsibility for their management decisions and bear the consequences of investment risk associated with their decisions. However, the growth of superannuation has led to the development of structures and products that are unethical, either in the level of fees charged or in the level of risk. Financial markets have demonstrated that they unable or unprepared to deal with this risk.

There are many examples of government minimising risk to consumers in material products through labeling, etc. AIR believes that government has a responsibility to approve financial products and to label those approved clearly for the benefit of individuals.

Approval by government of a financial product should also mean that the government should carry the investment risk. AIR proposes that a statutory authority, or similar, tied to APRA should be established for this purpose (see Section 6.3).

4.2.2 Longevity risk

Retirees, whether partly or fully self-funded, have a reasonable expectation that they can maintain a standard of living throughout their retirement comparable with that during their pre-retirement. In many cases they have worked to build assets for this purpose and do not wish to see these assets erode over time to the extent that their standard of living reduces unreasonably. In many cases these assets will have been built through the SG.

Many retirees wish to maintain their independent life style and to minimise their dependence on government support, but are deeply concerned that their assets may be eroded and not last until the end of their retirement life span.

They are afraid that they will then have to become dependent on family, friends, or government. They need to retain assets for inevitable unexpected medical, living, social, and transport needs.

Some retirees do not wish to closely manage their retirement assets. They seek a secure income that meets their needs over their retirement life span. Payment of pensions through the superannuation system meets their requirements. However, lifetime annuities pay very low incomes because the provider of the annuity has to meet the longevity risk. There is likely to be a positive return to government if it acted as the longevity risk taker in return for a higher return to the retiree. This would make annuities more attractive and would encourage retirees to use annuities rather than drawdown their assets, forcing them onto the Age Pension.

A superannuation authority, or similar body, tied to APRA could have the responsibility of meeting longevity risk. It could also act as the collector of small compulsory superannuation sums to avoid their loss to the member through fixed administrative fees (see Section 2.1.1).

Summary of the response to Question 4.2

- A superannuation authority, or similar, tied to APRA should be established:
    - to approve financial products to minimise investment risk,
    - to carry the investment risk associated with approved financial products,
    - to collect, integrate and invest small compulsory superannuation sums (see Section 2.1).

Response to Question 5.1

> *In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?*

5.1.1 Complexity arising from discrimination between the tax treatments of different groups of partly self-funded retirees

In its previous submission, October 2008, A.I.R. demonstrated that since 1 July 2007 the tax structure of the cohort of partly self-funded retirees has been split into three groups:

(a) partly self-funded retirees with taxed superannuation funds who pay no income tax on pension withdrawals or earnings, including capital earnings (subject to regulatory requirements),

(b) partly self-funded retirees with untaxed superannuation funds who pay income tax on pension withdrawals with some tax relief,

(c) partly self-funded retirees without superannuation who pay income tax on income from their private assets.

It is highly likely that many retirees in the future will maintain a combination of their private assets in superannuation and outside superannuation

The proportion of the group of retirees with taxed superannuation funds is expected to grow because of the SG. This group is expected to dominate the other two groups in the future. The group of retirees with all assets outside superannuation is expected to decline as a percentage of total retirees.

Discrimination between the tax treatments of the three groups is significant and should be removed at least to the following extent to reduce complexity and cost:

1. Part age pensioners should be exempt from paying income tax.
2. SATO should be continued but modified to phase out from the upper income threshold of the part pension to the upper income threshold of the 30 cents in the dollar marginal tax rate. The CSHC should apply to the upper income threshold p of the 30 cents in the dollar marginal tax rate but be returned to its original purpose of providing PBS and certain other health costs.
3. Capital gains tax should be abolished for retirees with equivalent incomes to the top of the 40 cents in the dollar marginal tax rate.

Each of these issues is discussed below.

5.1.2 Tax treatment of partly self-funded retirees

As noted in Section 5.1.1 partly self-funded retirees with taxed superannuation funds pay no tax on pensions received from the fund (subject to meeting regulatory requirements). With the introduction of SG, partly self-funded retirees with taxed superannuation funds are expected to become the dominant group.

From 1 July 2007, many partly self-funded retirees with taxed superannuation funds will pay little, if any, income tax on income, including the part Age Pension, outside superannuation—because of reduction in taxable income and the consequential reduction in marginal tax rate, and because of SATO.

Retirees with untaxed superannuation funds or with all their retirement income assets outside superannuation are discriminated against. They will become smaller groups proportionally and will become more obvious as groups treated inequitably for tax purposes.

Removing the requirement to pay income tax for partly self-funded retirees would remove the need to prepare tax returns, reducing their administrative burden and reducing governmental oversight costs. Income and asset tests for eligibility for the part Age Pension provides sufficient test of a retiree’s financial position. Preparation of a tax return simply duplicates the process. In the financial year 2007/2008 (the first year when taxed fund superannuation pensions were exempt from income tax) it is estimated that the cost to government would be $600 million or 12% of income tax paid by all retirees 65 and over[10]. This cost can be partially offset by removing the need to process tax returns for 314,000 individuals[11].

The tax transfer system is structured so that retirees receiving the full Age Pension presently pay no income tax. Partly self-funded retirees who receive a part Age Pension pay income tax while receiving government support, which leads to tax transfer churn.

[10] See Appendix 2
[11] See Appendix 1

Table 2 Tax Transfer Churn for Partly Self-Funded Retirees

Taxable Income	Age Pension	Tax Paid	Tax Transfer Churn	Tax Transfer Churn %	Comments
$17,805	$14,217	0	0	0	Max. Age Pension plus 'free' income
$25,867	$8,842	$750	$750	8%	Tax is paid and SATO reduces from this income
$28,000	$4,452	$1,337	$1,337	30%	
$30,000	$3,652	$1,887	$1,887	52%	
$32,000	$2,852	$2737	$2,737	96%	Tax paid approximates Age Pension received
$34,000	$2,052	$3,587	$2,052	57%	
$36,000	$1,252	$4,437	$1,252	28%	
$38,000	$452	$5,287	$452	9%	
$39,130	0	$5,767	0	0	Income limit at which the Age Pension cuts out

Note: Figures apply to the 2007/08 financial year. The figures do not include income from taxed superannuation funds.

Table 2 shows that the level of tax transfer churn is approximately 30% over the income range from $28,000 to $36,000 and over 50% in the income range from $30,000 to $34,000. The tax paid by a partly self-funded retiree with a total income of about $32,000 equals the part Age Pension received, or a tax transfer churn of 100%.

The tax collected from part age pensioners in the 2005/ 2006 financial year ($0.86 billion) approximated the amount of reportable pensions and allowances received ($0.9 billion), a tax churn of 1.04[12].

Partly self-funded retirees do not belong to the social group who can be expected to contribute tax revenue for redistribution to those in need. They are recipients of this tax redistribution. To require them to pay tax while receiving a part Age Pension is simply a way of the government appearing to provide largesse to a community group.

Most partly self-funded retirees will depend on government income support throughout their retirement life span. The Pension Review Background Paper shows that the current average period of receiving income support for retirees is 13.1 years. This is not a situation where people move in and out of government income support as their family or work situation changes. Instead, the tendency is to become more reliant on government income support with increasing age. Consequently, there is no justification for including partly self-funded retirees in the tax revenue system because of possible changes in their circumstances over time.

Removing the need to pay income tax would remove tax transfer churn.

[12] See Appendix 2

5.1.3 Modification of the tax structure to exempt part age pensioners from paying income tax

One of the Terms of Reference of the Review is directed to simplifying the tax system. In this context, linking offsets and appropriate allowances to marginal tax threshold limits would assist. Offsets, allowances, and concessions would automatically be adjusted to movements in these threshold levels. The principles of this model for partly and fully self-funded retirees are:

- partly self-funded retirees would pay no tax,
- tax transfer churn would be removed, and
- offsets would be linked to marginal tax thresholds.

The Senior Australians Tax Offset (SATO) was introduced to remove the need for full age pensioners to pay tax. Its flow-on effect was to reduce the tax paid by partly self-funded retirees.

A.I.R. proposes that SATO be restructured to commence from the taxable income at which the part Age Pension ceases (currently $39,130) and made equal to the tax payable on that income of $6,339 (the current full value of SATO is $2,220). SATO should then be phased out linearly to cease at the upper end of the 30% marginal tax range ($75,000), a reduction rate of 17.7%, against the current reduction rate of 12.5%. This proposal links SATO to the marginal tax/threshold limits applying to personal income tax revenue.

Removing the need for retirees with part Age Pensions to pay tax by restructuring SATO is estimated to cost the government $600 million, or 0.6% of total personal tax collected at 2007/2008 tax levels[13]. Phasing out SATO to zero at the upper threshold of the 30 cents in the dollar marginal tax rate is estimated to cost the government approximately the same amount. It is important to point out that these costs, as a percentage of total personal tax collected, will steadily reduce over time as the SG becomes mature.

5.1.4 Tax treatment of income from private assets held outside taxed superannuation funds

Discrimination between the tax treatments of income from taxed superannuation funds and from private assets can only be removed by removing income tax from income from all retirement assets, at least for the very high proportion of low to middle income retirees. Compared with the cost to government of removing income tax from taxed fund superannuation pensions, which commenced on 1 July 2007, the cost of removing income tax on income from private assets for low to middle income retirees is small and will steadily reduce in the future as the retirement income system matures[14].

As noted in Para 1.1.5, individuals have different priorities at different stages in their adult life. There is now evidence that younger people will choose to build the majority of their assets outside superannuation including through property acquisition. They are concerned over employment risk and do not wish to lock their assets away. As people approach retirement there is a greater emphasis on contributions to superannuation from after-tax earnings to gain the benefits of superannuation.

[13] See Appendix 2
[14] See Appendix 2

Present superannuation regulations exclude investment in residential property, although this exclusion is breaking down through the development of devices such as instalment warrants, which can circumvent this requirement. The original intent of the Superannuation Act has been breaking down. Investment rules are no longer transparent and are now extremely complex. A.I.R. sees this as a breakdown in government policy consistency, which increases complexity and impacts negatively on the superannuation system.

Many younger working age people invest in rental property. It is an attractive class of investment perceived to be a long term investment with flexibility to manage total investment assets during their working life. Because of capital gains tax requirements, they find it difficult to sell property assets after holding them for some years, especially to transfer assets into superannuation. Therefore, it is likely that many future retirees will maintain assets within and outside superannuation.

Many retirees feel a need to hold tangible assets perceived to be secure in the long term. Consequently, they hold a proportion of their assets in property. Managed Funds have developed to meet this need for superannuants. Capital Gains Tax, GST, and increased tax thresholds work to reduce the attractiveness of property. These disincentives effect the property investment market and place pressure on rental costs.

Assets are used to produce income to support the retiree over the retirement life span. At some stage, and usually on a number of occasions, some assets outside taxed fund superannuation need to be sold and converted into income for pensions, for lump sum capital purchases, for major maintenance, for accommodation changes, or for health and other emergencies. These assets were accumulated with after-tax income at full marginal tax rates.

To maintain the integrity of personal assets outside taxed fund superannuation during retirement, it is highly likely that some of these assets, whether they are in equities or property, will need to be sold and the proceeds invested in other assets. In many cases these assets will have been held for lengthy periods and will have accrued significant capital gains.

The payment of capital gains tax for retirees on the sale of assets required to meet income needs, to maintain the quality of assets, or for extraordinary one-off purposes, is a major disincentive to good management of assets and of income. The effect of Capital Gains Tax on retirement income gets worse the longer the asset is held. Retirees typically hold their investments for long periods. Income Tax is levied annually, but CGT is levied on retrospective gains over the number of years assets are held. The total gain is then lumped in with income in the year of the sale and taxed as though the whole of the gain occurred in that one year. This has the effect of pushing low income earners into higher tax brackets, and for self-funded retirees who do not have superannuation, denying them part of a sale to re-invest in other income-producing assets.

Capital gains tax does not apply to assets sold and bought to maintain the integrity of assets, or to pay pensions, in taxed superannuation funds (subject to tax-free regulations).

Superannuation policy recognises that asset sales may be lumpy causing disadvantage in a particular income tax year. For this reason contributors to superannuation are able to spread their contributions over a three-year period. This facility is not available in the determination of taxable income.

There is no distinction in the calculation of personal taxable income for retirees as to the purpose for which the capital gain is to be used. Capital gains tax is applied to all capital transactions for whatever purpose. Capital gains tax distorts good economic management as it causes retiree asset holders to continue to hold poorer yielding assets instead of moving to better yielding ones.

Individuals will take into account superannuation incentives and taxation issues such as capital gains tax while accumulating assets for their retirement. However, there is no evidence that removing taxation from pensions and earnings in taxed superannuation funds in the drawdown phase provides any incentive to sustain retirement assets throughout the retirement life span.

Taxing income from private assets outside superannuation, including capital gains tax either reduces net income or causes retirees to run down their assets at a faster rate to maintain their income and living standards. For the majority of retirees, the effect is to force them to require greater levels of government support as they age. This is not in the interests of government.

The argument that retirees may not use private assets outside taxed fund superannuation to support their retirement or to purchase non-earning assets not regarded by government as suitable for legitimate retirement pursuits became less valid, if it ever was valid, after 1 July 2007 when retirees can drawdown unlimited lump sums or pensions from their taxed fund superannuation.

This submission has argued that the great majority of retirees do not hold assets at a level that would be regarded as unreasonable. However, the current tax system acts negatively and seriously on retirees' ability to manage their assets over their retirement life span.

A.I.R. acknowledges the concern of government that the purpose of superannuation is not to enable assets to be built for estate planning purposes using government incentives. It believes that the number of retirees who have a concerning level of assets, over and above their risk management needs, to make this a concern is small. The number of persons with taxable incomes greater than $150,000 in the financial year 2005/2006 was 24,000, or 4 % of people 65 and over with taxable incomes[15]. This group paid 42% of income tax paid by individuals 65 and over. Linking exemption from payment of capital gains tax to the upper income threshold for the 40% marginal tax rate would be a simple method of limiting misuse of an exemption from capital gains tax that should be made available to the great bulk of retirees. This group represented 13% of the number of individuals 65 and over reporting a taxable income and generated 62% of net tax paid

It is proposed that discrimination between the tax treatments of retirees should be removed by removing tax on income from private assets held outside superannuation for retirees with taxable incomes less than the upper threshold of the 30 cents in the dollar marginal tax rate and removal of the requirement to pay capital gains tax for retirees with taxable incomes less than the upper income threshold of the 40 cents in the dollar marginal tax rate.

[15] See Appendix 1

5.1.5 Complexity in taxed superannuation fund regulations

It is accepted that assets accumulated in superannuation will become a major part of retirees' assets in the future. It is also accepted that these assets will not cover the full needs of retirees. It is in the interests of government to have retirees sustain their private assets to the maximum extent possible and to rely on government support as little as possible. Sustaining assets at real levels across the retirement life span allows:

- retirees to maintain their living standards and their dignity,
- retirees to have the greatest flexibility to manage their own financial priorities in terms of their maintenance, leisure and health needs,
- minimises the cost of government income support

APRA 10 year performance figures[16] for taxed superannuation funds show that over the period 1996 to 2006, retail superannuation funds[17] achieved a return on investment to contributors of 5.3%. During that period, the CPI increased at an average annual rate of 2.6%. Therefore, the real increase in superannuation assets based on the CPI averaged 2.7%. Thus, the income available to contributors, if they are to retain the real value of their assets as measured by the CPI, is 2.7%.

A contributor would require a superannuation asset of $211,000 to support an income of $120 per fortnight, which is the 'free' income allowed for each partner of a couple on the full Age Pension. The Pension Review Background Paper shows that only a very small percentage of pensioners report assets at or above this level[18].

Note that the CPI is not regarded as a good indexation measure of the needs of retirees. Over the period 1996 to 2006, the MTAWE has been used as a more appropriate measure for measuring costs for age pensioners, as it has increased at a greater rate than the CPI over the period. Hence, the CPI can understate the increase required to sustain retirement assets in terms of the real needs of retirees.

Taxed superannuation fund regulations require that at least 5% (this figure increases with age) of fund assets must be withdrawn each year. Hence, under present regulations, it is not possible to retain the value of superannuation assets over the average term of retirement (a reduction of at least 2.3% per year). The average return for all superannuation funds was 6.7% over the ten-year period. Even if this higher figure is used, there is still a decline in real assets of at least 0.8% per year. Furthermore, - noting for example, the current share market volatility - there is no guarantee that returns will remain at this level. A recent ASIC report shows that returns for the ten-year period prior to 30 June 2008 were significantly lower than those for the period 1996 to 2006[19].

[16] APRA Celebrating 10 Years of Superannuation Data Collection 1996-2006. Table 8
[17] The return for retail funds has been chosen because a high proportion of contributors come from small businesses or private companies. These contributors are likely to require government support through the Age Pension.
[18] Pension Review Background Paper August 2008 Dr Jeff Harmer. Executive Summary
[19] Ten-year performance of superannuation funds to 30 June 2008. www.fido.gov.au 1 September 2008

Using a superannuation fund asset of $200,000 as an example (approximating that required to meet the ‘free’ Age Pension income allowance), using an average CPI of 2.6% (the average between 1996 and 2006), and using the current age-related minimum withdrawal superannuation percentages, the value of the asset at age 90 in 2006 dollars will be approximately $86,000. If two withdrawals of 20% of the assets are made for capital purchases (car), or home maintenance, or emergencies at age 71 and at age 80, the value of the asset at age 90 in 2006 dollars will be approximately $62,000. These amounts at age 90 provide little comfort to a retiree that needs can be met.

Noting that the Pension Review Background Paper shows that the greatest percentage of Age Pension recipients has assets well below $200,000, it is clear that the minimum withdrawal percentages specified in the taxed superannuation fund regulations are too high.

Regulations forcing withdrawal of a fixed percentage of taxed superannuation fund assets presuppose that a retiree can invest the proportion of assets, forced to be withdrawn, outside superannuation, such investment then being subject to the normal taxation regime. Using the above example of a retiree with taxed fund superannuation assets of $200,000, with the amount withdrawn for income purposes of $104 per week (2.7%), and with a required minimum drawdown of 5%, the amount available for investment would be $88 per week ($4,576 per year). This amount is too small to justify a retiree making the effort to invest it other than in a bank. Thus, the returns would be less than those achieved in superannuation and the policy benefit to the government is negative. Indeed, the policy has the effect of encouraging a retiree to spend the total amount withdrawn, including the amount that should be used to preserve the retiree’s assets. A very high proportion of retirees on superannuation, now and in the future, will not wish to manage investments outside superannuation, other than a relatively small amount in a bank account.

If the minimum withdrawal figure is set at the difference between the average ten-year superannuation fund return and the CPI over the same period, a person with a superannuation asset of $200,000 would have assets in 2006 dollars remaining of $185,000 at age 90. If two withdrawals of 20% of assets are made at age 71 and age 80 respectively, the remaining assets in 2006 dollars at age 90 would be approximately $128,000. A.I.R. submits that this is a more reasonable approach to preserving assets over the retirement life span.

A.I.R. submits that the present regulations requiring a minimum amount to be withdrawn should be removed entirely. Alternatively, if the Government wishes to retain such a regulation, the percentage should be set at the real return on assets of retail superannuation funds based on the index used for indexing the Age Pension.

The superannuation system is in a transition phase and many contributors have not had the opportunity to build superannuation assets over a reasonable period. Instead, they have had to build their retirement assets outside superannuation. During this transition phase access to superannuation should be available to all retirees at any age, including beyond 75. In the future, the number of retirees wishing to contribute to superannuation beyond 75 will become insignificant.

The work test that is currently required for all retirees between the ages of 64 and 75 to allow them to contribute to superannuation is an arbitrary and iniquitous hurdle that does little to encourage people in this age group to continue to work. It simply adds to the complexity of the tax system and encourages attempts to obviate the law.

It is a disincentive for retirees between these ages to work. It disadvantages some retirees over others. An example is the case of widowed women who have not worked since marriage, but managed their households. Many do not have access to private business contacts to provide them with work. They are seriously disadvantaged. The work test also distorts the value that retirees give to the wider community, e.g. retirees in this age-group add more value than they receive without the need for a work test (see *The Future of Retirement, HSBC Report, June 2007*).

If tax is removed from income from private assets outside taxed fund superannuation for the majority of retirees, as proposed in this submission, the age-related provisions will become redundant for these retirees. It is most unlikely that the age-related provisions would be used, or could not be circumvented, by retirees with taxable incomes above the 40 cents in the dollar marginal tax rate upper threshold.

5.1.6 Discrimination between the tax treatment of taxed and untaxed superannuation funds

The pension stream derived from an untaxed superannuation fund, (the cohort (b) above) is not tax-free. Instead, the pension income is added to the income from ‘outside’ sources, and the tax payable is calculated. Then, a concessionary tax offset of 10% of the pension is subsequently applied to the tax payable, whose derivation usually involves the application of a higher marginal tax rate, on the combined taxable income.

The anomaly associated with the differing treatments of ‘outside’ incomes was addressed in the bipartisan *Report of the Senate Economics Committee (dated February 2007)* which recommended that, for equity reasons, the two types of income should be treated separately, viz

“3.58 The Committee is of the view that the Government should reconsider the way in which total taxable income is classified for those in untaxed schemes. Instead of combining both a superannuation income stream and additional income to produce a total assessable income, the two types of income should be assessed separately. This would enable additional income received by all superannuation income stream recipients to be assessed for tax purposes from a starting point of zero.

Recommendation 4: The Government should consider separately assessing, for taxation purposes, superannuation income streams and assessable income.”

Equity between taxed and untaxed superannuation funds would be achieved if superannuation income streams from both taxed and untaxed funds are assessed separately from other assessable income as recommended by the Senate Economics Report February 2007. However, this complexity would be removed if the need to pay income tax on all earnings was removed.

5.1.7 Tax treatment of retirees with moderate incomes above the upper threshold of the part Age Pension

The Commonwealth Seniors Health Card (CSHC) primarily provides access to concessional prescription medicines under the Pharmaceutical Benefits Scheme.

Even though the CSHC is linked with other Australian Government Transfers which attract adjustment for inflation[20], it has not been adjusted since 2001. There are approximately 285,000 recipients of the CSHC compared with 2.1 million Age Pension recipients, and the cost is approximately 1% of the cost of the Age Pension[21].

The CSHC was introduced from July 1994. Income test limits were increased in January 1999 and again in September 2001. They have not been increased since. Non-indexation is simply a means of reducing the number of eligible retirees over time and is a clear case of discrimination against self-funded retirees. Because of the impact of illnesses to which the elderly are vulnerable, if the CSHC is not available, the consequent drawdown of assets leads to a reduction of the asset base of the retiree.

The Bills Digest[22], which addressed changes to adjusted taxable income for the CSHC that were announced in the 2008 budget states that: “With the income test limits being set at $50,000 single and $80,000 partnered, the CSHC is now no longer a low-income health card”. A.I.R. rejects this statement.

The CSHC threshold limit has declined in real terms since 2001. If indexed since that time, the partnered income test limit would be over $110,000. It would more closely relate to recent government means tested cut-off points, which recognise average Australian incomes. For example, recent changes to the private medical insurance subsidy raised the limit at which extra income tax is payable to $150,000 per household. Similarly, the subsidy on installing solar electric panels has an income cut-off of $100,000. Income tax threshold levels have been increased to recognise average incomes of $150,000.

If the CSHC had been indexed for singles since 2001 it would have led to a threshold limit of approximately $70,000, which is close to the upper income threshold for the 30 cents in the dollar marginal tax rate ($75,000 in 2007/2008).

AIR believes that the fairest way to meet the future needs of low to medium income retirees (over 80% of all retirees) would be to change the upper income threshold for the CSHC for singles to the upper income threshold of the 30 cents in the dollar marginal tax rate and to maintain the present ratio between singles and couples (the threshold for a couple is 1.6 times that for a single). Further, if the model proposed in Section 5.1.3 is adopted for phasing of SATO, the CSHC could be returned to its original purpose—as a concession providing pharmaceutical benefits and certain other health concessions.

5.1.8 Tax treatment of retirees work income

The Government has recognised the advantages to the economy and the community of encouraging people over the age of 65 to work. Work creates activity and interest, which is important for the health of retirees. From a national perspective, it is particularly important at a time of chronic skills shortage. Some government incentives have been made available to encourage people to work, including the mature age workers Bonus.

[20] Architecture of Australia’s tax and transfer system Aug 2008 Australian Government Treasury. Table 2.8 Australian Government Transfers in 2006-07.

[21] See Appendix 1

[22] Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2008, Bills Digest

However, desirable it may be, the data indicates that a very small proportion of people over the age of 65 work. A.I.R. believes that this figure might be understated because many people may not wish to declare their interest in work. There has been little research to discover a) whether the percentage is higher because of hidden or undeclared work, and b) the categories of people over the age of 65 who work or the type of work they undertake. A.I.R. believes that there are a number of reasons that people work after retirement including: maintaining interest in their business, wishing to continue to use their personal skills through working as an employee or developing consultancies, wishing to use paid work as an activity in retirement, and assisting to maintain income.

A.I.R. supports the government in moves to encourage people to work during retirement, but does not support any policy that applies pressure on retirees to work, such as raising the retirement age.

5.1.9 Summary of the response to Question 5.1

- Part age pensioners should be exempt from paying income tax. This could be achieved by restructuring SATO to commence from the taxable income at which the part Age Pension ceases and made equal to the marginal tax payable on that income. SATO should then be phased out linearly to cease at the upper income threshold of the 30 cents in the dollar marginal tax rate. As a result:
    - the retirement income tax system would be significantly simplified, both for government and retirees,
    - tax churn would be removed from partly self-funded retirees,
    - the incentive for retirees in this group to work beyond the age of 65 would be significantly increased;
- The CSHC upper income threshold for singles should be changed to the upper income threshold of the 30 cents in the dollar marginal tax rate; the present ratio between singles and couples should be maintained. Further, if the restructuring model proposed above for SATO is adopted, the CSHC could be returned to its original purpose—providing pharmaceutical benefits and certain other health concessions;
- Retirees should be exempt from capital gains tax on the drawdown of private capital assets held outside superannuation for retirement income purposes up to the upper income threshold of the 40 cents in the dollar marginal tax rate;
- Existing regulations requiring a minimum amount to be withdrawn from superannuation should be removed entirely. Alternatively, if the Government wishes to retain such a regulation, the percentage should be set at the real return on assets of retail superannuation funds based on the index used for indexing the Age Pension;
- Age related regulations for persons 65 and over applying to superannuation should be removed;
- Superannuation income streams from both taxed and untaxed funds should be assessed separately from other assessable income as recommended by the Senate Economics Report February 2007.

Response to Question 6.1

> *The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?*

AIR supports the present role of the Age Pension to meet the needs of those requiring a safety net and those requiring a supplement to the income from their private assets. The number of retirees in the latter category is expected to grow substantially in the future. Models developed by Treasury show the anticipated costs of the system to be manageable and sustainable. The key issue is to remove the need for retirees in these categories to pay income tax. It is shown that the cost to government of removing income tax is small[23].

The Pension Review is addressing the level of the Age Pension and this is not discussed in this submission.

Summary of the response to Question 6.1

- Retirees with a part Age Pension should pay no income tax,
- Introduction of 'Simpler Super' removing the requirement to pay income tax on pensions and earnings in taxed superannuation funds during the drawdown phase means that the loss of revenue to government from exempting part age pensioners from payment of income tax would be small.

Response to Question 6.2

> *In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?*

A.I.R. believes that the retirement income system has only a small bearing on workforce decisions. There has been some decisions in the past that have led people to work in 'secure' environments such as the government service with its guaranteed pension in retirement. Provision of SG has helped to change this approach in recent years.

Summary of the response to Question 6.2

- The retirement income system has only a small bearing on workforce decisions.

Response to Question 6.3

> *What impact could financial intermediation have on the effectiveness of retirement income policy?*

6.3.1 Financial Intermediation

Financial intermediation can result in the competitive development of new products. Provided they have the objective of improving the return on private assets at an acceptable level of risk, they are valuable.

[23] See Appendix 2

Investment and longevity risks should not be transferred to individual retirees provided they invest in APRA approved products, but should only be capable of transfer to government. Recent episodes where retirees have lost retirement assets through investing in high risk investment schemes, and who believed these investments were ‘approved’, demonstrates the need for government to approve products and to act as insurer of default by providers of these products.

Some retirees are capable of understanding risk and return, are capable of making effective decisions, and are prepared to face the consequences of failure. The proportion of retirees in this category is small and probably about equal to the 5% of retirees with taxable incomes greater than $150,000. There are many instances where retirees, particularly with lower taxable incomes, have invested in high risk investments and lost their assets.

The net result of loss of retirement assets is that the government meets the cost through increased pensions. However, individual retirees suffer through reduced standard of living and loss of independence of choice. Government regulation should ensure that risk is managed conservatively in the development of financial products.

Education of retirees, in itself, is not the answer to managing investment and longevity risk. Education should be focused on improving understanding of the management of private assets across a retiree’s retirement life span, and should be included at the secondary school level.

6.3.2 A Superannuation Authority within the terms of reference of APRA

Consideration should be given to establishing a superannuation authority within the terms of reference of APRA with the following terms of reference:

- to receive and consolidate small superannuation holdings and to manage these without charging an administrative fee so that the assets do not decline in value for the individual;
- to act as the insurer against longevity risk as a means of improving returns on annuity type products for those retirees who do not wish to manage their retirement income;
- to act as the insurer against loss of individuals superannuation assets through investing in APRA approved investment products. This term of reference would provide an incentive for APRA to ensure that products are sound and ensure that retirees understand investments that are APRA approved.

Summary of the response to Question 6.3

- Investment and longevity risks should not be transferred to individual retirees provided they invest in APRA approved products,
- A statutory authority, or similar, tied to APRA should be established to act as insurer for APRA approved financial products. Its terms of reference should include:
    - to receive and consolidate small superannuation holdings and to manage these without charging an administrative fee so that the assets do not decline in value for the individual:
    - to act as the insurer against longevity risk as a means of improving returns on annuitv type products for those retirees who do not wish to manage their retirement income:

- to act as the insurer against loss of individuals superannuation assets through investing in APRA approved investment products. This term of reference would provide an incentive for APRA to ensure that products are sound and ensure that retirees understand investments that are APRA approved.

- Education should be focused on improving understanding of the management of private assets across a retiree's retirement life span. It should be included in secondary school curriculum.

Response to Question 6.4

The cost of providing health and aged care to older Australians is currently met by government through the health sectors. Should retirement income policy take into account projected increases in health costs for older Australians? If so, what would be the most effective mechanism and how might the transition to such a system be achieved?

6.4.1 The Commonwealth Seniors Health Card as a health cost measure

Government support systems recognise that some support should be given to self-funded retirees with incomes greater than the upper threshold for the part Age Pension. The Commonwealth Seniors Health Card is provided to retirees with a taxable income between the upper threshold of the part Age Pension and $50,000 for single retirees[24] ($80,000 for retiree couples).

The Commonwealth Seniors Health Card (CSHC) primarily provides access to concessional prescription medicines under the Pharmaceutical Benefits Scheme

Even though the CSHC is linked with other Australian Government Transfers which attract adjustment for inflation[i], it has not been adjusted since 2001. There are approximately 285,000 recipients of the CSHC compared with about 2 million Age Pension recipients, and the cost is approximately 1% of the cost of the Age Pension[25].

The CSHC was introduced from July 1994. Income test limits were increased in January 1999 and again in September 2001. They have not been increased since. Non-indexation is simply a means of reducing the number of eligible retirees over time and is a clear case of discrimination against self-funded retirees. Because of the impact of illnesses to which the elderly are vulnerable, if the CSHC is not available, the consequent drawdown of assets leads to a reduction of the asset base of the retiree.

The Bills Digest[26], which addressed changes to adjusted taxable income for the CSHC that were announced in the 2008 budget states that: "With the income test limits being set at $50,000 single and $80,000 partnered, the CSHC is now no longer a low-income health card". A.I.R. rejects this statement.

[24] Approximately 1.25 times OTWE
[25] Architecture of Australia's tax and transfer system Aug 2008 Australian Government Treasury. Table 2.8 Australian Government Transfers in 2006-07
[26] Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2008, Bills Digest

The CSHC threshold limit has declined in real terms since 2001. If indexed since that time, the partnered income test limit would be over $110,000. It would more closely relate to recent government means tested cut-off points, which recognise average Australian incomes. For example, recent changes to the private medical insurance subsidy raised the limit at which extra income tax is payable to $150,000 per household. Similarly, the subsidy on installing solar electric panels has an income cut-off of $100,000. Income tax threshold levels have been increased to recognise average incomes of $150,000.

If the CSHC had been indexed for singles since 2001 it would have led to a threshold limit of approximately $70,000, which is close to the upper income threshold for the 30% marginal tax rate, currently $75,000.

AIR believes that the fairest way to meet the future needs of low to medium income retirees (over 80% of all retirees) would be to remove the need to pay income tax up to the upper income threshold of the 30 cents in the dollar marginal tax rate.

Summary of the response to Question 6.4

- pharmaceutical costs increasing with age should continue to met through the CSHC,
- the CSHC should be recognised as a proper concession and suitable indexation should be incorporated (See Question 5.1).

Appendix 1

Estimates of the distribution of retirement income funds.

Figures quoted have been rounded. A detailed study is not available, but it is believed that the figures give a reasonable and broad picture of the distribution of retirement income. Taxation statistics are based on the 2005/2006 Financial Year (the latest data publicly available). As far as possible, other data is as at June 2007.

1.1 Overall Statistics

Australian Population[27])	21.2 million
Australian Population 65 and over	2.8 million (13.2% of total population)

Distribution of the population 65 and over

Total Age Pension recipients[28]	2.1 million (75% of age 65 and over)
Hence, fully self-funded retirees[29]	0.7 million (25% of age 65 and over)
Full Age Pension recipients[30]	1.22 million (44% of age 65 and over)
Part age pension recipients	0.84 million (30% of age 65 and over)
Hence, total partly and fully self-funded retirees	1.54 million (55% of age 65 and over)

1.2 Estimation of the relative proportion of income from private assets and from government support.

Taxation Statistics for the 2005/2006 Financial Year[31] show that for the approximately 1 million individuals 65 and over who provided tax returns before the 31 October 2006:

Total taxable and non-taxable income	$36 billion
Pensions and allowances reported	$3 billion
Taxable and non-taxable income net of pensions	$33 billion

The Pension Review Background Paper[32] states that assistance for the aged in 2006/2007 was $26.1 billion. This figure is consistent with that reported in Table 2.8 of the Architecture Paper. This is a marked difference to the amount of pensions and allowances reported.

It is difficult to reconcile the difference between pensions and allowances reported in the income tax returns and the figure quoted in the Pension Review. An estimate of the relative proportions of private savings and earnings and government income support is affected by:

- the extent of government concessions and allowances that are not reportable;

[27] ABS Population estimates Series 320109
[28] Architecture of Australia's Tax and Transfer System Treasury August 2008 Table 2.8 (including Veterans)
[29] Fully self funded retirees include those with the Commonwealth Seniors Health Card, which is treated as a concession.
[30] Centrelink data Q4 2008 Ref SF1177316
[31] Personal Tax Statistics 2005-2006 as at 1 October 2006, Treasury 00117625_2006PER11
[32] Pension Review Background Paper August 2008 Dept. FHCSIA Section 1.2

- the assumption made in these estimates that individuals reporting non-taxable income (approx. 1 million) were full age pensioners. However, this figure is greater than the estimate of 0.7 million full age pensioners in Section 1.1 above and would account for some of the difference.
- the different years used in the estimate. Net taxable and non-taxable income is likely to be higher in 2006/2007 than it was in the previous year, although this would not explain the difference between the government reported assistance figure and that reported in income tax returns;
- the fact that taxable income is net of deductions. Tax deductions on private assets held outside superannuation would be expected to be significant. Tax deductions on income from superannuation pensions would be expected to be small, probably limited to high health costs that are deductible.

We can reasonably estimate from the taxation statistics that the order of magnitude of private income is of the order of $33 billion. If we take assistance for the aged as reported in the Pension Review ($26.1 billion) as the order of magnitude of government support we can reasonably estimate that retirement income from retirement assets is slightly higher than government assistance for the aged, but of the same order of magnitude.

1.3 Estimation of the proportions of income earned from superannuation and from private assets.

As reported above, total taxable income in 2005/2006 net of government pensions and allowances was $33 billion.

APRA[33] reports that distributions from all non-exempt superannuation funds (including SMSFs) in 2005/2006 for payment of pensions was $15.5 billion and for lump sum payments was $22 1 billion. A very simplistic assumption is that all lump sums were paid for resignation, death, retrenchment, and disablement and were not declared in taxable income. With this assumption, taxable income from taxed fund superannuation (untaxed superannuation funds are not included but represent about 10% of total superannuation funds[34]) was $15.5 billion. Total taxable income net of pensions and allowances was $33 billion. Hence, income from taxed fund superannuation funds was of the order of one half of total taxable income, the remainder of taxable income coming from private assets outside superannuation.

Because taxed fund superannuation pension income is no longer included in taxable income from 1 July 2007 taxable income in the 2007/2008 financial year (not available) would be expected to be reduced by up to one half of that collected from individuals 65 and over in 2005/2006.

1.4 Proportions of retirees paying tax at different taxable incomes

The proportions of retirees paying tax at different taxable incomes are shown in Table 1.1[35].

[33] APRA Celebrating 10 years of Superannuation Data Collection 1996-2006
[34] Architecture of Australia's Tax and Transfer System Treasury August 2008 'Taxation of Superannuation' p.26.
[35] Personal Tax Statistics 2005-2006 as at 1 October 2006, Treasury 00117625_2006PER11

The tax contribution in 2005/2006 from part age pensioners (57% of total persons 65 and over paying tax) was $0.86 billion (12%) of the tax contribution from retirees 65 and over. Because taxed fund superannuation pension income is no longer included in taxable income from 1 July 2007 taxable income in the 2007/2008 financial year (not available) would be expected to be reduced by up to one half of that collected from individuals 65 and over in 2005/2006. While the percentage may remain roughly the same, the amount collected is estimated to reduce to less than $0.5 billion.

The contribution from the 23,900 persons with taxable incomes over $150,000 (4% of total persons 65 and over paying tax) is 42% of the total contribution from persons 65 and over.

Table 1.1 Proportions of retirees paying tax at different taxable incomes

Taxable Income	Comments	Persons	Persons % of Total	Tax Paid $billion	Tax Paid % Total
0 - $40,000	Part age pensioners	314,000	57%	0.86	12%
$40,000 - $80,000	Top of 30c marginal tax range	165,000	30%	1.82	26%
$80,000 - $150,000	40c marginal tax range	49,400	9%	1.44	20%
Over $150,000		23,900	4%	2.99	42%
Total	Total persons paying tax	552,000	100%	7.11	100%

Appendix 2

Tax treatment

Estimates in this Appendix are based on the 2005/2006 tax statistics unless otherwise stated.

2.1 Tax collected from individuals 65 and over in 2005/2006

Tax collected from individuals 65 and over	$7.1 billion
Total personal tax collected	$108.7 billion
Percentage of total tax collected from individuals 65 and over	6.5%

Effect of Post 1 July changes to tax on taxed superannuation funds

Assume that income from taxed superannuation funds is 0.3 times that of total taxable income and will be the same proportion in 2007/2008 (See Appendix 1 (b)). Then Income from taxed superannuation funds will be $33 billion. Hence, Tax collected from individuals 65 and over in 2007/2008 (0.7 times tax collected in 2005/2006) is likely to be $5 billion, or less than 5% of total tax collected from individuals 65 and over in 2007/2008.

Simpler super will reduce the percentage of tax collected from individuals 65 and over from the order of 6.5% to the order of 5% in 2007/2008. It will steadily reduce this percentage as the SG matures.

2.2 Tax churn for individuals 65 and over with taxable incomes less than $40,000 (approximately the cut-off for the Age Pension)

Tax collected	$0.86 billion
Percentage of total tax collected	0.8%
Reportable Pensions and Allowances paid	$0.9 billion
Tax churn (Pensions paid to tax collected)	1.04

The tax collected from part age pensioners was closely equal to the reportable pensions and allowances paid.

2.3 Effect of removing tax from individuals 65 and over with part Age Pensions and of phasing in SATO to zero at the upper threshold of the 30 cents in the dollar marginal tax rate.

	Tax Collection with no change to present policies $billion		**Effect of Proposed tax changes $billion**
Taxable Income Range	**Actual 2005/2006**	**Estimated 2007/2008**	**Estimated**
0 - $40,000	0.86 (12%)	0.60 (12%)	0
$40,000 - $80,000	1.82 (26%)	1.27 (26%)	0.6*
>$80,000 (>150,000)	4.43 (62%) (2.99 (42%))	3.10 (62%)	3.1

Total 65 and over	7.11 (100%)	4.98 (100%)	3.7 (74% of total 2007/2008 tax)

* It is assumed that tax collected will be approximately halved by the phasing out of SATO to zero at the upper threshold of the 30 cents in the dollar marginal tax rate.

The effect of removing tax from retirees with part Age Pensions is to reduce the estimated tax collected in 2007/2008 by approximately $600 million, or approximately 0.6% of total personal tax collected.

The effect of phasing out a revised SATO to zero at the upper threshold of the 30 cents in the dollar marginal tax rate is to reduce tax collected by approximately $600 million, or approximately 0.6% of total personal tax collected.