Association of Independent Retirees (A.I.R.) Ltd

RESTRUCTURE OF RETIREMENT INCOME SYSTEM

20 July 2012

Responses are sought from Members, Branches, and Divisions by Friday 28 September to a Proposal supporting A.I.R.s Policy to seek a Review of the Retirement Income System. An Executive Summary of the Proposal is set out below and the full Proposal can be obtained from the Members' Section of the A.I.R. Website. Responses should be forwarded to Dr Barry Ritchie – britchi1@bigpond.net.au – from whom responses to any specific questions can be obtained while considering the proposal.

The Board considered a submission from its Retirement Incomes Research Group on 29 June and agreed in principle:

- *With the four principles in the paper, namely:*
    - *the present super retirement phase is restrictive and need to be simplified;*
    - *access to tax-free income from earnings on retirement funds for everyday living expenses should be available to all retirees with or without super;*
    - *there should be equal access to concessions for retirees with or without super; and*
    - *age and work barriers to superannuation in the retirement phase should be removed.*
- *That the controlling principle behind the submission is to obtain agreement of the Government to review the drawdown phase of the retirement income system.*
- *That the paper should be revised in light of discussions at this meeting and that it should be circulated to members via Divisions and the A.I.R. website (submission available at www.independentretirees.com.au Members' Area) as a Board-considered paper for comment within a realistic timeframe.*
- *That the feedback should be reviewed and the paper amended as necessary before coming back to the Board for final endorsement prior to presentation to Minister Shorten, the COTA roundtable, and other appropriate organisations.*
- *That media releases should be issued at the appropriate time to promote A.I.R.'s position.*

EXECUTIVE SUMMARY OF SUBMISSION

June 2012

Two fundamental A.I.R. policies govern the submission, a) there should be equitable access to the same conditions for people with and without superannuation, and b) the complexity of the superannuation system in retirement adds to administrative costs and confusion and should be simplified. A.I.R. needs to have a consistent view on the way retirees are able to manage funds in retirement and develop a narrative to progress these policies with Government. In the last Pre-Budget Submission, A.I.R. tried to garner interest in a review of Government income policies and highlighted the difference between superannuation's accumulation phase and the use of funds in retirement.

The proposal in the submission involves moving the superannuation system in retirement into the personal tax system, and encouraging superannuation funds and other financial providers to develop a range of investment products available to retirees during retirement. As a consequence, simplification of superannuation costs, structure, and complexity is achieved. Following retirement people gain control of their retirement assets and income regardless of how they were obtained or where accumulated and they can decide how to manage them.

Provision of a tax-free threshold accessible to all retirees, regardless of whether they have superannuation or not and set at a value where most retirees with superannuation are not penalised, is a key part of the proposal. The submission contains an example of a tax-free threshold that would apply to 95% or more of all people with superannuation and compares the effect on Government revenues of a range of tax-free thresholds. It is acknowledged that people with very high wealth would be subject to additional tax; however this is consistent with current public debate that the superannuation system should not be used as a means of tax minimisation. It is emphasised that the example in the submission ($80,000 for singles and $60,000 for each partner in a couple) is provided for illustrative purposes only at this stage. Retirees with incomes above the tax-free threshold would pay tax on the excess at full marginal tax rates.

Regulation of superannuation assets, pensions, and taxation in retirement is inequitable, hamstrung with regulations, very expensive for retirees, and inefficient. Because those without superannuation took the initiative to provide for their retirement, they are denied access to concessions available to those forced to do so.

This is particularly disappointing because Australia has one of the best superannuation systems in the world for the accumulation of retirement savings combining a carrot in the form of tax reductions for contributions and a stick in that the savings are compulsory for employees and inaccessible until retirement. However, one criticism that can be leveled is that it has proved to be costly as the management of the accumulating funds has been put in the hands of independently run superannuation funds, which must cover costs, will inevitably attract rent seekers, and involves some investment risks.

Unfortunately when this system was devised much less thought went into how retirees would be able efficiently to use these accumulated savings when they become available on retirement. Each individual retiree has different and unique needs to manage as they age. They need simple and flexible financial systems and employment opportunities. They do not need welfare type regulation and control.

The result is a highly complex regulatory system for people to manage their superannuation in the retirement phase. Superannuation trusts effectively have control of retirees' superannuation assets and are able to charge fees for the privilege of managing them. Retirees do have the option to take funds as a lump sum, tax exempt in the year in which they are withdrawn; however, the deterrent is that all earnings in future years are taxed at full marginal tax rates.

As the retiree proportion of the population and the rate of compulsory contributions increase, the contingent liability to the Government in increased age pension costs and taxation foregone will increase exponentially and the system will become increasingly unworkable. Consequently, the level of complexity is continuing to increase as the Government tries to limit its future liability; recent reduction of contribution caps and reduction of concessions for those with taxable incomes above $300,000pa are examples.

The proposal, moving retirement incomes to the personal tax system and providing a tax-free threshold consistent with Government policy of exempting the use of already taxed retirement assets for retirement purposes from tax, removes the need for most regulation and dramatically reduces complexity and administrative cost. It would:

- Provide equity for all retirees over the tax-free threshold regardless of the way in which their retirement funds were accumulated.
- Dramatically simplify an individual retiree's retirement income management, provide a range of competitive and attractive retirement investment products, and increase income available by substantially reducing fees and charges.
- Remove the need for a superannuation structure of public superannuation funds and SMSFs in the retirement phase with its costly and complex regulatory and administrative systems.
- Provide equal taxation benefit for all retirees with incomes greater than the tax-free threshold regardless of their income and assets and whether they have accumulated some funds in superannuation or not.

- Act as an incentive for retirees under the tax-free threshold to undertake paid work as income would be tax free up to the tax free threshold.
- Provide a more balanced investment savings model for the Australian economy, maintaining and increasing investment in innovation and small business, by reducing the incentive to place all savings in superannuation with its overemphasis on investment in public corporations and high-value property.
- Bring a deceased person's estate taxation into line with the personal tax system;
- Create incentive for financial institutions including public superannuation funds to develop competitive and innovative retirement income products.
- It is anticipated that the simplification and equity provided by the model will be appealing to the next generation of retirees.

In terms of the benefits gained, the submission demonstrates that the cost to Government is realistic and declining over time (in contrast to the existing system) at a reasonable value of the tax-free threshold consistent with the tax exemption available to the majority of people who accumulated their assets in superannuation under the existing structure;

Issues arising as a consequence of the proposal

The Board was advised that the immediate objective is to get a Government review in place aimed at simplifying the drawdown phase, reducing overall complexity of superannuation, and achieving equity between those with superannuation and those without. Detailed issues set out below and transitional arrangements would be worked through in the review context including broad consultation. Some of the issues and consequences of the proposal are set out below.

Effect on SMSFs. SMSFs will remain very important in the accumulation of retirement assets. They will no longer be needed in the retirement phase resulting in savings including: less complex Trust Deeds, no administrative or audit costs, no Annual Return, and no need to keep annual financial records or minutes of investments, contributions, etc.

Account-based Pensions. In many cases the amount of an account-based pension includes the interest on the assets in the pension component plus an amount of the capital being drawdown to meet income requirements. Calculation of taxable income in the proposal does not include any drawdown of capital; that has already been transferred to the retiree tax free. Prudentially controlled financial institutions, including public superannuation trusts will offer pensions similar to account-based pensions, but without minimum drawdown restrictions, and which are likely to allow flexibility in contributions and withdrawals of principal and interest, and other attractive conditions.

Commonwealth Seniors' Health Card. Retirees with incomes less than the tax-free threshold will not need to declare their income. Consequently, those who meet the eligibility criteria for the CSHC will not be affected.

Transition to Retirement. The proposal retains the regulation of the Transition to Retirement stage within the accumulation phase of superannuation. Commencement of retirement is defined as the prescribed age for eligibility for the Age Pension.

Will retirees with superannuation be worse off? It is a reality that all change brings some impact and any model proposed has to be achievable politically. Hence the equity model proposed will limit the concessions available to the extremely wealthy. Calculations show that over 95% of retirees will be no worse off. Retirees who may be affected are those with very high incomes (note that the Government has recently reduced concessions for those with taxable incomes greater than $300,000pa and may well continue to reduce the taxable income level in future years). A small group of people with both superannuation and also private investment earnings may exceed the tax-free threshold and may incur higher tax than under the present scheme. Note that the calculation of taxable income does not include any drawdown of capital as it does for account-based pensions.

Transition to the Proposed Model. The submission includes a transition phase of five years for retirees to adjust any consequences of the proposal.

Splitting of Assets. There is nothing in the model to prevent a couple splitting their assets equally to derive maximum benefit by both individuals meeting the tax free threshold. The current regulations governing such activity would disappear.

Capital gains. One advantage of capital assets (most commonly property and sharemarket equities) held in super funds is that when they are sold they are not subject to CGT where they are held in pension mode. However, it should be noted that: a) capital gains held for over twelve months in superannuation attract a discount of 30% compared to the personal tax discount of 50%, b) sales of equities can be managed to ensure that the total falls below the tax-free threshold, c) On the death of a super fund member the ATO is currently proposing that where a single member dies then all the capital gains accumulated in the fund will be taxed in the hands of the beneficiaries, d) with property it should be remembered that within a super fund in the pension mode property does not have the benefit of utilising negative gearing because there is no tax paid whereas in the proposal this traditional approach to property investment will be able to be used, and e) the submission includes a proposal that capital gains be able to be spread over three years for tax purposes.

Effect of cost differences between a single and a retiree couple. The submission acknowledges that the tax-free threshold for singles should be higher than half that of a couple to allow for additional costs accruing to single people.