Association of Independent Retirees (A.I.R.) Limited
Working for Australians in Retirement

Submission in Response to Treasury's Re:Think Tax Discussion Paper

29 May 2015

Re:Think – Tax Discussion Paper

We are pleased with the decision of the Government to produce this discussion paper and to initiate nationwide discussion, community consultation and debate on Taxation Reform and Federalism.

The Association of Independent Retirees (A.I.R.) Limited is the national peak body representing partly and fully self-funded retirees. We are a member-driven, not for profit, non-political national organisation who has branches and members across Australia. We work to advance and protect the interests and independent lifestyle of Australians in retirement.

Our mission is to secure recognition, fairness and equity for Australians who, through their diligence and careful management, fully or in part self-fund their own retirement needs.

Currently there are over 1.6 million Australians who fully or in part self-fund their own retirement needs.

Our Association's response to this Re:Think – Taxation Discussion Paper only covers those areas that we consider specifically relate to those Australians who are retired and in part or fully self-fund their retirement.

In close consultation with our members, we believe we have provided both pragmatic and realistic recommendations in this submission for consideration and adoption.

Our members have a clear understanding of the financial issues and risks they face in retirement, and those other issues that impact on their capacity to maintain an independent retirement and to continue contribution to the economy. However, the ability to continue to do this does depends on a vibrant Australian economy that provides a real interest rate return to investors and embraces a strong, confident business sector with reliable returns together with continuing low inflation. This remains an ongoing issue for our members.

We are mindful of the long term challenge of maintaining and improving standards of living through economic growth for all Australians, the current fiscal position and the need for the Government to maintain a disciplined approach to economic management. In accepting this, our position is that A.I.R. is opposed to any change to superannuation, welfare and pension arrangements that negatively impact on any retiree who in part or fully self-fund their retirement. We will consider proposals which form part of a comprehensive review of retirement incomes however; the outcomes of any review must not disadvantage current retirees and those soon to retire. Future changes must include grandfathering and transition provisions to protect those retirees whose retirement income is based on the current rules.

If further information on the submission is required, please contact A.I.R.'s Policy Director Robert Curley on 02 6290 2599.

Yours sincerely

Max R Barton
National President

29 May 2015

EXECUTIVE SUMMARY

This submission from the Association of Independent Retirees (A.I.R.) Limited contains the following recommendations in regard to Discussion Questions 22, 20, 25 and 51.

RECOMMENDATIONS

Section 4 – Savings: Discussion Question No 22

Recommendation 1
That there is no change to the tax free status of income from assets in an individual's Account Based Pension and that there be no inappropriate forced withdrawal or taxing of annual income from these assets

Recommendation 2
That changes are made to lower the % or extending the age criteria of the % aged related minimum drawdown requirements for account based pensions to ensure with the now increasing longevity of retirees and diminishing returns for markets that funds do not run out prematurely due to the existing age based minimum drawdown requires of Account Based Pensions. Many individuals will have 30+ years in retirement and this must be the main consideration for fairness and equity and any retirement income stream decisions / deliberations should not be based on average life expectancy tables.

Recommendation 3
That for improvements to the use of Account Based Pensions and to eliminate the use of Account Based Pensions for purposes outside the providing of an ongoing income stream pension in retirement that there needs to be a controlling of the access to superannuation tax free earning Account Based Pensions by limiting to a set amount that any individual can transfer into an Account Based Pension / Pensions. The criteria is that Account Based Pensions should only be available to provide retirees with a regular ongoing steady income stream and access to a lump sum for special purposes* in retirement. This change must be simple for fund managers and SMSF trustees to administer at the time setting up and of transferring superannuation funds into an individual's Account based Pension. Any assets in superannuation above this set amount would need to remain in a taxed accumulation scheme or withdrawn and invested outside superannuation.

Recommendation 4
That the preservation age be expanded 65 years (this is beyond the current changes that run to 2023) and that special conditional Transfer To Retirement continue to be available at 60 years of age to allow for those who are looking to transition into retirement and reduce their work hours prior to reaching the preservation age. This would provide the opportunity to use some of their assets in superannuation set up an account based pension to provide a regular income stream to supplement their reduced earnings from their reduced working hours. This remains in place until they meet the requirement of being fully retired.

Section 4 – Savings: Discussion Question No 20
Section 5 – General Business Tax Issues: Discussion Question No 25

Recommendation 5
That the dividend imputation system remains as is and the agreement from 1987 to relieve double taxation is still critical for self-funded retiree investments and cash generation needs in the drawdown income stream pension phase in retirement.

Section 4 – GST and State Taxes: Discussion Question No 51

Recommendation 6
That there be no changes or broadening of the GST without adequate and full compensation to offset any increase in the cost of living for those Australian who are retired and in part or fully self-fund their retirement and have limited fixed incomes.

SECTION 4 – SAVINGS

4.2 Superannuation

Discussion Question No 22:

- **How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity?**
- **How could they be improved?**

On these two questions our association's input and response is only in regard to the retirement drawdown income stream pension phase of superannuation.

We consider that superannuation for fairness, complexity and improvements needs to be considered in three distinct phases that have unique circumstances that impact on any considerations. These are:

1. The Accumulation Phase (long term growth with a moderate to high investment risk portfolio)
2. The reaching of the Preservation Age (decision time that can have long term implications)
3. The Drawdown Income Stream Pension Phase (assets change to a low investment risk portfolio that needs available cash, has dividend generating and has easily liquidated assets for a monthly ongoing income stream)

Please accept that we are only providing recommendations with rationale and comments on improvements and greater fairness related to the drawdown income stream pension phase of superannuation.

We firstly feel that on page 69 of the Discussion Paper the commentary is misleading and fails to acknowledge that not everyone 60 years and over is receiving a tax free benefit. Regardless of their age, tax will continue to be withdrawn on income and capital gains (CG) as long as individuals remain in the accumulation phase of superannuation. Tax on superannuation assets does not stop being applicable at 60 years of age as we feel is implied by the statement in the Discussion Paper.

Also the paper states that balances in the fund at 60 years or over can be withdrawn tax free. Yes, but this is no different from withdrawing part or all of the balance from any bank account. This "60 years and over" criteria will change as the superannuation preservation age is increased by the Government.

It is only when one converts their superannuation into an account based income stream pension that these superannuation assets then have zero tax on income and CGs from these assets; BUT this is then offset by the onerous requirement with account based pensions of a minimum aged-based % withdrawal that offsets the tax free status.

It has been stated in the recent Treasury Discussion Paper on Retirement Income Stream Regulation that the aged based minimum % withdrawal requirement is intended to:

- ensure that account-based pensions are used to provide income in retirement;
- facilitate the provision of a steady level of income flowing from the account over the many years in retirement;
- ensure that funds are withdrawn from the concessionally taxed superannuation account-based pensions each year over time at the % aged based rate.

We consider that the aged based minimum % withdrawal requirement offsets the benefit of zero tax on income and CGs from these assets and also there are rigid regulations to be met to convert a person's superannuation assets into an account based pension and no contribution can be added to the account based pension once it has been established.

Finally, it has been said by many that the purpose of superannuation is to provide an income stream in retirement and that in some instances this has been abused by a small number who have very high superannuation account balances. We believe that due to the special nature of account based pensions, that there should be a maximum cap on the amount of capital an individual or couple may have in account based pensions. This needs to be determined to ensure it is equitable for all and that it balances the question of fairness in receiving a tax free status on income received from the capital invested in account based pensions.

With this specific tax treatment of superannuation account based pensions, and particularly when it comes to relatively high superannuation balances a recent ASFA paper stated that in 2012/13 with account base pensions there were:

- 24,000 individuals who had an account balance of >$2m; and
- 51,000 individuals who had an account balance of between $1m and $2m; and
- 232,000 individuals who had an account balance of < $1m.

ASFA rightly points out that there is a small proportion (around 0.5 per cent) of individuals who have very high account superannuation balances (above $2.5 million), who are receiving tax concessions that could be regarded as being outside the purpose of the retirement income system.

In regard to addressing the question of equity and fairness relating to drawdown income pension phase, A.I.R.'s recommendations are:

<u>Recommendation 1</u>
That there is no change to the tax free status of income from assets in an individual's Account Based Pension and that there be no inappropriate forced withdrawal or taxing of annual income from these assets

<u>Recommendation 2</u>
That changes are made to lower the % or extending the age criteria of the % aged related minimum drawdown requirements for account based pensions to ensure with the now increasing longevity of retirees and diminishing returns for markets that funds do not run out prematurely due to the existing age based minimum drawdown requires of Account Based Pensions. Many individuals will have 30+ years in retirement and this must be the main consideration for fairness and equity and any retirement income stream decisions / deliberations should not be based on average life expectancy tables.

<u>Recommendation 3</u>
That for improvements to the use of Account Based Pensions and to eliminate the use of Account Based Pensions for purposes outside the providing of an ongoing income stream pension in retirement that there needs to be a controlling of the access to superannuation tax free earning Account Based Pensions by limiting to a set amount that any individual can transfer into an Account Based Pension / Pensions. The criteria is that Account Based Pensions should only be available to provide retirees with a regular ongoing steady income stream and access to a lump sum for special purposes* in retirement. This change must be simple for fund managers and SMSF trustees to administer at the time setting up and of transferring superannuation funds into an individual's Account based Pension. Any assets in superannuation above this set amount would need to remain in a taxed accumulation scheme or withdrawn and invested outside superannuation.

**Lump sum special purposes withdrawals are those when needed, above the day to day monthly income stream for very specific items such as:*

- *Necessary home maintenance*
- *Replacement of household equipment like refrigerator, washing machine, etc.*
- *Replacement of the family motor vehicle*
- *Family holidays*
- *Special support for family members*
- *Specific aged care and medical procedure costs*

Another alternative in addressing of the question *of How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity* would be to progressively increase the preservation age and the Transition To Retirement (TTR) rules where retirees aged 60 years and over are not required to pay tax when they receive superannuation benefits—irrespective of whether benefits are disbursed as lump sums or income streams.

In the Australian Law Reform Commission Report into Grey Barriers to Work in Commonwealth Law in 2012 it was stated that prior to the introduction of the rules in 2005, workers under 65 years of age generally had to retire before accessing any superannuation benefits. In 2004, the Australian Government noted that this may have led "people deciding to retire prematurely just so they can access their superannuation". Accordingly, the TTR rules to some extent were designed to address this incentive for early retirement.

In today's environment with the need to expand mature employment, the supporting of an early retirement incentive with early access to withdraw the total assets in the superannuation, needs to be reassessed.

Our recommendation on this is:

<u>Recommendation 4</u>
That the preservation age be expanded 65 years (this is beyond the current changes that run to 2023) and that special conditional Transfer To Retirement continue to be available at 60 years of age to allow for those who are looking to transition into retirement and reduce their work hours prior to reaching the preservation age. This would provide the opportunity to use some of their assets in superannuation set up an account based pension to provide a regular income stream to supplement their reduced earnings from their reduced working hours. This remains in place until they meet the requirement of being fully retired.

SECTION 4 – SAVINGS

4.2 Shares, Private Companies and Trusts

Discussion Question No 20:

- **To what extent does the dividend imputation system impact savings decisions?**

SECTION 5 – GENERAL BUSINESS TAX ISSUES

5.2 The Dividend Imputation System

Discussion Question No 25:

- **Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open?**
- **Could the taxation of dividends be improved?**

The dividend imputation questions are in two separate areas of the Discussion Paper and we are addressing this only from the perspective of those who self-fund their retirement.

We acknowledge the statement that Australia had a 'classical' system of dividend taxation that resulted in the double taxation of company profits when they were distributed to non-corporate shareholders as dividends. Dividend imputation was introduced in 1987 to relieve double taxation.

Dividend imputation is now firmly established in the investment strategies for retirees who self-fund their retirement with their investment and assets being management either by a financial service and investment management provider or by the trustees of a Self-Management Superannuation Fund. Some self-funded retirees also have direct investments in the Australian Share market.

There is a strong emphasis for self-funded retirees, based on the benefit that dividend imputation provides, to have a high percentage of investment in Australian shares and especially in those higher dividend paying companies for the cash flow that is needed in the drawdown income stream pension phase of superannuation where the investment and assets strategy changes to a low investment risk portfolio that needs available cash, has strong dividend income and has easily liquidated assets for the provision of a monthly ongoing income stream.

We note the statement in the Discussion Paper from the final report of the Australia's Future Tax System Review in 2010 that…

> *The benefits of dividend imputation have declined as the Australian economy has become more integrated into the global economy. In particular, benefits in relation to financing neutrality between debt and equity financing have fallen, while the bias for households to over-invest in certain domestic shares has increased.*

We strongly suggest that this is not the case in regard to those in retirement with their superannuation assets in an income stream product such as an account based pension.

It is considered that removing dividend imputation will dramatically impact on the financial returns and the cash flow situation of self-funded retirees with their asset being managed either by a financial service and investment management provider or by the trustees of a Self-Management Superannuation Fund. If dividend imputation were to cease this would, we believe, result in much reduced income and ultimately an accelerated reliance on the Age Pension system. Some also suggest that this will create a drop / crash in the share price of the higher yield Australian stock self-funded retirees are investing in, and could result in a dramatic GFC-like drop of the Australian share market.

We believe the dividend imputation system is important and supports self-funded retiree investment / savings decisions and that the dividend imputation system is continuing to serve Australians in retirement well. As such we are strongly against and oppose any changes to the dividend imputation system.

Our recommendation in regard to both the Savings section question and the General Business Tax Issues section question on Dividend Imputations is:

Recommendation 5
That the dividend imputation system remains as is and the agreement from 1987 to relieve double taxation is still critical for self-funded retiree investments and cash generation needs in the drawdown income stream pension phase in retirement.

SECTION 8 – THE GOODS AND SERVICES TAX AND STATE TAXES

8.2 Pressures on the GST base

Discussion Question No 51:

- **To what extent are the tax settings (that is, the rate, base and administration) for the GST appropriate?**
- **What changes, if any, could be made to these settings to make a better tax system to deliver taxes that are lower, simpler and fairer?**

Whilst the Goods and Services Tax and State Taxes are to provide States and Territories with the necessary funding for providing and expanding services including infrastructure, transport, public housing, hospitals, health service and primary, secondary and tertiary education we are concerned that any changes made to the GST will not deliver a lower, simpler and fairer outcome for retirees.

We see that the normal living costs will increase significantly and this would not be offset in the income received from investments from assets for those who in part or fully self-fund their retirement. Our recommendation on this is:

Recommendation 6
That there be no changes or broadening of the GST without adequate and full compensation to offset any increase in the cost of living for those Australian who are retired and in part or fully self-fund their retirement and have limited fixed incomes.