# Supplementary Submission on Retirement Income to the Tax Review

## August 2015

National Seniors Australia

## Introduction

National Seniors welcomes the opportunity to provide a brief supplementary paper on Australia's retirement income system to accompany its main submission to the 2015 Tax Review.

With around 200,000 individual fee-paying members across the country, National Seniors is the largest independent organisation representing Australians aged 50 and over.

Our main submission considers the tax system as a whole, including what may be considered obvious retirement income elements such as pensions and superannuation. However, it also considers those unlikely tax elements which inadvertently impact later-life decisions, for instance, stamp duties on downsizing.

This supplementary paper will argue that Australia's retirement income system, one of the best in the world, must be underpinned by enduring principles that ensure it not only remains fair, decent, sustainable and above politics, but encourages people to provide for themselves.

## Australia's Retirement Income System

In 2000, Australia's retirement income system[1] was considered one of the best in the world for its comprehensive coverage, cost effectiveness and sustainability.

While other OECD countries were being warned to brace for population ageing, a World Bank economist declared Australia had "no need to adjust as it had, through a series of historic events, developed the three-pillar retirement income system recommended by the World Bank…[and]…provided full protection at the lowest cost (as a share of GDP) of any OECD country".

Since then the retirement income system has strengthened further. Australia's $2 trillion funds management market is now the largest in Asia and, in performance, ranks third in the world behind Denmark and the Netherlands.[2]

More pointedly, dire warnings of future pension costs are increasingly unrealised, and a check of early Treasury forecasts bear this out.

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[1] Comprising the age pension, compulsory superannuation and private savings.
[2] Mercer Global Pension Index, 2013

In 2014, Australia spent around 2.9 per cent of GDP on pension payments – this is well below the current OECD average of 7 per cent, less than the 3.06 per cent forecast by Treasury in 1999 for 2010[3], and the same spent in 1999.

By the time of Treasurer Peter Costello's second Intergenerational Report (IGR) in 2007, which modelled the impact of population ageing on productivity, the ship had turned. Each report since has further allayed fears of population ageing. This year the fourth IGR predicts pension outlays, at worst, will rise to 3.6 per cent in 2054, and, at best, fall to 2.7 per cent of GDP.

Yet, despite evidence of sustainability in 2015 a billion dollars a year has been slashed from the age pension to boost the budget bottom line. Supported by the welfare lobby and largely unchallenged by the media, the cuts have played neatly into a divisive narrative that erroneously casts older Australians as living in five million dollar harbour homes while drawing a government pension.

The reality is tens of thousands of ordinary mid- to low-income older Australians who have worked and saved under a certain set of rules will, in 18 months, find themselves living off less than someone with no savings receiving a full age pension.

In an excellent submission to the Senate Community Affairs Legislation Committee, the ANU's Tax and Transfer Policy Unit, compares how the changes will affect two home-owning retiree couples assuming a conservative 5% nominal return and 2.5% real return on assets.[4]

It finds that Couple A, with $823,000 of assets, will have an income of $20, 575 per year; and, Couple B, with $375,000 of assets, will have an income of $40, 543 per year (maximum age pension of $42, 343 less $1800 due to deemed income). Couple A, with extra savings, will live off $19,968 less than Couple B; or $13,000 less than the $33, 766[5] the Association of Superannuation Funds says is required to live a modest retirement.

That current retirees have not had the full benefit of the superannuation guarantee over their working lives,[6] and are more reliant on less tax-advantaged earnings and personal savings than future generations, renders the pension changes particularly unfair.

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[3] "Independence and Self-Provision in Retirement Discussion Paper", National Strategy for an Ageing Australia, Commonwealth of Australia, 1999

[4] Tax and Transfer Policy Unit, Submission to the Senate Community Affairs Legislation Committee, 12 June 2015, Australian National University

[5] ASFA Retirement Standard, 2015.

Super tax concessions - which have tripled in cost since 1999 to around $32 billion in 2015 and, in 2018-2019, will outstrip the age pension at $50 billion – remain untouched. Suggestions of limiting tax concessions on balances over $2 million are not unreasonable considering that the current average at-retirement superannuation balance is $198,000 for men and $112,600 for women.

## Observations

The political events of this year bring into sharp focus key elements of the retirement income system that warrant stating in this review process.

### First, Australia's retirement income system is world class and has excellent foundations.

We must recognize this and build on it.

### Second, Australia's retirement income system must be above politics and ideology.

Australians must have faith that the system they invest in over the long term will not change on political whim or be raided to prop up budgets. Nor should it or the people strive to operate within it be denigrated to further an ideological agenda. Any changes should be the result of wide consultation and analysis, and then grandfathered to ensure fairness.

### Third, Australia's retirement income system must encourage self-provision.

People who make provision for themselves should expect to have a higher income than the age pension alone. In the current low-interest environment, the new taper rates and asset test limits are a disincentive to save.

It is National Seniors' view that:

a. *The deeming approach in a combined age pension means test (that excludes the family home) as recommended in the Henry Tax Review is fairer and preferable to the new assets test announced in the 2015 federal budget.*

### Fourth, the full age pension is a safety net for those people who have been unable to provide for themselves.

As a society we must ensure that the pension remains at a level that allows older people to fully participate and age with dignity. The current indexation method does this.

### Fifth, the age pension will continue to be a significant proportion of retirement income for many people, even when the superannuation system is fully mature.

This is a characteristic of Australia's retirement income system - not a reason to claim it is unsustainable. While the share of over-65s receiving any pension has reduced slightly from over 80 to 77.9 per cent from 2003 to 2011, the pension proportion of their retirement income has lowered from 67.8 per cent in 2001 to

59.9 per cent on average in 2011.[7]

### Sixth, workforce participation is critical for both nation and individuals.

In the past 15 years the workforce participation rates of older Australians have increased significantly. Between May 2002 and May 2012, the labour force participation rate for those aged 45 to 64 years increased by 6.2 points to 73.9 per cent.

However, once unemployed older job seekers are out of work for an average 71 weeks compared to the 41 weeks of those aged 25 to 44. Long periods of unemployment have a devastating impact on retirement incomes. Raising the pension age without ensuring jobs for people in their 50s, let alone their 60s or 70s, will simply see workers shifting from one form of welfare to another.

It is National Seniors' view that:

a. *Investment must be made in changing community attitudes and pro-actively supporting mature age Australians in the workplace. In a life course approach to retirement income policy high youth unemployment warrants similar attention.*

b. *The legal barriers to mature age workforce participation such as age-based workers' compensation and licensing restrictions, and the tax treatment of redundancy packages must be removed.*

c. *Programs like the former Pension Bonus Scheme that rewarded people for working past retirement age and the current Work Bonus that allows retirees to supplement their pensions with casual employment are commendable and must be explored further.*

### Seventh, the financial services industry must be held to a higher standard.

As the system grows more complex, Australians are increasingly forced to place their trust in a sector that is murky, unaccountable and heavily conflicted through vertical integration. Thousands have seen their retirement incomes decimated by corporate collapses and shonky schemes such as Storm, Opes Prime and Timber Corp. As the Murray Inquiry confirmed, consumer interest must lie at the heart of the financial system - a system that is fair, transparent, efficient and resilient.

It is National Seniors' view that obvious first steps include:

[7] Household, Income and Labour Dynamics in Australia Survey, 2014

a. *Establishing a clear goal for the superannuation system;*
b. *Improving the net returns for members of superannuation funds;*
c. *Fostering greater fee competition between superannuation funds;*
d. *Taking action to reverse the trend of vertical integration;*
e. *Making financial product issuers more accountable; and,*
f. *Increasing the capacity for intervention by the regulator*.

### Eighth, home ownership has great cultural significance and is inextricably linked to wellbeing in retirement.

In old age, a family home without mortgage, represents independence and financial security. Besides a sense of place and belonging, National Seniors members often describe their home as the centre-piece of their financial planning and a reserve to draw upon in times of ill health or aged care.

It is National Seniors' view that:

a. *Older Australians are strongly opposed to including the family home in the pension assets test and have a mistrust of reverse mortgages.*

b. *A lack of appropriate housing stock and costs such as stamp duties are an ongoing disincentive to downsizing.*

c. *Models of equity release through downsizing (without compulsion) for asset rich but income poor retirees are worth developing. The recent Housing Help for Seniors pilot that allowed a portion of the proceeds from the sale of the home to be quarantined from the pension test and set aside for future costs is a notable example.*

d. *The impact of negative gearing on housing affordability and its implication for future generations in terms of later life security must be a priority for government.*

### Ninth, older Australians want choice in retirement income products but not compulsion.

Contrary to regular media reports, older Australians are not blowing their superannuation lump sums. Productivity Commission research finds that most retirees are attune to longevity issues and prudent in the way they draw down their superannuation.[8] Less than 30 per cent of super benefits are taken as lump sums, with most taken as income streams. Where they are taken as lump sums,

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[8] Productivity Commission, Superannuation Policy for Post Retirement, Melbourne, 7 July 2015

they are used to pay down debt, invest in income stream products and purchase durable goods for retirement.

However, retirees face policy and regulatory impediments to taking super benefits as an income stream. Examples include: prescriptive rules restricting earnings tax exemptions on superannuation pensions - in particular minimum annual withdrawal rules; higher relative tax rates on interest-earning assets such as bank deposits; and the inability to convert home equity into an income earning asset without loss of pension asset test exemption.

It is National Seniors' view that:

a. *Individuals should not be compelled to take part of their superannuation balances as a commutable income stream. However, a default arrangement with opt-out provisions, subject to full public consultation and consideration of all risk, costs and benefits is worth consideration.*

b. *Regulatory impediments to the development of an appropriate range of retirement income products should be removed, and the current rules-based approach to determining eligibility for tax and social security exemptions for retirement products be replaced with a principles based approach.*

## Conclusion

In conclusion, Australia's retirement income system leads the developed world in terms of coverage, fairness and sustainability.

However, ill-considered, ad hoc changes driven by politics, ideology or commercial interests can easily threaten the smooth workings of its many inter-related parts. These include pensions, superannuation, workforce participation, home ownership, product development and the integrity of financial advice.

Policy makers would do well to embrace the well known strengths of our retirement income system while striving to better create the conditions and products that encourage and enable Australians to provide for themselves.