RICEWARNER

Insight like no other

Submission to Tax White Paper Task Force

Quo Vadis?

Superannuation needs effective policy... not politics

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This report has been prepared in response to a call for submissions from the Tax White Paper Task Force.

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1. Executive Summary

1.1 About Rice Warner

Rice Warner was established in 1987 to support superannuation funds and businesses operating in the financial services industry. It is an Australian business, owned and controlled by its key executives.

Over the last three decades, it has built a strong reputation for insightful commentary. Its independence means clients can be sure the firm always acts in their best interest and provides unbiased advice. Clients include most large superannuation funds and life companies as well as many other participants in the industry (service suppliers, regulators and industry bodies).

Through its research and public policy activities, Rice Warner has built an unrivalled reputation for delivering a unique perspective across the superannuation, wealth management and life insurance industries.

1.2 Focus of this submission

This submission specifically addresses Question 22 of the Tax Discussion Paper, namely:

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

It looks at the effectiveness of the three pillar structure of superannuation comprising the Age Pension, mandatory employer contributions (superannuation guarantee) and voluntary contributions.

We note the size of tax concessions provided on contributions and earnings as well as the growing expenditure on Age Pensions. We comment on whether the tax concessions are well targeted and whether they will reduce dependence on welfare benefits for the retired population.

In our opinion, the current structure fails some of the Principles set out by the task force regarding equity, efficiency and simplicity. We show what changes are required to meet these Principles. This occurs because superannuation suffers from political confrontation which is a barrier to effective policy.

We have limited our analysis to the retirement system but we note that the share of personal taxation has risen to 48% of the $415b of revenue expected to be raised in 2015-16. We expect this will need to be reduced in future years though the Discussion Paper suggests the share of personal taxes will continue to grow.

We suggest the top marginal tax rate should be lowered in time to no more than 40 cents in the dollar. It is well known that tax rates are not efficient nor internationally competitive at the current level of 47% (including Medicare levy) or 49% if we also include the Temporary Budget Repair Levy.

If the top marginal rate is reduced, the cost of superannuation concessions will reduce since the concession will be lower. We have noted this when costing our suggested improvements.

1.3 Purpose of Superannuation

1.3.1 Systemic issues

The main reason for having a superannuation system is to encourage people to become self-sufficient in retirement.

The system has many well-known issues:

- The Age Pension is neither a safety net nor a universal benefit since Australia has a unique system of means-testing its State benefit. This makes it difficult for workers to plan for retirement, given the majority will receive a full or part Age Pension during their retirement.
- The means tests for the Age Pension exclude the value of the family home. This favours home owners over renters. It also creates anomalies between different home owners. A couple with a home worth $500,000 and $1.25 million of financial assets would receive no Age Pension. In contrast, a couple with a $3 million home and minimal financial assets would receive a full Age Pension, at the expense of taxpayers in much less fortunate situations. Further, as Australia has limited death duties, the family home is passed tax-free on death in retirement. This could occur even if a married couple receives a full Age Pension throughout retirement – and this is worth more than $800,000.
- Taxation has a complex basis. Superannuation funds are taxed on contributions and earnings and this reduces the end benefits members will receive. In contrast, most earnings and benefits received after age 60 are tax-free.
- Tax concessions are generally agreed to be inequitable even though they are changed by government frequently.
- Default investment strategies in the working years are world-class. However, there are no defaults in the retirement phase and the interaction between superannuation, taxation and the Age Pension is complex.

1.3.2 Principles

The recent Financial System Inquiry suggested the following objective for superannuation:

"To provide income in retirement to substitute or supplement the Age Pension"

This statement precludes the use of superannuation for purposes other than providing retirement incomes. There is already one major diversion of retirement savings for the provision of insurance within superannuation. This is worthwhile as it has greatly enhanced the level of life and disability cover within the community at a reasonable cost. We would suggest that the value of sustaining this insurance framework should be recognised in setting objectives for the system.

Some commentators have suggested that funds be used for a variety of other purposes including:

- assisting young people to meet deposits on house mortgages
- paying for health costs in the retirement years
- funding Aged Care facilities late in life

As we know that projected superannuation benefits will be inadequate to deliver a comfortable lifestyle in retirement for many members, it is not practical to extend the use of superannuation to these other purposes.

1.3.3 Goals

The superannuation system would be more highly regarded if the population accepted that it was:

- Fair and equitable
- Sustainable for government
- Simple for members to understand and use
- Providing reasonable benefits in retirement
- More certain about the rules with far less annual change (which is seen as tinkering)

A review of superannuation taxation and integration with the Age Pension is needed. Changes can be made which will improve all the above goals.

1.3.4 Philosophy of providing tax concessions

We know that most people would not naturally be inclined to save for retirement until quite late in life. Consequently, tax concessions are an encouragement for workers to save earlier. Early savings also generate higher benefits due to the compounding effect of earnings.

The arguments for tax concessions are:

- Australia has a high, mandatory savings rate required for retirement benefits (currently 9.5% and rising to 12%). There should be a reasonable reward for locking up this deferred pay for decades.
- Benefits are inaccessible (except under some limited conditions) until the member reaches Preservation Age (between 55 and 60). For many young members in the workforce, this period could be in excess of 40 years.
- The concessions reward and compensate participants in the superannuation system for foregoing their take home pay to provide income for their own retirement and not be totally reliant on the government Age Pension. Therefore, the government should benefit from reduced future welfare payments.
- Tax concessions encourage additional savings through voluntary contributions (Pillar 3)
- Without tax concessions, there would be no reason for Australians to put aside additional savings specifically for the purpose of retirement savings. Most savings would shift to unregulated investment vehicles which would place people at higher risks.
- This encourages planning for retirement over other use of disposable income. This means benefits grow at a faster rate during the accumulation phase.

1.4 Structure of superannuation

Section three of this submission reviews the structure and costs of providing Australian superannuation.

The key observations are:

- The Three Pillar structure and the taxation of superannuation are complex. It is confusing for members and retirees.

- Retirees take on all risks as there is little mortality pooling. The main reason for this is the absence of suitable products. There are lifetime immediate annuities available but they deliver poor value if purchased at the time of retirement.
- Retirees are sensible about using their superannuation benefits wisely. More than 90% of superannuation benefits (measured by assets) are converted into retirement savings and are not consumed at the time of retirement.
- The cost of providing tax concessions to superannuation funds is growing and needs to be curtailed. The longer this is delayed, the more severe the adjustments that would ultimately be needed.
- The tax concessions are not well targeted. The concessions are tilted towards the well-off and the projection of retirees who will be self-sufficient in later years will still be relatively low (less than 30% in 40 years according to the latest Intergenerational Report – and some of these will be working rather than retired).
- Superannuation funds will pay tax of about $8 billion this year and this will grow in future years.
- The cost of providing Age Pension benefits is also growing but is affordable
- Integration of the Age Pension and superannuation is poor. Consequently, the Age Pension has the dual roles of providing a safety net for the poor and a benefit entitlement for the bulk of retirees.

1.5 Taxing superannuation

1.5.1 Taxing earnings

We recommend having a uniform tax rate of 12% across the earnings of accumulation and pension accounts. The current rate is 15% on accumulation accounts and nil on pension accounts.

We suggest a rate of 12% of earnings, though a lower rate of 10.5% would provide revenue equality.

The application of this change has many benefits which are set out in section 4.2.1

1.5.2 Concessional Contributions

We agree with the logical solution of the Henry tax review to make the deductions fairer by equating the tax benefit to all personal income tax payers. We suggest a uniform 20% rebate be allowed on concessional contributions. This would reduce the benefit for a high income earner from 49% (including Medicare Levy and Budget Deficit Repair Levy) to 20%.

At this level of concession, it would be possible to increase the allowable concessional contributions from $35,000 to (say) $50,000 a year. This higher limit would be useful for people who wanted to top-up their superannuation by making larger payments later in life when they have the ability to do so.

In order to simplify administration, we would change the collection basis of the tax. Rather than tax contributions at 15% in the fund, we would tax them in the personal tax return of the member. This would also have the benefit of increasing the value of the SG contribution from 8.1% (after tax) to 9.5%, which will increase superannuation savings.

Low income people would receive a tax credit through the rebate system.

1.5.3 Non-concessional contributions

At present, the limit for non-concessional contributions is $180,000 a year. We propose imposing a lifetime cap of (say) $500,000 on non-concessional contributions from any source.

1.5.4 Benefit components

Once contributions are in a fund, we believe the difference in components (pre-83, concessional, non-concessional) should disappear. Any tax on benefits should not vary according to the source of contribution.

1.5.5 Withdrawals during pension phase

We recommend removing the distinction between lump sums and pensions. Once a member has attained the pension age, they simply start drawing their tax-free pension.

The current levels of minimum withdrawal values should be cut by 25% or 50% to allow retirees to hold their superannuation for longer periods, recognising that life expectancies have increased since the current factors were decided.

We recommend reintroducing maximum withdrawal factors for account-based pensions so that the pension benefits are not spent too quickly. An appropriate level might be three percentage points above the minimum withdrawal factor. The factor would be 7% up to age 65 then 8% until age 74.

We would allow superannuation fund members to draw up to (say) $100,000 in any year even if this exceeds the maximum under the factors. This would be the proxy for lump sum withdrawals. Further, pensions could be commuted to pay for entry into an aged care facility.

Some commentators have suggested that large pension benefits should be taxed. It would be reasonable to include any withdrawal above (say) $100,000 a year in the retiree's personal assessable income.

1.5.6 Benefits tax - death on pension

At present, the death benefit on a residual pension benefit not left to a dependant is 17% (15% plus 2% Medicare Levy). However, the actual tax rate is much lower due to so-called re-contribution strategies. These are widely used for the sole purpose of reducing tax on future death.

This structure could be disallowed simply by taxing the full death benefit at 17% irrespective of the source of contributions. A variation would be to allow the benefit to be transferred tax-free into the superannuation (or pension) account of close family members (spouse, siblings, children or grand-children) free of any tax.

1.6 Social Security – The Age Pension

We believe the part Age Pension should be phased out. Retirees should first spend their own assets and be eligible for a full Age Pension when they fall below a threshold.

We suggest that retirees should be allowed some exempt assets. It would be appropriate for a couple to keep the family home up to a value of $1.5m and all other assets (including superannuation) up to about $500,000. If they have assets above this, they cannot claim the Age Pension. This still favours home owners over renters so you might allow higher levels of assets for renters to compensate. This level of exempt asset would move some people currently on a part pension to a full pension and others to no pension (though we favour grandfathering of the current retirees for at least a decade).

If people run out of income but still have a valuable home, they have the choice of downsizing or requesting a government pension which will be paid as a loan with the home as security. At present, people won't downsize as the cash generated impacts on their Age Pension.

We also suggest two measures to correct the current incentives to run down funds quickly and fall back on the Age Pension:

- Retirees should be able to receive a Health Card irrespective of their financial assets from a specified age, say 75. This would remedy the current situation where linkage of eligibility for the Health Card with being on the Age Pension acts as a powerful incentive for retirees to manage their affairs in a way that makes them eligible for at least a Part Pension.
- Retirees beyond an advanced age, for example age 90 (the age to which about 25% of retirees will survive), should be able to receive the full Age Pension without means testing. This would incentivise retirees to spread their retirement savings over longer periods and help to counteract the pressures in the opposite direction that are inherent in any means testing system. The eligibility age should be linked to changes in life expectancy so that it can be adjusted as needed to keep the benefit sustainable.

1.7 Other changes

1.7.1 Franking credits

We consider that franking credits provide an incentive for superannuation funds to invest in the Australian economy, both in listed and unlisted entities.

Removing franking credits would put equity investments at a disadvantage to debt investments. This could encourage investment into lower yielding portfolios which would lead to lower retirement incomes for the population and a greater call on the Age Pension. It could also tilt capital structures towards a higher proportion of debt capital, potentially increasing the rate of failure of business, especially in times of financial crisis.

1.7.2 Guaranteed retirement products

We have suggested that pension earnings be taxed at the same rate as accumulation earnings, say 12%. It would be possible to leave immediate and deferred lifetime annuities tax free above age 60 to provide an advantage to offset the high cost of these products. However, on balance, we believe all products should have the same rate of tax and this concession should not be provided.

1.7.3 Joint accounts for couples

We have canvassed the possibility of superannuation funds holding joint accounts for married couples. This already happens in the SMSF segment as about 85% of SMSF funds are run for a married couple[1].

Joint accounts should lead to reduced fees, higher levels of engagement and higher levels of adequacy.

[1] According to research from the SMSF Association

Although it is not a tax issue, we believe joint super accounts for married couples will also make the system simpler and easier to understand.

1.8 Cost of proposed changes

We have costed the impact of making changes to contributions tax, earnings tax and the abolishment of part pensions. The results of this costing are given in Table 1 and Table 2.

We would hope that the top marginal tax rate could be lowered to 40% (including Medicare levy) and the cost of the concessions would then reduce significantly. We have modelled the results including a reduction in the top marginal tax rate to 40% in the 'combined policies' scenario.

The results show a government saving of $6b in the first year rising to $59b in 2055 at today's prices.

Table 1. Policy costings – 2014-15 FY

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension^	Total Savings
	($m)			
Reform contributions tax (marginal less 20% rebate)#	6,587	(17)	0	**6,569**
Reform earnings tax (12% flat)	0	390	0	**390**
Abolish part pensions	0	0	0	**0**
Combined policies*	**5,696**	**377**	**0**	**6,074**

*components may not add due to interaction effects
^there is no immediate effect on the Age Pension given the recommended grandfathering arrangements
#Contributions tax is paid outside superannuation

Table 2. Policy costings – 2055 (in 2014-15 Prices)

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension^	Total Savings
	($m)			
Reform contributions tax (marginal less 20% rebate)#	3,138	4,361	(605)	**6,894**
Reform earnings tax (12% flat)	0	6,575	(1,636)	**4,939**
Abolish part pensions	0	0	51,908	**51,908**
Combined policies*	**3,138**	**6,098**	**50,248**	**59,484**

*components may not add due to interaction effects
#Contributions tax is paid outside superannuation

1.9 Timing

We consider that most changes could be done at short notice. However, the removal of part Age Pensions would need time to implement. We suggest that there be a three year notice period so that people about to retire do not have their plans disrupted.

We consider that grandfathering existing arrangements adds to future complexity and should generally be avoided. However, we expect that existing retirees receiving a part Age Pension would continue for a longer period until a transition plan can be developed and worked through.

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2. The purpose of superannuation

The main reason for having a superannuation system is to encourage people to become self-sufficient in retirement. Most people do not worry about superannuation before they attain age 40. Before that, families have more pressing needs for their disposable income including buying their home residence and raising their family.

The superannuation guarantee structure mandates that employers pay 9.5% of salaries into superannuation and this provides a floor of personal savings for retirement throughout everyone's working life[2].

The system has many issues, most of which have been canvassed by industry bodies and government inquiries over a number of years. The main themes of these reviews are:

- The Age Pension is neither a safety net nor a universal benefit since Australia has a unique system of means-testing its State benefit. This makes it difficult for workers to plan for retirement, given the majority will receive a full or part Age Pension during their retirement.
- The means tests for the Age Pension exclude the value of the family home. This favours home owners over renters. Further, as Australia has limited death duties, the family home is passed tax-free on death in retirement. This could occur even if a married couple receives a full Age Pension throughout retirement – and this is worth more than $800,000.
- Taxation has a complex basis. Superannuation funds are taxed on contributions and earnings and this reduces the end benefits members will receive. In contrast, most benefits received after age 60 are tax-free.
- Tax concessions are generally agreed to be inequitable even though they are changed by government frequently.
- Default investment strategies in the working years are world-class. However, there are no defaults in the retirement phase and the interaction between superannuation, taxation and the Age Pension is complex.

2.1 Principles

The recent Financial System Inquiry (FSI) suggested the following objective for superannuation:

"To provide income in retirement to substitute or supplement the Age Pension"

Most people would regard this simple statement as sensible. In fact, most superannuation benefits are used appropriately in line with this objective.

The FSI also suggested the government ascertain support for a number of subsidiary objectives, namely:

- Facilitate consumption smoothing over the course of an individual's life
- Help people manage financial risks in retirement
- Be fully funded from savings
- Be invested in the best interests of superannuation fund members

[2] Though the self-employed are not compelled to make superannuation contributions nor are employers required to pay contributions for a part-time person earning less than $450 in a calendar month.

- Alleviate fiscal pressures on Government from the retirement income system
- Be simple and efficient, and provide safeguards

It should be noted that these objectives do not include the use of superannuation for purposes other than providing retirement incomes. There is already one major diversion of retirement savings for the provision of life insurance within superannuation. This is worthwhile as it has greatly enhanced the level of life cover within the community at a reasonable cost. However, the $7 billion a year of life premiums paid out of superannuation funds must reduce retirement benefits. We believe that this is a key component of the current system, and that its value to members should be recognised in the objectives of the system.

Some commentators have suggested that funds be used for a variety of other purposes including:

- assisting young people to meet deposits on house mortgages
- paying for health costs in the retirement years
- funding Aged Care facilities late in life

As we know that projected superannuation benefits will be inadequate to deliver a comfortable lifestyle in retirement for many members, it is not practical to extend the use of superannuation to these other purposes.

2.2 Goals

The superannuation system would be more highly regarded if the population accepted that is was:

- Fair and equitable
- Sustainable for government
- Simple for members to understand and use
- Providing reasonable benefits in retirement
- More certain about the rules with far less annual change (which is seen as tinkering)

A review of superannuation taxation and integration with the Age Pension is needed. Changes can be made which will improve all the above goals.

2.3 Philosophy of providing tax concessions

We know that most people would not save for retirement until quite late in life. Consequently, tax concessions are an encouragement for workers to save earlier. Early savings also generate higher benefits due to the compounding effect of earnings. Even with these concessions, much of the population relies on the mandatory employer contributions and they do not make use of the third pillar of voluntary contributions.

The arguments for tax concessions are:

- Australia has a high, mandatory savings rate required for retirement benefits (currently 9.5% and legislated to rise to 12% from July 2025). There should be a reasonable reward for locking up this deferred pay for decades.

- Benefits are inaccessible (except under some limited conditions) until the member reaches Preservation Age (between 55 and 60). For many young members in the workforce, this period could be in excess of 40 years.
- Tax concessions reward and compensate participants in the superannuation system for foregoing their take home pay to provide income for their own retirement and not be totally reliant on the government Age Pension. Therefore, the government should benefit from reduced future welfare payments.
- Tax concessions encourage additional savings through voluntary contributions (Pillar 3)
- Without tax concessions, there would be no reason for Australians to put aside additional savings specifically for the purpose of retirement savings. Most savings would shift to unregulated investment vehicles which would place people at higher risks.
- This encourages planning for retirement over other use of disposable income. This means benefits grow at a faster rate during the accumulation phase. These higher retirement benefits can offset Age Pension expenditure in the future.

3. The Structure of Superannuation

3.1 Three Pillars – and more

3.1.1 Accumulation

Australia has a three-tier superannuation system based on a defined contribution structure. Members bear all investment and inflation risks throughout life, including the period in retirement.

Table 3. Three Pillars

Pillar	Participation	Eligibility
Age Pension – a State benefit funded from tax revenue	Payable to older singles and couples subject to means tests on both assets and income	Currently age 65 increasing to 67 by 2023 and foreshadowed to move to age 70 by 2035
Superannuation Guarantee	Mandatory employer contributions of 9.5% of wages. Scheduled to increase to 12% but currently frozen for next 7 years.	Not required if wages below $450 in a month Not required on wages above $203,240 (2015/16 FY), so capped at $19,308 a year
Voluntary contributions	Concessional	$30,000 a year to age 49, then $35,000
	Non-concessional	$180,000 a year

All the Pillars are subject to constant changes for fiscal reasons. This makes it difficult to plan long-term. Australians in accumulation funds don't know what they are going to receive at retirement – and they are even less certain about how much they need and how they should spend their benefit in the retirement years. Superannuation is complex enough but the means-tested Age Pension adds another dimension of uncertainty.

3.1.2 Retirement

Retirement is complicated too. Members can draw pensions once they have attained the Preservation Age (which was 55 but is shifting to 60). Pension fund earnings are tax-free and benefits from age 60 are also tax-free. Members do not have to retire to draw a pension but can run an accumulation account and pension account simultaneously.

It is often stated that Australia has a lump sum mentality given the free access to benefits in retirement. Certainly, many members retire with less than $100,000 and they take a lump sum. However, 85% of retirement benefits (by benefit amount) are converted into pensions and at least one-third of the balance is taken as a lump sum and reinvested in bank term deposits – another form of saving. The residual benefits consumed are usually used for debt reduction[3].

[3] http://ricewarner.com/media/111738/New-analysis-shows-our-%E2%80%98lump-sum-culture%E2%80%99-is-an-exaggeration-Colonial-First-State-Income-Stream-Index-Launched-280415.pdf

Most retirees holding account-based pensions draw these frugally and make their funds last for as long as possible during retirement. The average drawdown of pensions is circa 7% of the account balance. Thus, on average, members draw their earnings plus a small amount of their capital each year.

3.1.3 Annuitisation

There has been criticism that this frugal spending leads to benefits unspent by death and this should be used in the retirement system. The Henry review suggested mandatory annuitisation as a means of making all retirement benefits used for the purpose of paying retirement income. However, such an arrangement is naïve and would simply reduce living standards for the retired population. A recent Paper by two of our actuaries demonstrates that lifetime annuities bought at the time of retirement provide the lowest value of all pension products[4].

It makes more sense to tax any bequest if it is intended to claw back some concessions made earlier. There is already a tax of 15% on any benefit left by a retiree to a non-dependant.

3.1.4 Integration with Age Pension

Rice Warner considers that the integration of the Age Pension with superannuation is poor. We suggested reforming the system in April 2012.[5] Since then, we have developed our thinking and we have set out in this submission how better integration could reduce expenditure and improve tax equity in the retirement system.

3.2 Fiscal cost of superannuation

In Australia, superannuation tax is levied on contributions, fund earnings and some benefits. The broad tax treatment is set out in Table 4.

[4] http://actuaries.asn.au/Library/Events/FSF/2014/Rice3b.pdf
[5] http://ricewarner.com/media/75088/Reforming-the-Age-Pension_August-2012.pdf

Table 4. Tax treatment of superannuation savings: taxed defined contribution funds[6]

Taxable Item	Age or Income band	Tax Rate
Concessional contributions (pre-tax)	If salary + super < $300,000	15%
	High income - (salary and super exceed $300,000)	30%
	Low income (up to $37,000)	Refund of tax up to $500 (LISC[7])
Non-concessional (after-tax) contributions	Up to $180,000	Nil
	Amounts > $180,000	Marginal tax rates
	Low income ($35,454 to $50,454)	Up to $500 government co-contribution paid into fund[8]
Fund Earnings	Income in accumulation accounts	15%
	Capital gains during accumulation phase (if held for 12 months)	10%
	Income in pension phase	NIL
Benefits	Below Preservation Age	Lump sums up to 20% Income streams at marginal rates
	Between Preservation Age and age 60	Lump sums are tax-free up to $185,000 and taxed at a maximum of 17% thereafter. Income streams are taxed at marginal rates less a 15% offset.
	Above age 60	NIL
	Death on pension (without dependent)	17% on concessional component of benefit

[6] Some government funds are 'untaxed' so the benefits paid to members have a higher tax structure.
[7] The Low Income Superannuation Contribution commenced in July 2012 to reverse the impact of tax on contributions for low income earners.
[8] Since July 2003, the co-contribution scheme has provided between $500 and $3,000 for low income employees who make personal (after tax) contributions to superannuation

3.2.1 Tax concessions

Treasury calculates the cost of providing tax concessions on superannuation. The cost is the largest concession in the tax system after the tax-free status of the family home.

The number is accepted to be overstated:

- It assumes that, in the absence of concessions, individuals would take the contributions as additional salary and pay tax on them at their marginal rate whereas they could use another form of tax efficient savings such as negative gearing of investments
- The published statistic does not offset taxes received from superannuation funds (see section 3.2.3)
- Any reduction in superannuation would lead to higher levels of Age Pension payment in future years

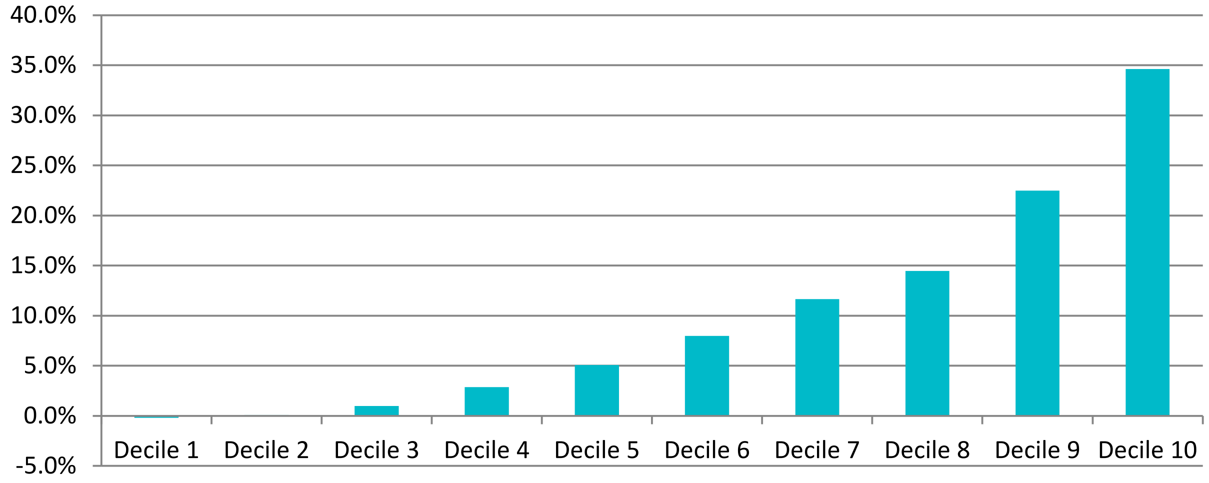
Nonetheless, the amount is considerable and the trend in the cost of concessions is growing. As a significant amount of the concessions is provided to high income earners, they are not well targeted.

Table 5. Cost of providing superannuation concessions – Treasury estimate

Financial Year	2014-15 $m	2015-16 $m	2016-17 $m	2017-18 $m
Concessional taxation of employer contributions	16,300	17,350	18,100	19,050
Concessional taxation of superannuation entity earnings	13,400	16,150	21,600	26,800
Other concessions	1,735	2,170	2,665	2,805
Superannuation Tax Concessions	**31,435**	**35,670**	**42,365**	**48,655**

High income earners receive the majority of tax concessions in superannuation as shown in Graph 1. This is unsurprising as they pay the highest rate of tax, contribute the most into superannuation and the rate of tax in superannuation is broadly flat.

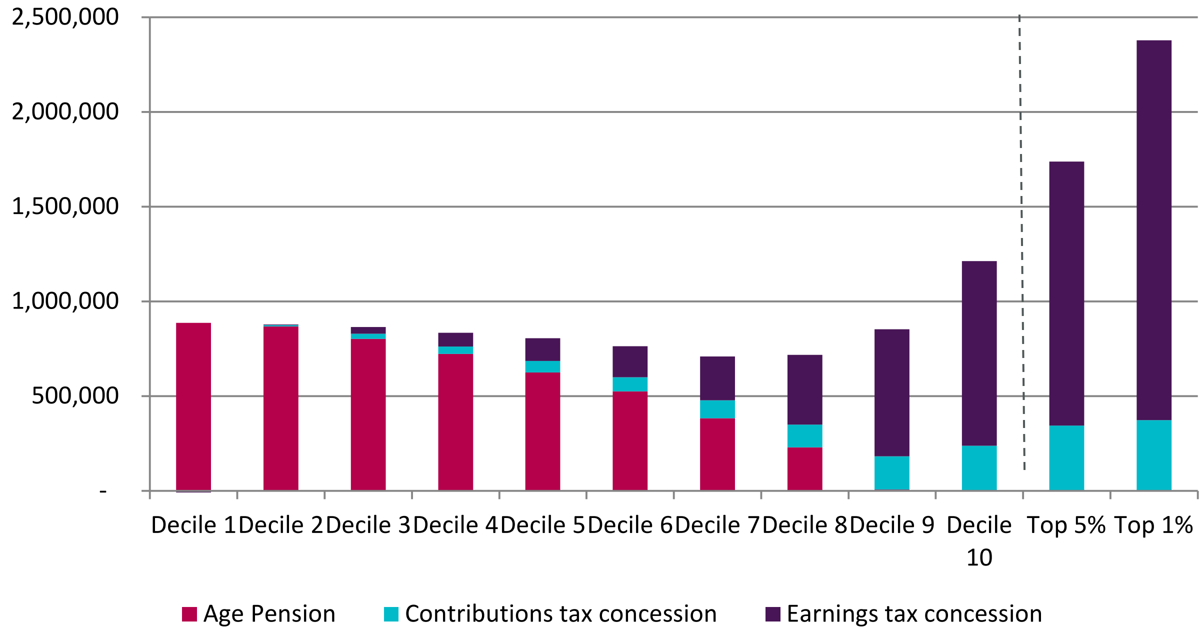
Graph 1. Share of tax concessions by income decile (2015 estimate)



Many commentators omit that low income earners also receive government support in the form of the Age Pension. Graph 2 shows the lifetime government support that a married couple would receive (if they retire in 2055 with a lifetime of SG contributions) under current tax and pension parameters by income decile.

Interestingly, those in the lowest income deciles receive more in the form of government support than middle Australia. The graph also shows that tax concessions are poorly targeted for those in the top 5% and top 1% of incomes where concessions can amount to well over $1m over a lifetime. These cohorts will have sufficient savings for retirement and will not rely on the Age Pension, yet they receive an inequitable share of tax concessions.

Graph 2. Government support by income decile – whole of life, couple retiring in 2055 (today's dollars)



3.2.2 Age Pension

Income support for seniors increases each year. The growth comes from:

- Indexation of the Age Pension based on wages (so the benefit grows in real terms each half-year)
- Improving longevity which means pensioners receive benefits for longer periods of retirement
- Thanks to medical treatment and lower accident fatalities, an increasing number of people are surviving to retirement
- The bulging population of pensioners as the baby-boomers enter the retirement years

The cost of providing the Age Pension is the largest budget expenditure item and the figures will grow quickly due to the pending retirement of the baby-boomer cohort.

Table 6. Income Support for seniors [9]

Estimates			Projections	
2014-15 $m	2015-16 $m	2016-17 $m	2017-18 $m	2018-19 $m
41,648	44,178	46,234	47,719	50,371

The annualised pension payments at July 2014 are set out in Table 7. The total payment (from the Department of Social Services, DSS) of $42.085 billion was re-estimated at $41.648 billion in the May Budget (as shown in Table 6 above).

Table 7 gives a breakdown of the financial status of Australians aged 65 and above. It can be seen that about 73.5% of this cohort receive a full or part Age Pension.

Table 7. Number of Australians aged 65 and over in 2014

Age Pensioners		Number of people	% of population	Payments [10] $m
Full	Individual	700,281	19.8	$15,662
Full	Couple	715,910	20.2	$12,069
Part	Individual	342,221	9.7	$5,923
Part	Couple	646,335	18.2	$8,431
Total		**2,404,746**	**67.9**	**$42,085**
DVA Pensioners over age 65 [11]		198,661	5.6	$6,115
Still Working		174,281	4.9	
Self-Funded		764,779	21.6	
Population over age 65		**3,542,467**	**100.0**	

[9] 2015-16 Budget paper No. 1 – Table 9.1

[10] Rice Warner Estimates

[11] The Department of Veterans' Affairs pays equivalent benefits to retired service veterans.

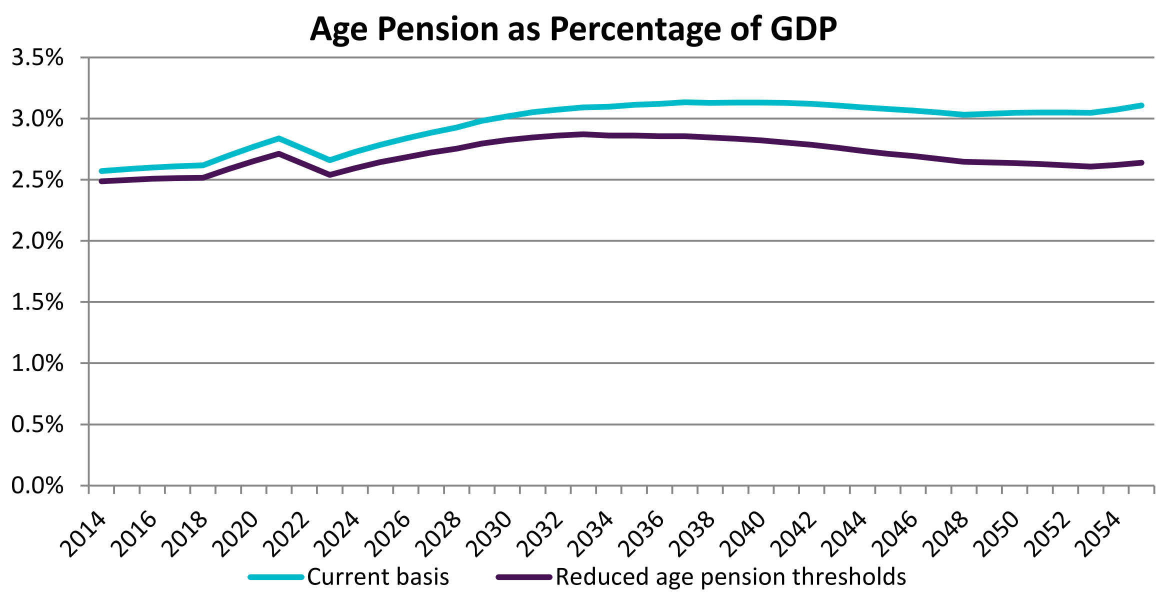
In addition, there were a further 372,507 retirees aged 55 to 64 and more than 460,000 people above age 50 who received Disability Support Pensions[12]. In practice, the great majority of these are early retirees who will transfer automatically to a full Age Pension when eligible.

The Age Pension will grow moderately relative to GDP over the next 40 years as demonstrated in our projections shown in Graph 3. The projections show Age Pension expenditure will grow modestly from 2.5% of GDP today to 3.0% in 40 years. This is less than the expected increase made by Treasury in its IGR report since it assumes retirement benefits will be consumed more rapidly, leaving more people on a full Age Pension at an advanced age.

We have also modelled the recently announced changes to Age Pension payment thresholds which show the costs of this benefit growing and then receding over the same period.

Our projections are lower than Treasury projections in the latest IGR. We believe the discrepancy is due to the drawdown method applied in each model. We believe Treasury assumes benefits will be fully drawn down by the end of life expectancy (at the time of retirement). Whereas, we assume retirees will spend their superannuation benefits more slowly with many of the 50% surviving past this life expectancy still holding some of their superannuation. These will defer the receipt of some Age Pension benefits. The outcome is that a proportion of superannuation benefits will be left on death and bequeathed to the retiree's estate.

Graph 3. Age Pension as a proportion of GDP



3.2.3 Taxation of superannuation funds

Superannuation tax receipts are expected to grow strongly next year (2015/16FY). Large superannuation funds will commence PAYG instalments and the government expects continued recovery in capital gains taxes following recent growth in all real assets. Superannuation fund taxes are

[12] Characteristics of DSP Recipients, Department of Social Services, June 2013.

expected to grow from $6.1 billion in this financial year (2014/15) to $9.2 billion next year and to $11.8 billion in 2018/2019. This is strong growth and appears to rely on a combination of:

- higher wages,
- increased voluntary contributions,
- higher levels of capital gains tax, and
- the move to monthly pay as you go instalments for large superannuation funds.

In practice, continued movement of superannuation into tax-free pensions (particularly transition to retirement) will offset some of this expected growth.

Some superannuation is held in life company statutory funds and this is included in the national accounts as company tax rather than superannuation fund taxation. We estimate the additional tax received is $2.1 billion.

Clearly, there is significant tax revenue from superannuation funds to partly offset the value of tax concessions made.

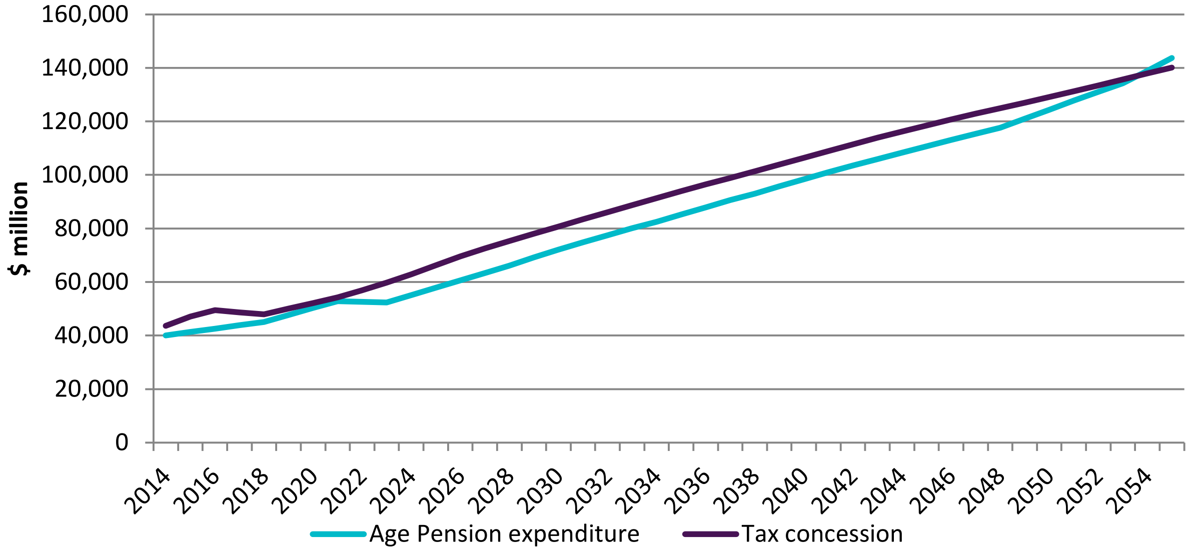
3.2.4 Future trends

The various tax concessions to superannuation funds, taxation of funds and Age Pension payments numbers cannot be offset directly against each other. For example, tax concessions made now should reduce the dependence on the Age Pension in future years. Age Pension payments now are made to people who have already retired, and who received most of their concessions during their working life.

Graph 4 shows projected tax expenditures vs. Age Pension payments until 2055. The Age Pension expenditure is expected to grow at a faster rate than tax expenditures (under the current system) due to the ageing population. Contributions tax expenditures are less sensitive to this as they are only received by those in the workforce, which does not grow significantly over this period.

Although seniors get high tax concessions in the retirement phase since earnings are untaxed, most retirees do not have much income outside superannuation, so their personal tax benchmark is low.

Graph 4. Projected growth of tax expenditures 2014-2055



Rice Warner estimate from modelling for Industry Super Australia.

4. Taxing pensions

4.1 Assets held in pension phase

We note that more than 31% of all superannuation assets are held in retirement pensions and we project this to rise to about 38% over the next 15 years as set out in Table 8.

Table 8. Retirement projections results (2014 dollars)

Market segment	Today		In 5 years		In 15 years		CAGR^
	30 June 2014		30 June 2019		30 June 2029		
	($M)	(%)	($M)	(%)	($M)	(%)	(% p.a.)
Not for Profit Funds	86,277	14.8	178,211	23.2	412,731	29.3	11.0
Commercial Retirement Products	178,253	30.7	209,502	27.3	375,981	26.6	5.1
Self-Managed Super Funds	316,870	54.5	380,046	49.5	622,222	44.1	4.6
Total retirement market	**581,400**		**767,759**		**1,410,935**		**6.1**
Retirement assets as percentage of all superannuation assets		**31.6**		**32.2**		**38.1**	

4.2 Proposed change to tax on pensioner earnings

The previous government was concerned about wealthy retirees holding significant assets within a superannuation pension on which they paid no tax on earnings. It attempted to address this with a convoluted process to tax earnings above a threshold - which would have incurred considerable administration costs for the industry.

There is a better way of improving tax equity without breaking this government's promise not to tax retirement benefits. We consider it sensible to have a single rate of tax across accumulation benefits and superannuation pensions. We have argued for this before in past newsletters and speeches and it was also a recommendation of **Australia's Future Tax System Review**.

The government only taxes accumulation assets which are 70% of superannuation fund assets. Consequently, it has an effective gross rate of tax of about 10.5% - and the actual rate collected is lower due to allowable deductions such as fund costs and insurance premiums. Once pension assets become 40% of all superannuation assets (in about 15 years), the effective gross rate will fall to 9% of total superannuation system earnings (and a lower effective rate after deductions).

We suggest the government consider a 12% rate across all fund earnings rather than 15% since existing assets would also be taxed. We do not recommend grandfathering of existing pensions as this adds complexity and does not overcome current inequity.

As 30% of all assets are in pension phase, the current 15% tax could be lowered to 10.5% to raise the same amount of revenue, but 12% allows the government room to reduce taxes elsewhere. Further, 12% is still a highly concessional rate and it still provides considerable advantages for high income earners.

We have considered whether there would be any social impact of increasing taxes on the earnings of pension accounts. It could be argued that low-income earners would be able to avoid the tax on earnings by withdrawing their retirement benefit and depositing them in a savings account with a bank.

In fact, this is already established behaviour. The majority of members with accumulated retirement benefits under $100,000 already take their benefit as a lump sum and then place it in a bank account. As these members have little personal income, their earnings on these deposits are tax-free[13].

Superannuation funds would want to retain retirement benefits as pensions so the onus would be on them to show that the fund earnings after tax and fees will be better than the return made from money left in a bank. As it is a competitive market, members would have good options either way.

4.2.1 Impact of Proposed Change

There are several advantages of this proposal including:

- Wealthy retirees will contribute towards reducing the Budget deficit and will pay an equitable share of tax in future. Taxing earnings means that those with larger balances pay more tax which is progressive and broadly equitable.
- The long-term tax rate (say, 12%) would help younger Australians build higher retirement benefits. While these would be extinguished faster if pension earnings are taxed, that could be addressed separately in future if the growth in the economy permits future enhancements.
- Shifting from accumulation to pension will not void accrued deferred CGT liabilities. These add about 3% to the benefit of an SMSF when it shifts to pension phase as the deferred CGT held in the accumulation phase is wiped.
- Several administrative functions would be removed such as the requirement for Actuarial Certificates to segregate assets between accumulation and pension accounts. This would be a net saving to the system and would reduce tax deductions.
- Superannuation administration would be simplified as members would not need to change accounts when they move into pension phase. This would remove the need for an expensive range of extra products.
- It would be easier to set up a default retirement solution as there would be a smooth transition into retirement if members did not need to set up a separate pension account.
- The costs of managing Transition to Retirement benefits would disappear as these accounts would cease. It could be argued that these benefits are simply a method of reducing taxes without any long-term increase in national savings.
- The government would not suffer a continuing erosion of revenue over the next decade as the baby-boomers move into a tax-free earnings environment
- Super funds would hold half the number of unit prices held for investment strategies (as the pension ones will be the same as the accumulation ones)
- The system would be simpler to administer and this would lead to lower costs for members and lower deductions against taxable revenue.

[13] http://ricewarner.com/media/111738/New-analysis-shows-our-%E2%80%98lump-sum-culture%E2%80%99-is-an-exaggeration-Colonial-First-State-Income-Stream-Index-Launched-280415.pdf

5. Taxing Superannuation

5.1 Contributions

5.1.1 Concessional Contributions

Contributions which are claimed as tax deductions by individuals or businesses are called Concessional Contributions. These form part of the assessable income of a superannuation fund and are taxed at 15%. This tax rate was introduced in 1988 as a benefit tax brought forward. The 30% tax on lump sum benefits was reduced to 15% at the same time.

The Henry tax review noted that the deductibility was worth more to high income tax-payers and that low income tax payers get little or no benefit from the deduction.

We agree with the logical solution of Henry to make the deductions fairer by equating the tax benefit to all personal income tax payers. We suggest a uniform 20% rebate be allowed on concessional contributions. This would reduce the benefit for a high income earner (above $300,000) from 34% (including Medicare Levy and Budget Deficit Repair Levy) to 20%.

At this level of concession, it would be possible to increase the allowable concessional contributions from $35,000 to (say) $50,000 a year. This higher limit would be useful for people who wanted to top-up their superannuation by making larger payments later in life when they have the ability to do so.

In order to simplify administration, we would change the collection basis of the tax. Rather than tax contributions at 15% in the fund, we would tax them in the personal tax return of the member. This is done by adding the contributions to the individual's salary and including them as part of their assessable income. They would receive a 20% rebate on all concessional contributions made.

This change also increases the effective amount of the mandatory contributions paid into superannuation from 8.1% (after tax) to 9.5%, an effective increase in the SG of 1.4% of salaries. Employers would need to deduct PAYG on the contributions made into super.

Low income people would receive a tax credit through the rebate system. The industry would be simpler to administer since:

- All contributions would be treated the same within a fund – none would be assessable income and subject to tax
- The higher tax on contributions for those with taxable income plus concessional contributions exceeding $300,000 would not be needed
- We would not need to maintain the LISC scheme for low income members
- The government co-contribution could be shelved too.

5.1.2 Non-concessional contributions

These are contribution made out of after-tax funds. At present, the limit for non-concessional contributions is $180,000 a year. There is also scope for small businesses to put the proceeds of any business asset (up to $500,000) into superannuation as a non-concessional contribution.

The level of allowable non-concessional contributions appears large relative to concessional contributions. These could be controlled by imposing a lifetime cap of (say) $500,000 on non-concessional contributions from any source.

5.1.3 Restricting benefit size

Before 2006, there were maximum limits imposed on benefits. Since then, generous contribution levels and high earnings have pushed many people into large balances. This is desirable given these people have taken risks and are now self-sufficient for their retirement years. However, once people have 'enough', should they be entitled to further tax concessions?

ASFA has proposed a policy of limiting tax-sheltered benefits to $2.5m. Presumably all contributions would cease from the point when all of a member's combined accumulation and pension accounts reach that level. However, the holistic changes we propose will have the effect of reducing concessions, since:

- Fund earnings in retirement will be taxed
- Non-concessional contributions will be capped
- Re-contribution strategies will cease (including the one of drawing $180,000 from a pension tax-free and then paying the same amount tax-free as a non-concessional contribution into a spouse's account).
- Benefits to non-dependants will be taxed at a higher level.

The combination of these changes should be enough to curb concessions to those with large accounts without setting a dollar limit on a members' total combined account balances, which would be difficult to administer.

5.1.4 Benefit components

Once contributions are in a fund, we believe the difference in components (pre-83, concessional, non-concessional) should disappear. Any tax on benefits should not vary according to the source of contribution as discussed later.

5.2 Tax on benefits

5.2.1 Withdrawals during pension phase

We believe we should remove the distinction between lump sum and pension benefits. Once a member has attained the Preservation Age, they should be allowed to start drawing a tax free pension.

The current levels of minimum withdrawal values for pensions appear to be too high for many people. Certainly, many retirees only draw the minimum and several re-contribute to maintain the value of their pension assets. Given we want retirees to use their funds over their remaining years, it would not be unreasonable to cut the levels by 25% or 50%. This did happen after the GFC and the amount of pension benefits fell sharply (since many members did not want to draw money out of their fund until the asset values had recovered).

A separate issue is whether there should be a maximum withdrawal amount. We recommend reintroducing maximum withdrawal factors for account-based pensions so that the pension benefits are not spent too quickly. An appropriate level might be three percentage points above the minimum withdrawal factor. The factor would be 7% up to age 65 then 8% until age 74.

We would allow members to draw up to (say) $100,000 in any year even if this exceeds the maximum under the factors. This would be the proxy for lump sum withdrawals. Further, pensions could be commuted to pay for entry into an aged care facility.

Some commentators have suggested that large pension benefits should be taxed. It would be reasonable to include any withdrawal above $100,000 a year in the retiree's personal assessable income.

5.2.2 Death on accumulation

Benefits are not taxed if the beneficiary is a dependant but the tax is 17.0% (15% plus Medicare levy) if a member dies and leaves the benefit to a non-dependant.

If desired the tax could be levied at 20% rather than 17% to match the concession we recommend in Section 5.1.1

5.2.3 Death on pension

At present, the death benefit on a residual pension benefit not left to a dependant is 17% (15% plus 2% Medicare levy). However, the actual tax rate is much lower due to so-called re-contribution strategies. These shift money from the concessional component (which is taxed) to the non-concessional component (which is tax free on death).

This structure could be disallowed simply by taxing the full death benefit at 17% irrespective of the source of contributions. A variation would be to allow the benefit to be transferred tax-free into the superannuation (or pension) account of close family members (spouse, siblings, children or grand-children).

If it were desired to claw back past concessions, the rate of tax could be adjusted.

6. The role of the Age Pension

6.1 Role of Age Pension – welfare or entitlement?

It is not possible to consider retirement incomes without looking at tax concessions and social security. Three quarters of retirees receive a full or part Age Pension as the first Pillar of their retirement benefit. Consequently, the eligibility rules for that benefit are critical in formulating a retirement income strategy.

As the Age Pension is not a universal benefit paid to everyone above a nominated eligibility age, it has a dual role. It is a welfare benefit for the poorest retirees but it is also a supplementary benefit for middle-income Australians. It is not provided at all to those with sufficient assets to live independently in retirement.

The means-test is applied to differentiate between its application as a welfare entitlement or a retirement benefit supplement.

Some relevant facts about the Age Pension are set out below:

Table 9. ASFA Retirement Standards for those aged around 65 (March Quarter 2015)

	Modest lifestyle – single	Modest lifestyle – couple	Comfortable lifestyle – single	Comfortable lifestyle – couple
ASFA Retirement Standard	$23,438	$33,799	$42,569	$58,444
Age Pension	$22,365	$33,717	$22,365	$33,717
Difference from Age Pension	**$1,073**	**$82**	**$20,204**	**$24,727**

Table 10. Assets test

Category	Assets ($)	-	100,000	200,000	300,000	400,000	500,000	750,000	1,000,000
Home Owner	Individual	22,365	22,365	22,365	18,543	14,643	10,743	993	-
	Couple	33,717	33,717	33,717	33,190	29,290	25,390	15,640	5,890
Non Home Owner	Individual	22,365	22,365	22,365	22,365	20,357	16,457	6,707	-
	Couple	33,717	33,717	33,717	33,717	33,717	31,104	21,354	11,604

Table 11. Income Test[14]

Category	Assets ($)	0	100,000	200,000	300,000	400,000	500,000	750,000	1,000,000
	Income ($)	0	6,000	12,000	18,000	24,000	30,000	45,000	60,000
Home Owner	Individual	22,365	21,445	18,445	15,445	12,445	9,445	993	-
	Couple	33,717	33,717	31,409	28,409	25,409	22,409	14,909	5,890
Non Home Owner	Individual	22,365	21,445	18,445	15,445	12,445	9,445	1,945	-
	Couple	33,717	33,717	31,409	28,409	25,409	22,409	14,909	7,409

Table 12. Assets Test with proposed assets test and taper rate changes

Category	Assets ($)	0	100,000	200,000	300,000	400,000	500,000	750,000	1,000,000
Home Owner	Individual	22,365	22,365	22,365	18,465	10,665	2,865	-	-
	Couple	33,717	33,717	33,717	33,717	31,767	23,967	4,467	-
Non Home Owner	Individual	22,365	22,365	22,365	22,365	22,365	18,465	-	-
	Couple	33,717	33,717	33,717	33,717	33,717	33,717	8,991	-

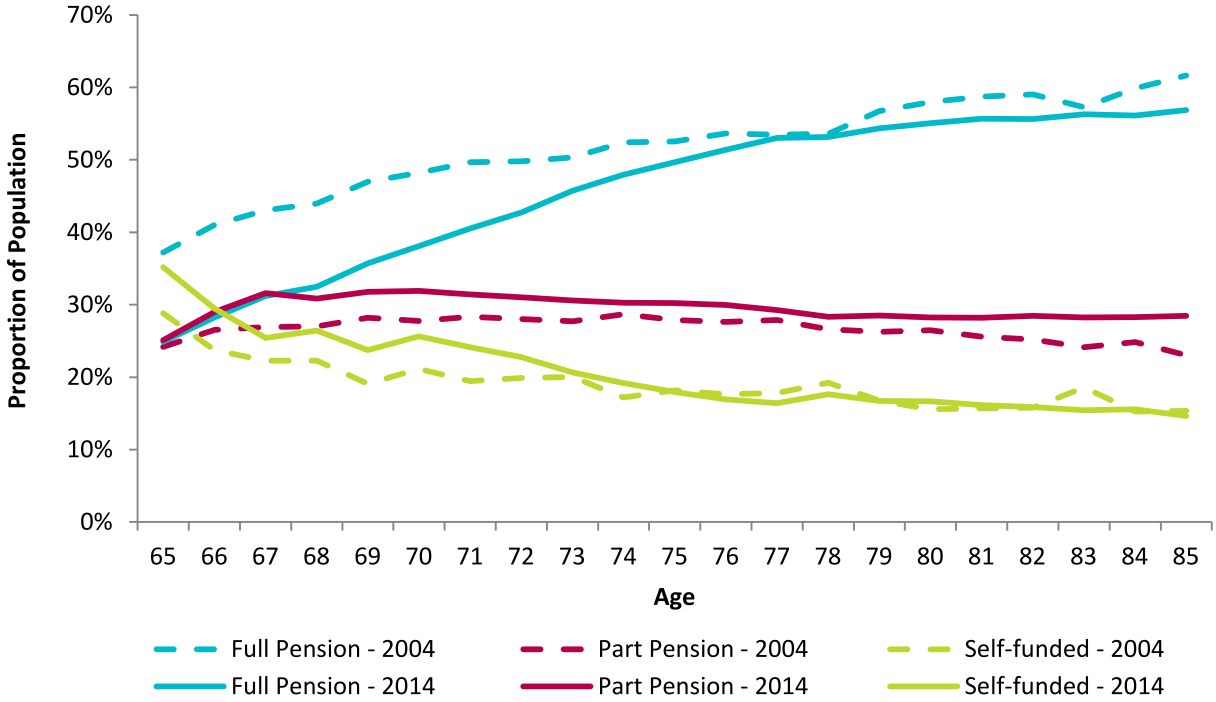
6.2 Problems with part pensions

Over the past 10 years the proportion of retirees receiving full pensions has fallen. However, the proportion that is self-funded has not shifted by anywhere near as much. This is driven by the generosity of the means testing which means that many retirees with significant assets continue to receive part pensions.

Self-funded retirees include people still working and those who have retired but whose wealth means they have no claim to any Age Pension benefit.

[14] We assume the retiree's assessable income equals 6% of the value of their assets.

Graph 5. Proportion of the population receiving the Age Pension and self-funded retirees – 2004 and 2014



6.3 Phasing out of part pensions

We first suggested abolishing the part Age Pension three years ago in a newsletter. It costs Centrelink well over $1 billion a year to administer and the means-testing is highly unpopular.

We suggest that retirees should be allowed some exempt assets. It would be appropriate for couples to keep the family home up to a value of $1.5m and all other assets (including superannuation) up to about $500,000. If they have assets above this, they cannot claim the Age Pension. This still favours home owners over renters so you might allow higher levels of assets for renters to compensate.

This level of exempt asset would move some people currently on a part pension to a full pension and others to no pension (though we favour grandfathering of the current retirees for at least a decade).

We selected the value of $500,000 as, in normal economic times when funds should earn 7% annually this should provide an income close to the Age Pension for a couple. In the current environment of low long-term interest rates, many retirees are earning less and will need to draw on their capital to provide the same level of consumption.

Renters would be allowed higher levels of exempt assets to reflect their additional consumption need. Singles would have lower thresholds than couples.

If people run out of income but still have a valuable home, they have the choice of downsizing or requesting a government pension which will be paid as a loan with the home as security. At present, people won't downsize as the cash released impacts on their Age Pension.

This will have the impact of making the Age Pension a genuine safety net (like Newstart for the working population). The costs would be cheaper but the benefit will be better targeted. It might even be possible to leave the eligibility age at 65 since poor people who cannot get jobs at older ages will suffer as the eligibility age is raised (possibly to age 70 by 2035).

We also suggest two measures to correct the current incentives to run down funds quickly and fall back on the Age Pension:

- Retirees should be able to receive a Health Card irrespective of their financial assets from a specified age, say 75. This would remedy the current situation where linkage of eligibility for the Health Card with being on the Age Pension acts as a powerful incentive for retirees to manage their affairs in a way that makes them eligible for at least a Part Pension.
- Retirees beyond an advanced age, for example age 90[15], should be able to receive the full Age Pension without means testing. This would incentivise retirees to spread their retirement savings over longer periods and help to counteract the pressures in the opposite direction that are inherent in any means testing system. The eligibility age should be linked to changes in life expectancy so that it can be adjusted as needed to keep the benefit sustainable.

Our proposed thresholds are given in Table 13.

Table 13. Proposed assets test thresholds

Family situation	Homeowners	Non-homeowners
Singles	$300,000	$450,000
Couples combined	$500,000	$650,000

[15] About 25% of retirees should survive to this age

7. Other related equity issues

7.1 Franking credits

Australia has a system of providing imputation credits for franked dividends to avoid double taxation of company profits.

There has been a debate about franking credits with some commentators claiming that:

- Franking credits are a form of tax subsidy for equities.
- Loans and other fixed interest assets are disadvantaged by these subsidies and should also receive the same treatment.
- The tax subsidy is giving equities a favoured status and is encouraging superannuation investors to over-invest in equities and thereby expose themselves to too much risk.

These are all unsustainable claims and are at variance with the purpose of franking credits.

Franking credits were introduced for a number of reasons including:

- Without franking credits, dividends from equities were tax disadvantaged in comparison to interest receipts from bonds. Interest payments on bonds were (and are) tax deductible to the entity making the interest payments. Dividends however are paid from after tax income.
- Taxing dividends in the hands of investors therefore imposed a second level of tax.
- The introduction of franking credits ensured that investment returns were taxed once only and at the end tax payer's marginal rate.
- The double taxing of company earnings in the hands of investors also raised the cost of capital for companies in comparison to debt therefore encouraging higher, and potentially inappropriate, gearing levels. The introduction of franking credits was seen as a way to encourage responsible capital management.

The implication that there is excessive investment in equities in Australian superannuation portfolios is also false. We would argue that superannuation and retirement portfolios require a high allocation to growth assets if they are to satisfy their primary purpose of providing sustainable, inflation protected incomes in retirement. Removing franking credits and once again putting equity investments at a disadvantage to debt investments would encourage investment by superannuation funds into lower yielding portfolios which would lead to lower retirement incomes for the population and a greater call on the Age Pension.

Further, superannuation funds are major shareholders in listed Australian companies. This influences corporate behaviour. Many companies need taxable profits as shareholders want full franking of dividends. If dividends were not franked, businesses would probably lower their payments and shareholders would seek more favourable capital gains as an alternative.

Dividends (including the associated Franking Credits) provide a solid source of reliable income for retirees with relatively low levels of volatility. For those retirees who are prepared to live off their income and consume capital by taking profits occasionally, they provide protection against inflation and longevity risks.

Finally, if the government wants to cut the cost of franked dividends, this should be done as part of tax reform which includes cutting the corporate tax rate (say) to 20%. The imputation credits would fall in proportion.

7.2 Guaranteed retirement benefits

Several organisations have suggested that deferred annuities would be a suitable product to protect against longevity risks. These products pay a lifetime annuity but commence at an advanced age. The commencement date is often chosen at the age of life expectancy at the time of retirement – typically, 85 to 90. At present, the assets held by the life insurer during the period of deferment are taxed at the superannuation rate of 15%. As soon as the annuity commences to be paid, the assets are tax-free on earnings like any other pension product.

We have suggested that pension earnings be taxed at the same rate as accumulation earnings, say 12%. In this case, creating tax neutrality for deferred annuity products would be simplified, as they could simply be subject to the same single tax rate as other superannuation.

7.3 Grandfathering

We consider that grandfathering of benefits creates legacy products and long-term anomalies. For example, should individuals holding assets purchased prior to 1985 still be exempt from CGT on future sale? This provision is now 30 years old.

Perhaps grandfathering should be restricted to 10 years.

7.4 Joint superannuation accounts

We have canvassed the possibility of superannuation funds holding joint accounts for married couples. This already happens in the SMSF segment as about 85% of SMSF funds are run for a married couple[16].

Joint accounts should lead to reduced fees, higher levels of engagement and higher levels of adequacy.

Although it is not a tax issue, we believe joint super accounts for married couples will also make the system simpler and easier to understand.

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[16] According to research from the SMSF Association

8. Cost of recommended changes

8.1 Policy costings

We have projected the impact of our suggestions for reforming tax of contributions, earnings and the Age Pension on:

- aggregate superannuation savings
- tax collected on superannuation earnings and contributions
- Age Pension expenditure
- tax concessions

Our calculations of the value of concessions for contributions are based on the current personal tax rates. As the top marginal tax rate of 49% (45% plus 2% Medicare levy plus 2% Temporary Budget Repaid Levy) is too high, the concessions are overstated.

We would hope that the top marginal tax rate could be lowered to 40% (including Medicare levy) and the cost of the concessions would then reduce significantly. We have modelled the results including a reduction in the top marginal tax rate to 40% in the 'combined policies' scenario.

The results are given in Table 14 (impact today) and Table 15 (projected forward 40 years).

Table 14. Policy costings – 2014-15 FY

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension^	Total Savings
	($m)			
Reform contributions tax	6,587	(17)	0	**6,569**
Reform earnings tax	0	390	0	**390**
Abolish part pensions	0	0	0	**0**
Combined policies*	**5,696**	**377**	**0**	**6,074**

*components may not add due to interaction effects
^there is no immediate effect on the Age Pension given the recommended grandfathering arrangements

Table 15. Policy costings – 2055 (in 2014-15 Prices)

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension^	Total Savings
	($m)			
Reform contributions tax	3,138	4,361	(605)	**6,894**
Reform earnings tax	0	6,575	(1,636)	**4,939**
Abolish part pensions	0	0	51,908	**51,908**
Combined policies*	**3,138**	**6,098**	**50,248**	**59,484**

*components may not add due to interaction effects

8.2 Impact on the equity of government support

We have modelled the impacts the combined reforms would have on lifetime government support provided to the population by income decile as well as the top 5% and top 1% of earners. The results are shown on two bases:

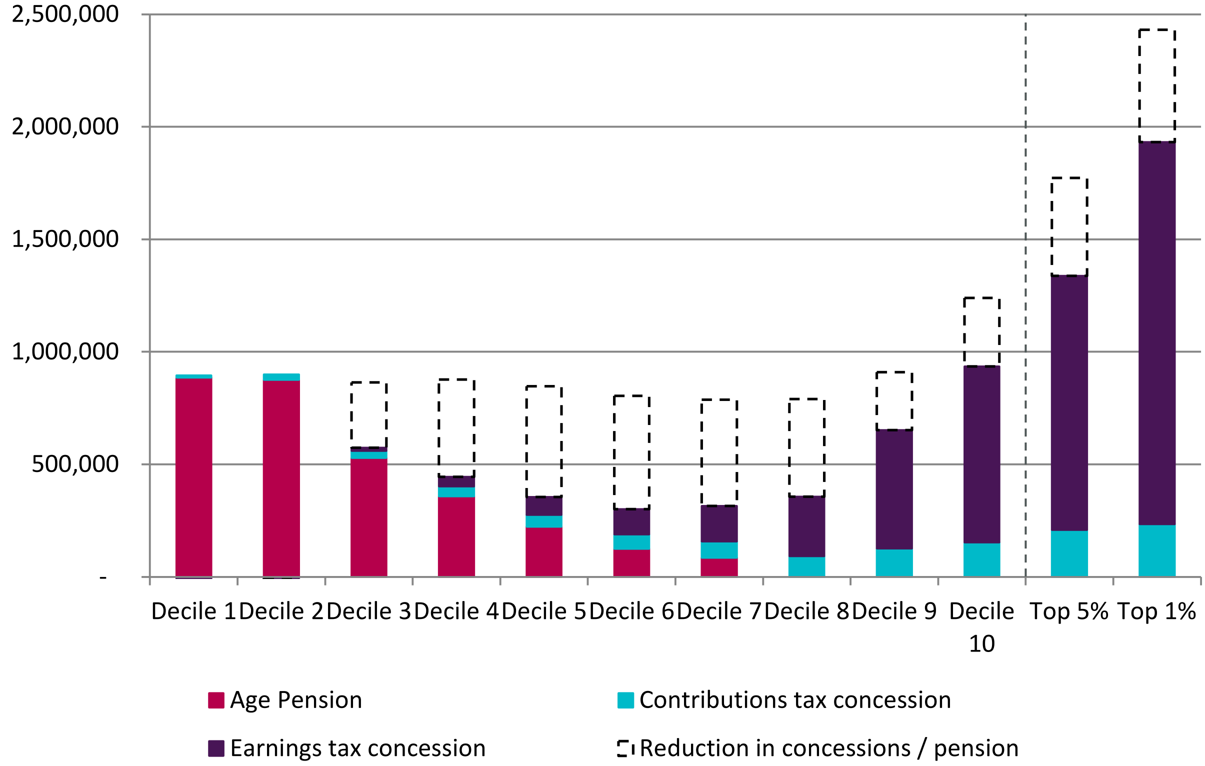
1. Drawdowns on superannuation are similar to current member behaviour (Graph 6)
   - we assume that some members leave bequests to their estate
   - income stream drawdowns are modest, (equivalent to 1 / life expectancy subject to minimum drawdown rules)
2. Drawdowns on superannuation are optimised to extinguish assets by life expectancy (Graph 7)

The results show that:

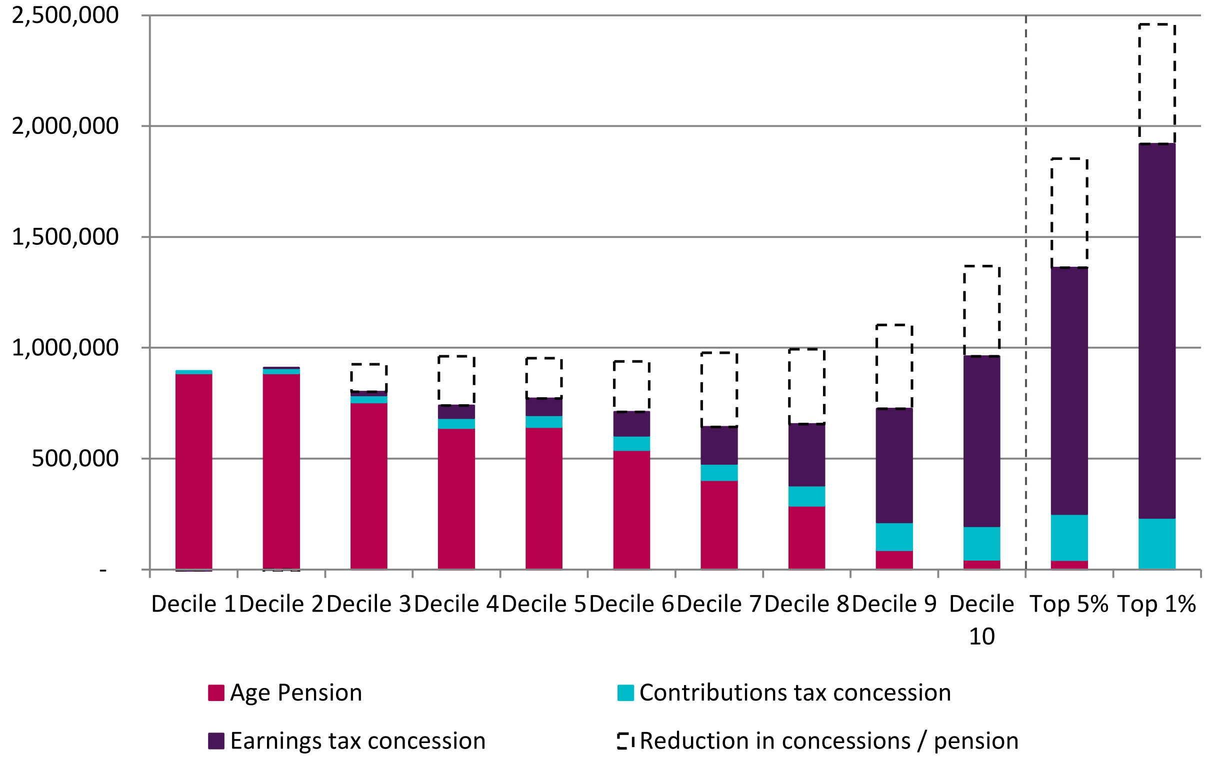
- The combined effect of the policies reduces government expenditure across income deciles 3 - 10
- Income deciles 1 and 2 receive more in the way of assistance due to reforms to contributions tax
- If there is no change to member drawdown behaviour, there would be a large reduction in middle class welfare as well as a reduction in tax concessions to the rich
  - Under this assumption, the policy changes would have too big an impact on middle Australia
- If retirees choose to drawdown more of their super to make up for the loss of the part pension, there will be only a modest reduction in government expenditure to the middle class. However, there will still be a large saving in tax concessions to the rich.
  - This is a much fairer outcome

In reality, the reduction in government support is likely to result in a pattern somewhere in the middle of these two scenarios; retirees are unlikely to extinguish savings by life expectancy as they do not know how long they will live. One of our earlier suggestions, a universal Age Pension without means testing from age 90, could have the effect of giving retirees more certainty at advanced ages, which may encourage them to drawdown on their savings earlier. Further, it could encourage retirees to downsize or move to aged care facilities at advanced ages without impacting their Age Pension eligibility.

Graph 6. Government support by income decile – whole of life, couple retiring in 2055 (today's dollars) - combined policies (current drawdowns)



Graph 7. Government support by income decile – whole of life, couple retiring in 2055 (today's dollars) - combined policies (optimised to life expectancy)



8.3 Impact on adequacy

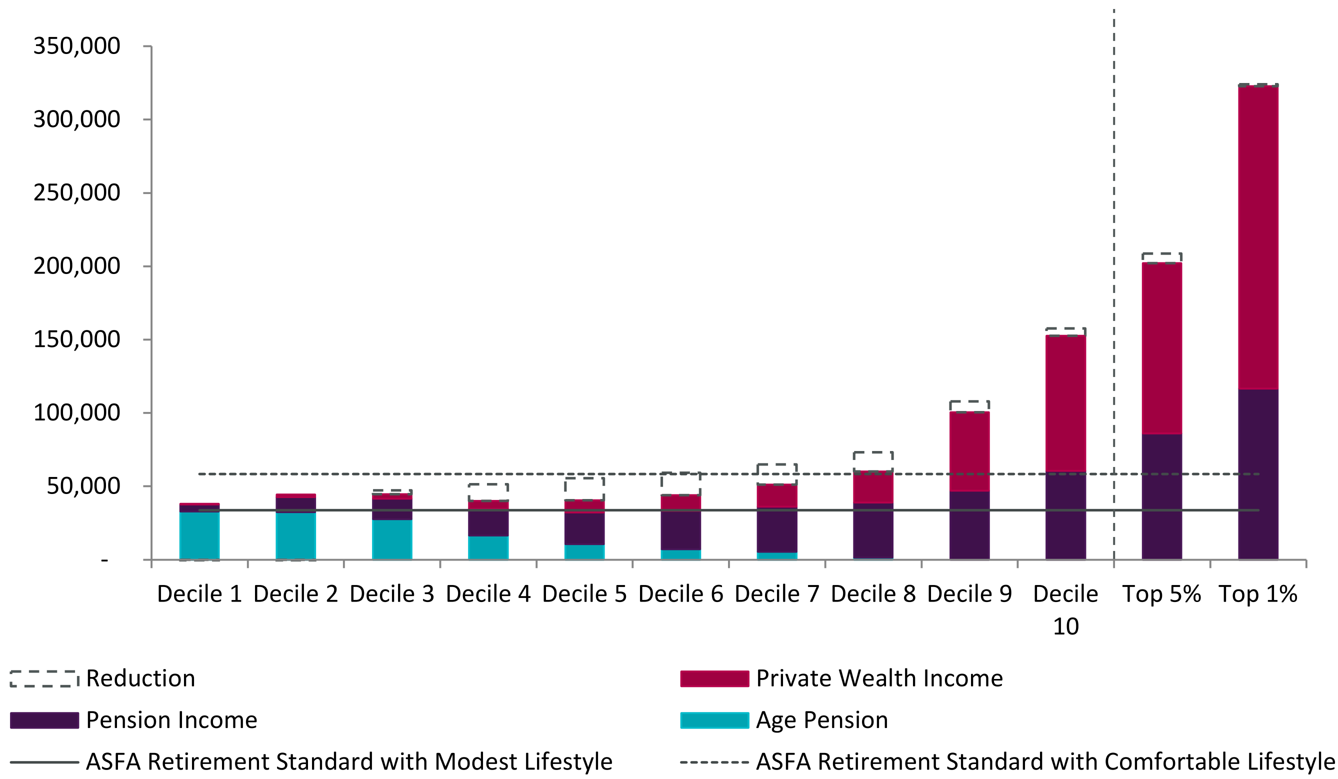
We have modelled the impacts the combined reforms would have on adequacy (relative to ASFA comfortable and modest benchmarks) by population by income deciles as well as the top 5% and top 1% of earners.

1. Drawdowns on superannuation are similar to current member behaviour (Graph 8)
   - we assume that some members leave bequests to their estate
   - income stream drawdowns are modest, (1 / life expectancy subject to minimum drawdown rules)
2. Drawdowns on superannuation are optimised to extinguish assets by life expectancy (Graph 9)

The results show that:

- Australians across all income deciles should receive at least a modest retirement income
- Those below decile 5 are unlikely to receive a comfortable retirement under current or adjusted tax scenarios
- The policies modelled could reduce retirement incomes below comfortable levels for some deciles if behaviour does not change. However, comfortable levels of retirement income to life expectancy could be achieved for some deciles if drawdowns increased.
- Again, in reality the result will be somewhere in between. Middle Australia will most likely receive a retirement income somewhere between the ASFA modest and ASFA comfortable standard.

Graph 8. Average retirement income by income decile for couples retiring in 2055 - combined policies (current drawdowns)



Graph 9. Average retirement income by income decile for couples retiring in 2055 - combined policies (optimised to life expectancy)