Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

I would like to make a Submission in relation to the Tax White Paper and on the overlap with the concurrent discussions on the Age Pension.

INTRODUCTION

1. When the Age Pension was introduced by the Federal Government many years ago, it was intended as a Welfare measure to ensure no-one would be left in poverty. It was intended to cover the basic **cost of living**, and not intended to be:

- a right for being a taxpayer, or
- a compensation for those that could, but chose not to, save for their own retirement because they could rely on a Government 'hand -out', or
- to account for the **increasing prosperity** of the nation.

Recommendation 1:

The Pension was welfare for the needy, and we should (slowly) revert to that objective.

2. It should be noted that those that save and invest in a Defined Benefits Pension (or Superannuation), such Pensions are linked to the CPI. So, given enough time, those in receipt of a public 'charity' Aged Pension linked to Average Weekly Earnings will be receiving more than Superannuants whose 'pensions' are linked to the CPI. That's a ridiculous situation. If it's fair for Defined Benefits superannuants eg those receiving Federal & State Government superannuation it should be fair for 'Pensioners'.

Recommendation 2:

The Age Pension should be indexed to the CPI, and not Average wages.

SUPERANNUATION CHANGES

3. In relation to Superannuation, I believe there is much dog-whistling (or is it 'Urban Myths'?) about three main issues -

A. So-called wealthy individuals divesting themselves of assets just so they can get the Age Pension and/or the Health Card;

B. What actually constitutes a wealthy superannuant; and

C. "There are large numbers of 'wealthy' superannuants who also receive a whole or part Age Pension?"

4. Claims are made by politicians, radio & TV commentators, Reporters, radio call-back responders, etc that make unsubstantiated claims about such things. I even heard **John Hewson** refer to "pensioners in $10m homes". Come on! Really? How many? Is it really a drag on the budget? In any event, nothing (presumably) was done outside the rules.

5. I like to go by the evidence......and I cannot find any statistics that indicate any of the above issues are of any significance to the budget or a burden to the taxpayer. That's not to say that these matters do not arise, only that they seem to have been grossly exaggerated.

6. On TV on one of the recent "PM Agenda" shows, **David Speers** asked the panel:

(rhetorically) "How much do you need in your Super? What is your Super for? It is to last until you and your partner die. Should it also be there to build an estate to pass on to the next generation?" **Mark Kenny** responded : " The point of the tax concession is to take pressure off the taxpayer in your retirement."

But no-one quoted any statistics !

7. On a Friday night's "Viewpoint" show, the compare **Kris Kenny** said to **Adam Creighton** (Economics Journalist, The Australian) : "*You've* crunched the numbers on some of this [*people in homes over $2m in value and with other assets of over $1m*] and still getting the pension. [*How many are there?] "* **His response** *: "*The actual number of households I don't know, but the cost to the Government is..[*I think he said $350m]."* Repeat : He doesn't know.

8. On **Andrew Bolte's** TV Show a few weeks ago, he quoted the Opposition Shadow Treasurer Mr Bowen stating that the top 10% of income earners get 30% of the superannuation tax concessions. Well that's not surprising as it is only later in one's working life, when wages are higher and expenses reduce in comparison to one's wage, or even disappear, (eg mortgage, school fees) is a worker able to put larger amounts into superannuation. *Which surely is exactly what any government would want!*

9. Mr Bowen was also quoted as saying that there are more than 475 people with more than $10m in their superannuation accounts and they earn $1.5m pa tax free. Well, let's examine this claim. If it's a self managed super fund, it can have up to 4 members in it eg family members. So it's possible that each member of the fund has only $2.5m, which I think is what at least one Social Security advocate association is recommending as being a fair sum before taxation is applied. Further, the quoted $1.5m pa earnings is a misuse of statistics - only in a good year does a fund earn this (15%). Super funds on average, over time, earn about 7.5% pa ie about 4.5% 'real" ie above inflation[1]. Now that is only $750,000 actual or $450,000 real, on a $10m Fund. And if dived by 4 members equals $112,500 pa (real) each. Now that's a good income, but its well below the so-call rich barrier of $180,000 pa. There have been many other times when well known people have made criticisms without quoting statistics or facts, eg by radio commentators ....but the point is made.

10. Having argued the above, I recognise that those few wealthy individuals and families that *do* have large funds already in Superannuation are indeed getting large tax benefits. The question is : is it right to apply a tax on them now, retrospectively, is it good policy, and would it make a big difference to future budgets by taxing those funds (as distinct from future new large funds) ?

11. And finally, as I address below, the rise of large numbers of huge Superannuation accounts is not likely to arise again with the current rules, and can be deterred and even prevented, with new rules and with the introduction of new taxes.

THE CURRENT SITUATION - Superannuation

12. The aim of Government (of any persuasion) is to encourage people (eg through tax benefits) to save for their retirement so that, **ideally, eventually very few will be reliant on the Age Pension in whole or in part as they will be fully or near fully self-supporting *for the whole of their retirement***. But is this realistic, and what is required to achieve this? I found it was very interesting when working 'backwards' from this main objective of compulsory Superannuation, which analysis follows.

A. The Pension Assets Test & Incomes Test now applies to funds in Super.

B. A **Single** person is NOT be eligible for a Pension (and side benefits) if their Assets exceed about $775,500

C. Logically then, for that person **NEVER** to be eligible for any part of a Pension or Health Card *during the whole of their retirement*, their Super balance must **NEVER fall below** $775,500

13. I am not an actuary, but applying various tables published by financial institutions and magazines, and making the following assumptions (in some cases to make the calculations easier)

- a Single retiree
- drawing down the minimum requirement each year on 1 July in one payment that covers the whole year using the current draw-down rules
- makes no additional Lump Sum withdrawals
- retires at age 65, dies approaching age 91
- the fund grows at 4.5% pa in real terms on average[1],
- calculations in today's dollars, thus ignoring incremental increases due to inflation and any indexing,

then

a) that person must start with a fund of about $2.8m in value to ensure it NEVER goes below $775,500 and

b) This would require regular savings of $370/wk.
The current Average Wage is $75,000. So Superannuation deductions would have to be 25.6% Clearly never achievable in the current environment (though I believe Singapore has achieved this level, or even higher)

c) that retiree will NEVER leave an estate of zero value, it must at least be about $750,000

d) that $750,000 in (e) is probably partially taxed and will go into the economy in some way as it will be distributed to beneficiaries generally in a taxed environment.

e). For a married couple, it is likely these numbers would increase by at least 50%.

14. Interesting comparisons :
- minimum drawdown at age 65 on $2.8m is 5% = $140,000 pa tax free
- current maximum term deposit earnings on $2.8m = $90,000 pa taxable (approx, and falling)
- single aged pension incl benefits (excl rent allowance) = $25,000 approx (tax free, indexed)

POLICY CONTRADICTION

15. Drawdown rates increase with the age of the retiree and are supposed to leave the retiree with *near zero funds* on death
and
Government policy is that a citizen, *ideally*, should be self-funding *till death and not rely on the Age Pension* or Health Card.
This is impossible as they contradict ! When the balance falls below $775,000 the retiree becomes eligible for a part-pension plus benefits.

16. **So, how then does the Government get as many as possible off the *full* Pension, noting that this will leave a substantial number on a part-Pension (+ benefits).**

a) Current Average wage =$75,000 pa = $1442 /wk
Consider Super Contributions of $72/wk = only **5%** approx of the Average Wage
(A low paid worker @ say $35,000 pa ; Contribution of $72/wk = **10.7%** of wage)

After allowing for :
- the 15% contributions tax, the actual net contribution = $61/wk,
- a 45 year working life,
- contributions into a fund earning 4.5% pa (real, after costs and fees)[1],
- Single, a non homeowner
- drawdowns are kept to the Government specified minimums

constant average super contributions of $72/wk will achieve a Fund starting value of $0.46m. **This person can start claiming a part pension immediately, and the full pension from about age 70**. (For a homeowner it is a part pension immediately on retirement and full pension from age 80.) And any additional drawdowns brings these eligibility ages for the full pension lower. **Clearly this does not meet the Government's objectives.**

b) Contributions of $137/wk (9.5%) will achieve a Fund starting value of $1.04m. With only the minimum drawdowns, t**his person can start claiming a part pension at the age of 70** (and 67.5 if a non homeowner). With a prospective retiring age of 67 (male) and in time maybe higher, this too **will not meet the Government's objectives.**

c) Similarly, if one could achieve it, a starting balance of $1.5m and minimum drawdowns, non homeowner single part pension claims start at age 77.5; and for a $2m balance, at age 83. And ***ALL*** these ages can be brought forward if Lump Sum drawdowns are permitted.

d) **It would seem that only the latter starting sum of $2m, with no withdrawals above the current minimum drawdown limits, will deliver the Government's objective of having a major impact on future budget outlays**.

e) But preventing additional withdrawals would not only be unfair to those waiting to enjoy their retirement after perhaps sacrificing certain expenses during their working life, it would be politically unpalatable.

A COMFORTABLE RETIREMENT

17. Many organisations such as ASFA[2] suggest that a "Comfortable Retirement" for a single person requires a minimum of $42,000 (after tax or tax free). To maintain this to say age 90 means that the Super Fund would require a final balance of about $389,000 (minimum drawdown is 9% at age 89). Tracking backwards would mean a starting balance of $1.4m. And this retiree would in fact be entitled to an increasing part pension from age 72 if a non homeowner and from age 75 if a homeowner. Thus taking his total income slightly above $42,000 pa.

18. If the guiding principle is $42,000 pa, and if the Government is comfortable in supplementing the retiree's superannuation income through a part pension up to roughly that amount, then a Super starting balance of about $1.0m would probably be sufficient to meet this aim, *though this almost certainly will encourage additional drawdowns to improve the amount of the part pension*.

CONCLUSION 1

19. Given the difficulty under the current rules to have a super fund of $2.5m, when my generation's children (the Baby Boomers children) reach 67, very few will be able to rely on their Super contributions alone and will rely on obtaining a part pension for most of their retirement.

20**. PROBLEM : is it appropriate for Government to discourage or even prevent extra drawdowns?**

21. Retirees generally are only in a position to put away larger sums into Super in the latter stages of their working life. Such high cost expenses such as raising children, discharging a mortgage etc have gone and they have advanced in their business or employment to a stage where they can contribute extra to Super. They may well be delaying such high cost things as a holiday, a new car or even the discharge of a mortgage, until retirement to enable a debt free and enjoyable time. To deny the ability to have such flexibility in retirement seems unfair and unjust. This is just what Super savings is for.

22. However, it is also probable that drawing down such funds will increase the retiree's entitlement to a part or full pension, plus its benefits. This clearly is not the intent. So is there a way to meet both objectives - freedom to drawdown and spend while not increasing pension entitlement? I believe so :

23. **Apply a Deeming Test to all drawdowns in excess of the minimum drawdown**. These would be called **Excess Drawdowns**, and would be positively and negatively cumulative.

24. For the purpose of calculating the minimum drawdown in any one year, the Super fund balance could be 'deemed' to still have those preceding Excess Drawdowns, and the minimum drawdown amount could be based on that notional sum. Alternatively, and easier and fairer, the minimum drawdowns could apply to the actual super balance. This latter method would have the advantages of extending the fund's life and push out any future part pension eligibility.

25. To avoid Asset Divestment to qualify for a Pension, Lump Sum withdrawals could be cumulative, and called the Cumulative Lump Sum (CLS). It would be a **deemed asset** for Government Benefit Application purposes.

26. Unlike the Gifting & Divestment rules for age pension eligibility ($30,000 over a rolling 5 year period), the CLS shall have no time limit.

27. Only non-concessional contributions should be permitted to 'pay back' any Cumulative Lump Sum (CLS) already incurred. A CLS should never be less than zero meaning contributions cannot be used to offset future prospective Lump Sum withdrawals

28. Replacement of the accrued deemed amount in whole or in part should be permitted at any time without a 'Work Test'.

29. The accounting for this would be easy, and it would allow new retirees to go on a holiday, buy a car, discharge a mortgage etc without penalty (and replenish it later) - but it will have no impact on their eligibility for a Pension. It would be their choice.

Recommendation 3:

Introduce the concept of Deemed Assets within a super fund for Lump Sum withdrawals in excess of the minimum drawdown amount.

TAXING SUPERANNUATION EARNINGS/PAYMENTS

30. There is great concern over the tax concessions given to large funds. To tax them retrospectively is unfair and would not raise large funds for Government in any event. Further, with the introduction of limits on permitted deposits into a fund, such huge funds will in time disappear. Also, there are still ways to get around these limits, and I offer some suggestions in that regard.

Recommendation 4:

There should be no additional tax burden on CURRENT larger super funds balances or withdrawals.

Recommendation 5:

If there *must be* any reduction in the various tax concessions of Super earnings I suggest an incremental tax on that part of the actual payment that is in excess of $180,000 pa minimum drawdown amount only, and that any tax not be retrospective.

TAX HAVEN FOR BENEFICIARIES

31. There are now limits on how much a person can contribute to Super, so the days of piling in $millions every year are over. Also, no matter how much is in the Super Fund, when the Retiree dies all his/her funds are distributed to persons or groups outside the Super environment and serve the economy. Thus the current concerns over very large balances are only temporary.

32. Never-the-less, while low & middle income workers cannot make large contributions to Super till later in their working life, which should be encouraged, it *is* possible for the high worth and high income individuals and families to make very large

non-concessional contributions each year throughout their and others' working lives eg to themselves, spouses, parents and children, thus protecting assets in a tax favoured environment and grow large balances. For example, the maximum of $180,000 pa gifted to a child for all their working life, and with earnings compounded in a tax friendly fund, gives a very nice sum indeed on that person's retirement. **This could be limited.**

Recommendation 6:

Use an incrementally increasing scale of permissible concessional and non-concessional contributions linked to a person's age.

33. This could be zero until say age 40, $25,000 pa ages 41 to 50, and so on. This would also suit most peoples ability to contribute. The objective should be to obtain about a $2.5m balance at retirement age.

LUMP SUM DRAWDOWNS & MILLIONAIRES HOUSES

34. Addressed in part, above, but also : where is the evidence that millionaires are divesting their assets just to get a low Pension? It doesn't make sense that smart investors would move large sums from a low tax or nil tax environment with good yields, just to get the Pension. In any event, there are Asset Divesting (eg gifting) Rules regarding pension eligibility. My recommendation on Deeming of Excess Drawdowns will overcome this matter.

35. Again, where is the evidence that there are many people in multimillion dollar homes even getting the Pension? Or conversely, selling up and piling their assets into buying a multimillion dollar home (to become their residential address) to avoid the assets test for the Pension? Who would be so silly? There may be a few but the rest should not be penalised for those fools, and supervision would be expensive.

36. I am aware that some may have qualified for the Health Card by moving assets into Super, but this loop-hole is now closed with the introduction of including both an assets and incomes test that includes Super Funds & income.

Recommendation 7:

If not already in place, Superannuation assets and income shall be included in any test for the Health Card, with no time limit in considering divested assets.

37. COMPARISON : PENSION v SUPERANNUATION INCOMES

- A Single Pension, with all eligible Supplements = $22,365 pa
- Add other benefits excl rent allowance (Health Card, reduced Rates, reduced Car Rego etc) = say $25,000 pa TAX FREE
- Financial Advisers, and even the Government, tell retirees to invest safely, at minimum risk, to protect their Capital and income *at their age*. Thus Pensioners wishing to protect their Capital will utilise Bank Accounts & Term Deposits in the main.
- In the current low interest environment (and set to go lower), the deposit required in Term Deposits @ 3% to earn the equivalent of the tax-free pension of about $25,000 pa is about $900,000 (taxable)

- This is close to the $1m figure suggested by many organisations as a minimum Super fund balance to give a basic level of standard of living. It is also the same as what was calculated above (para 16 b).

CONCLUSION 2

38. A Self Funded Retiree with $1m in Super is not that much better off than a Pensioner !! And I say worse off in many cases, as no doubt some Pensioners were spending on lifestyle benefits for 45 years while the superannuant was doing without while saving ! So if the Pension is to prevent poverty and give those that rely on it a basic quality of life....a superannuant with $1m in their fund is in exactly the same starting position. Big Deal! Why sacrifice for 45 years many would ask. And with that amount, superannuation asset divestment is lucrative and the Government does not meet its objective of moving many people off the age pension and its benefits. Clearly a starting sum of about $2.5 m is required, and incentives must be put in place to achieve this, or not removed to discourage such saving.

Recommendation 8 :

The superannuant deserves a better deal than that of an Age Pensioner. A *much better* deal.

Recommendation 9 :

The Transition to Retirement Scheme should be abolished.
39. This is just a tax lurk to churn taxed income into an untaxed environment.

Recommendation 10 :

The Work Test should be abolished.
40. This inhibits a person's ability to save for their retirement. Who cares where the deposited funds come from (gift, inheritance, lottery win, work, etc) as long as it targets the purpose of retirement? Besides, removing this fits in with the theme of removing red tape.

Submitted by
Raymond Shaw
North Bondi
NSW

Note 1
According to Chant West & other) Charts, one can assume the long term average of lower risk fund streams averages about 4.5% above inflation (effectively 4.6% pa for weekly deposits compounded monthly)

Note 2
ASFA = The Association of Superannuation Funds of Australia Limited

Disclosures :
I receive a CPI indexed CSS 'pension'
I have a SMSF under $1m in value
I am the only one in my family that has a SMSF