Retirement Income review - Annuities

I wish to make a submission to the Retirement Income Review Panel regarding annuities as they are currently offered.
My thesis is that Annuities currently offered in the current market place are poor investments made even poorer by the unfair taxation by the Australian Taxation Office (ATO).

I request the Review Panel agree my arguments below and recommend:

1. That the marketers of annuities be required to offer annuities with better returns and
2. That the ATO give full and immediate credit for the full amount of the deductible amount.

Currently available annuities
I will use the annuities marketed by Challenger Annuities (as I understand they are the largest marketer of annuities). https://www.challenger.com.au/personal/products/payment-rates/lifetime-annuity-payment-rates?cid=ps_br_c_generic_google_df_

An annuity is like a reverse bank loan, you pay a large sum of money now for a stream of payments into the future. There are two main forms of annuities:

a. Term annuities. These are payable for a fixed term from the date of purchase (typically 10 years) and
b. Whole of life annuities. These are payable for the remaining life of the purchaser.

My submission relates mainly to whole of life annuities. Within whole of life annuities there are two categories:

a. Fixed amount and
b. Indexed amount (typically indexed using the consumer price index).

Typically, a person buys an annuity either at commencement of their retirement or some time into their retirement. Typically, there are two types of pension available.

a. Whole of life with no refund if the annuitant dies early, and
b. Whole of life with a partial refund if the annuitant dies early

Annuities should be an attractive retirement income investment. They provide a guaranteed income indexed at cpi for the remainder of the annuitant's life. The annuity that a member of the public is most likely to buy a whole of life with partial refund if the annuitant dies early and with full indexation and I will use this to demonstrate my arguments.

The table below is from Challenger. The table gives the amount of annual pension paid for $100,000 of purchase price with partial refund in first 15 years.

AGE *		**AMOUNT OF INFLATION PROTECTION**		
		Full	Partial	Nil
65	100%	$2,679	$3,004	$3,094
70	100%	$2,671	$2,950	$3,017
75	70%	$3,742	$4,075	$4,144
80	20%	$5,627	$6,208	$6,376

Let us consider that the annuitant buys such an annuity for $1 million at age 65 and that inflation is 2% pa.

Life expectancy for a 65 year old male is another 18.5 years, ie to age 84.
https://guides.dss.gov.au/guide-social-security-law/4/9/5/48

Rate of return Issue

The pension for such a person would be $26,790 pa, increasing at 2% pa. Assuming he lives to 84, he will have only collected $651,000. He would have to live to 93 just to get his $1 million back. The internal rate of return to age 84 is **minus 1.28%!!!!** This in an era when superannuation funds have a mean earning rate of 8%!!! Surely they can do better. He would be seriously better off just leaving his $1 million in the bank and drawing down as required and at least earning a small amount of interest. **I ask you to recommend that annuity providers provide annuities with a seriously better rate of return.**

Taxation Issue

But it gets worse.

Annuity annual payments comprise two components, the return of the cost in the annuity cost prorated over the life of the pension (called the deductible amount) and a taxable amount. The taxable amount is the difference between the annual annuity payment and the deductible amount. In this case the taxable amount is negative between the start of the annuity and age 100!!!!

In earlier years, the full annuity payment was shown at item 7 in the tax return and the deductible amount was shown at item D8. If this were followed today the annuitant would have a deduction he could apply against other income. Regrettably the ATO recently changed the rules. The Annuity payment less the deductible amount is to be shown at income item 7 in their tax return and if the amount is less than zero, then the annuitant is to show zero at this item, ie the ATO is stealing the annuitant's tax deduction. In the above case the annuitant loses a tax deduction of $27,000 in the first year, falling to $15,000 in the 15th year. If the difference between the annuity payment and the deductible amount had been positive, the annuitant would have had to pay tax on it at their marginal rate.

This treatment is unfair and I ask you to recommend the ATO go back to its previous practice of allowing tax deductions where the deductible amount is greater than the annual annuity payment.