Retirement Income Review 2019/20

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Personal Background

I am a 68 year old retiree, married with three adult children. I hold a degree in Economics from the ANU and have worked mainly in natural resource management. My wife (retired nurse/midwife) and I live off my defined benefit superannuation income supplemented by income from our modest joint self-managed super fund. This provides for an adequate living. We do not receive any Centrelink or other direct government benefits. This is a personal/private person submission with no affinity to any formal organisation.

Context

In general I support the 'three pillars' approach to retirement income in Australia as set out in the consultation paper, but with necessary amendment. I also concur with the approach set out in the consultation paper in adopting the *four principles* as a means of assessing existing arrangements.

At the outset, I would like to suggest that at a higher level is the question of what kind of society we wish to live in. Do we wish to take a path towards an inclusive community model with broad-based support for all sectors (aka the 'Scandinavian model') or an individualist 'me-first', minimal tax/government model (aka the 'United States')? I propose the former as providing for a healthier social environment and greater opportunity across all sectors.

The Four Principles

As there can be considerable overlap across the *four principles*, I will address this matter essentially by means of a set of value statements as follows.

Who Pays?

- Access to quality housing, personal and community space, recreational opportunities, quality water, air and environmental health and absence of congestion contribute to wellbeing in retirement but may not be well measured in dollar terms. These are important quality of life components that must continue to be pursued and funded where necessary through government revenues.
- All members of the community benefit from public goods such as compliance, public administration, legal systems, defence and infrastructure to name a few which need to be funded in addition to the formal government pension system. All members of the community, pre- and post- retirement should contribute towards these services according to their means.
- Persons who work hard and hone their skills and abilities should benefit from their efforts. However, not all members of society start with the same opportunities and many require support via a progressive taxation system.
- Without good reason to expect other than modest national growth in productivity in the medium to longer term, the capacity of the working population to shoulder a greater burden for pensions and aged care will be limited accordingly.

- As per capita real income is increasing at levels close to zero, we should not expect productivity increase to resolve the looming budget problem associated with an aging population. With the required infrastructure investment per immigrant in the order of $100,000 the net contribution from immigration to support our elderly population is limited.
- The capacity of the Australian community to support its retiring and aging sectors is well within our means. The increasing cost to federal and state budgets of pensions, health and aged care can be met, and will have to be met, through revenue fairly and reasonably sourced from both pre- and post- retirement incomes.
- Pensions, and welfare generally, are a recurring non-capital expense that should not be funded by debt.

Adequacy

- There are different views about what is an adequate government pension retirement income. I have no expertise in this area. The amount should be a respectable margin above poverty level but lean enough to encourage saving by those seeking a higher living standard post-retirement.
- As at present, the taxation system should encourage those with more moderate means to strive to save towards their retirement and not discourage work to supplement income after retirement.
- The pension should be reviewed periodically by a tribunal. The tribunal would consider pension levels for non-home owners.
- The pension should be linked to average real wage movements, not CPI. CPI is an inadequate measure for the cost of living, replacement cost and housing but that is a matter for a tribunal to consider.
- Increasing home ownership could potentially generate large budget savings in the longer-term in the form of reduced rental supplementation. Governments (state and federal) must address other factors that make it harder for Australians to own their own dwelling, including.
    - negative gearing for housing,
    - the rate of immigration (pushing up demand).
    - Ensuring that sufficient low cost housing is made available for lower income groups.

Equity

- Australian workplace activity has moved away from large scale manufacturing and this trend is unlikely to reverse in the medium/longer term. Our living standards are dependent on having a highly skilled, innovative and healthy workforce that can compete on a global scale. Education and health are key requirements.
- A person retiring at age 65 can look forward to in the order of another twenty years of life, on average.
- Retirees are entering their period of highest health and age care cost. Those with private health cover continue to be subsidised in terms of insurance premiums, medical and pharmaceuticals (access to PBS) and also by having access to the public health system, which is itself under immense funding pressure. Aged care and carer support is heavily subsidised across all retirement income levels and the recent royal commission has questioned adequate funding by governments.

- Prosperous retirees should not be permitted to freeload upon a younger generation when those retirees are well able to contribute towards their own upkeep. It is also reasonable to expect the more prosperous to make a continuing contribution towards public goods and community development (including education of the next generation) to grow the society in which they were able to generate and accumulate that wealth.
- The more prosperous sector that has paid taxes that contribute towards the funding of pensions and health benefits for pensioners, but who themselves do not receive a pension, may well consider themselves entitled to some concessions at time of retirement. They already get that through the Superannuation Guarantee (SG) system, to a level the lower income retiree can only aspire.
- Recent studies have demonstrated that in retirement, the well-off are able to utilise the superannuation system, and other taxation concessions such as family trusts, negative gearing, income sharing and franking credits to substantially reduce their taxable income. Continuing subsidy of the well-off is inconsistent with the concept of a progressive taxation system.
- On equity and sustainability grounds reducing taxation concessions available to those who have the capacity to contribute in retirement, would increase the revenue base for government pensions and aged care.

Example of current system excess benefits
A well-off couple can have up to $1.6m each ($3.2m in total) in a self-managed superannuation fund generating a tax-free income of $80,000 each ($160,000) at 5% per annum plus real capital growth. This is a modest return estimate as during the last decade the ASX generated annualised growth of 8.2% plus dividends (and franking credits).

If that couple had additional income generating assets amounting to $400,000 each producing taxable income of $20,000 each ($40,000 in total) they would have to pay no tax and no Medicare levy on a total household income of $200,000. In addition they would be able to utilise franking credit benefits to reduce taxation on any further investments.

- By judicious use of the 'work rule', the couple can also during their ages 65 to 75 (ie half their average 20 retirement) deduct $25,000 each from their individual taxable incomes and put it into their superannuation fund.
- This concession allows no tax or Medicare levy to be paid on the $25,000 concessional contribution on what otherwise may have been income at the highest tax bracket.
- They can also add up to $100,000 in non-concessional contributions to their superannuation fund, should it fall below the maximum level.

Well known entrepreneur Dick Smith recently declared that, as a well-off person, he has been able to generate a taxation free income in excess of $500,000 p.a. by utilising the current taxation concessions available to him. He also need not pay Medicare levy on this non-taxable income.

Sustainability

- The Federal Government does not have an expenditure problem with superannuation/pension arrangements. It has a flawed revenue problem.
- There is no indication that the SG system was intended to enable retirees to keep topping up their untaxed, or lightly taxed SG funds with what otherwise would be taxable income, for the purpose of reducing taxation on those non-SG funds.
    - The requirement to withdraw increased percentages from the fund as retirees age suggests that the funds were intended to be depleted over time.
- Without wholesale change to superannuation taxation/concessions arrangements the budget position will become unsustainable. 'Unsustainable' meaning that the system will increasingly impact other federally funded programs unless funding revenues are increased substantially.
- Other key programs relating to health, education and social security should not be funded from debt nor eroded to pay for retirement/aging welfare.
- The current SG system is back to front. Savings incentives should continue to be applied at the accumulation earnings/capital growth phase but taxed as part of normal income at the withdrawal (pension) phase.

Cohesion

- The SG system has been progressively modified over time to enable it to be used to divert taxable funds towards lower-tax pension arrangements. It is expected that revenues will continue to be eroded under these arrangements.
- Ideally the current SG system should be replaced with one where income at the pension draw-down phase would be added to other income for assessing total taxable income.
    - The current double incentive which provides tax relief at both contribution and withdrawal stages is excessive and unnecessary under a mandatory SG system.
    - This also would correct some of the inconsistent treatment of franking credits between self-managed superannuation (SG) funds and those under retail/industry management.
- Within existing superannuation arrangements it is certain that the wealthy retiree will continue to manipulate the SG system to gain a taxation advantage on non-SG income by making top-up contributions.
    - By removing the top-up provisions, retirees on lower incomes and therefore lower tax rates, will have less to lose than those with larger assets and incomes. This would correct much of the distortion in the current system.

Recommendations

If there is to be no wholesale modification of the superannuation system as suggested above, it is recommended that at least the more excessive concessions be removed:

- Medicare levy should be fully payable on withdrawals from all superannuation funds.
- Franking credits should not be paid to retirees or non-retirees where income is zero or negative.
    - If franking credits are removed from zero incomes then the ability of retail/industry SG funds to use the positive incomes of contributors at the accumulation phase to offset the negative incomes of those at the pension phase should not be permitted.
- People who work beyond age 60 should be permitted to continue to accumulate to their SG fund but not once they commence the draw-down pension phase.
    - Savings towards retirement once the SG superannuation pension phase has commenced would be outside the SG system, added to any other non-SG income and subject to normal taxation measures even where those funds are below the $1.6m threshold.

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