Comments on Retirement Income Review Consultation Paper November 19

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Brief background:

I commenced in the workforce in 1965 and worked until retirement in 2010. I have experienced a number of negative outcomes to me from the constant changes to the superannuation system. These changes date back to the large-scale changes made by the Keating Government.

At present my wife and I are self-funded retirees with no age pension entitlement. We have a modest income and pay a modest amount of income tax. We have at times reorganised our assets, such as freeing up funds by moving to a less expensive home and selling a holiday home to boost our investment capital and earnings.

I provide my comments on a number of the questions you address in your paper.

ADEQUACY

- **Age Pension**: The "Safety Net" age pension is generally inadequate if relied on for the sole source of income. This is particularly so when the recipient does not own their own home and wants to reside in one of the main Cities. I doubt any reasonable thinking Australian would disagree with this.
- **Age Pension Rebates from Income and Assets Tests**: The present tests act as disincentives for age pensioners to improve their income from other sources. They require revision to create incentive to increase additional income.
- **General Adequacy of Retirement Incomes**: Provided the safety net age pension is adequate it flows that all retirement incomes are adequate. It is clearly the responsibility of the individual to manage their affairs appropriately if they wish to have greater than "adequate" income in retirement. I do not see the Government being responsible to provide a system to provide for "greater" incomes other than the removal of disincentives.
- **Systems in other countries**: We have a mature system that only needs adjustments. We do not need to pay too much attention to the practices of other countries. In most cases there are too many variances in taxes, employment conditions etc to be able to draw fair comparisons.

The capacity of Government to increase the pension maybe derived by reviewing taxation on retirement incomes from superannuation that I deal with in the question of equity.

<u>EQUITY</u>

- **<u>Taxation of Superannuation in the "Retirement" Phase</u>**: The extremely favourable tax-free treatment of retirement incomes derived from superannuation urgently needs to be reviewed with a sensible and fair bipartisan outcome. This includes the tax-free status of the funds in respect of members in the "Retirement Phase".

It is irrational that this sector of the community has been blessed with a taxation policy that exempts them from paying income tax. Even the age pension is taxable income in the event that a pensioner has sufficient additional income to place them in a taxable income bracket. (yes – it can happen)

- **<u>Political Influence:</u>** The ALP tried to partly tackle this through the backdoor with their franking credit policy at the last election. We saw the power of the ballot box on that occasion. Whilst that policy deserved to be crucified because of the poor and unfair structure it sent a clear message that any changes to "Retirement Incomes" needs bipartisan support or they are doomed.

- **<u>How to apply the income tax:</u>** The income tax needs to be levied at the fund earnings to ensure it is only earnings that are taxed and not the return of capital that may form part of the superannuation pension. It seems sensible and simple to treat superannuation funds (In the retirement phase) in a similar manner to investment trusts where the earnings of the Trust in respect of the account holder are deemed to be the account holder's personal income for income tax purposes.

- **<u>Rate of Income Tax to apply:</u>** Our progressive income tax system strives to ensure that the level of tax is fair and comparable for all members of the community. There should be no flat tax such as the 15% the Turnbull policy applied to larger fund balances as that clearly favours the wealthy. The level of tax will be the normal individual scale. Payment of the tax could be facilitated by drawings on the fund if required.

- **<u>Capital Gains Tax</u>**: To achieve equity with others in the retired community the question of capital gains tax needs to be addressed. Superannuation funds in the retirement phase do not pay capital gains tax. It may be reasonably argued that the need to sell down assets to fund pension payments makes capital gains tax an unreasonable burden. However, the same argument applies for those with assets outside superannuation that are used to fund retirement. A consistent approach is required, be it to tax all or none in the retirement phase of their life. A complete review of additional pension payments balanced by tax increases from superannuation would determine the capacity to remove capital gains tax for all or the need to impose it on superannuation funds.

- **<u>Tax on the Age Pension:</u>** Age pensioners general do not pay tax income tax because of their low incomes and not because the age pension is exempt from income tax.

However, the rebating of the Age Pension at 50% for every dollar earned above the threshold is a default taxation. The figure of 50% is out of line with the income tax rates for incomes of that level and for equity purposes should be "softened" to encourage Age Pensioners to earn additional income.

- **Age Pension Assets Test:** The "Turnbull" Government revised assets test effectively deemed assets to be earning 7.8% per annum when the pension is rebated by $3 per fortnight per $1,000 for assets over the threshold. You correctly raise the potential of pensioners "over" investing in their residential property to avoid the impact of the assets test rebate and I wonder how many Financial Planners are promoting that concept. Equally many pensioners would see it as an incentive to spend money on travel etc when they are subject to the assets test and on a part pension. It effectively returns them a guaranteed 7.8% on money they have already spent. This sort of incentive is totally nonsensical. It results from the pension rebate amount being too high. It most cases a part pensioner is unlikely to be able to match that 7.8% return on capital so why not spend it. I acknowledge a fix is not simple as any relaxation of rebate rates would place more pressure on Government to fund increased part age pensions. However, the present structure does not work.

- **Assets test on Residential Property for Age Pension**: It is clearly just silly to totally exclude the family home from the assets test. A reasonable threshold amount should be excluded from the test and the balance of value subject to the assets test. There is no credibility to argue otherwise as people with substantial wealth tied up in their residential home have the capacity to better manage their financial affairs to generate a retirement income. The present system would fail the pub test of "should the taxpayer pay for someone to live in a mansion?"

SUSTAINABILITY

I believe the answer lies in the following issues –

- **The continued incentives for people to invest in superannuation to provide a retirement income** : The burden for increasing the rate of contribution should be shifted from employers to employees to ensure they have some ownership of the arrangements. The old line prevails – if you don't pay for it you don't value it.

- **The capacity of individuals to fund their retirement savings** : Individuals' capacity to save changes through their lifetime and our present system of having compulsory superannuation at the same rate for a working lifetime is too rigid and not suitable. The rate of contribution should increase (say 15 years from retirement age) and be funded (compulsory) by the employee. Anyone who has been through the full life cycle will tell you that the rate of accumulation and capacity to accelerate accumulation comes later in life. There are tax incentives for older people to up their superannuation contributions but only the frugal and smart do – it needs to be

compulsory if we are to move the typical "she'll be right" individuals from the age pension to self -funded retirees.

- **<u>Retirement Savings for Women</u>**: Changes to our society will see this evolve. An acceleration of superannuation contributions in later working life is needed to enable a "catch up". This can also be applicable for men who have been out of the workforce for some reason so it does not need to be a gender issue. Flexibility is required in the system to allow greater contributions for people who have had periods out of the workforce without negative tax impacts.

- **<u>Taxation of Superannuation</u>** : The Tax Free status of "Superannuation" in the retirement phase is not equitable and importantly not sustainable. In coming years we will continue to see the value of superannuation funds in the retirement phase grow rapidly and the untapped taxation of the income of these funds will see Governments look at other tax raising measures to fund their programs.

- **<u>Recent Taxation Changes for Superannuation in the "Retirement Phase":</u>** The "tinkering" with larger individual superannuation balances introduced by the Turnbull Government was really attacking the problem with a wet feather. The past year has seen funds generate returns well in excess of 10% so a "capped" fund of $1.6m probably earnt upwards of $160,000 tax free income – hardly equitable to the average wage earner or investor outside the superannuation system.

  The risk of not dealing with the equitable taxation of superannuation in the retirement phase is the potential for future governments to try and do similar things to that which labor attempted in the 2019 election with their franking credit policy.

- **<u>Superannuation Pension Amounts (Legislated Minimums)</u>**: The present minimum rates of superannuation pension payments seem to drive the vast majority to believe they should restrict their drawings to that level. Clearly it is not easy to predict future earnings but there should be encouragement for people to draw larger amounts when earnings can comfortably cover. The funds do not seem to want to encourage greater drawdowns, perhaps for their own selfish motivations. The present "Tax-Free" treatment of superannuation funds in the retirement phase also provides a strong incentive to leave investments in what is a "tax shelter". Taxing the fund earnings (in the hands of the individual) would negate this incentive.

- **<u>Taxation of death benefits:</u>** It is not well understood in the wider community that superannuation balances paid to non-dependants at death are taxable. In the majority of cases where the last survivor of a married couple passes away there are no dependant children simply because of the average age at death. Many people have the desire to leave an inheritance to their children and avoid taking money out of superannuation as they have the incorrect understanding that there will be no tax. A tax on earnings coupled with better education by funds to their members could remove the incentive to squirrel money away in superannuation funds for the purpose of inheritances by children.