Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

1st February 2020

Retirement Income Review

Thank you for the opportunity to make a submission to the Retirement Income Review. This submission outlines structural changes to the superannuation retirement system that could be considered to substantially simplify its operation. The proposed changes outlined in this submission offer potential improvements in the Review's focus areas of Equity and Sustainability, as well as increased Cohesion with the broader taxation system.

Yours sincerely,

Brad Matthews
Director
Plain English Economics Pty Ltd

About Plain English Economics Pty Ltd

Operating for over 20 years, Plain English Economics provides economic and investment analysis, commentary and consulting with a focus on servicing the financial services and education sectors.

Contact Details

Brad Matthews
info@plain-english.com.au
0414 591 190

A simpler retirement savings system

In 2017, the Commonwealth Government introduced the $1.6 million transfer balance cap, which limits the total amount of superannuation that can be transferred into tax free pension vehicles. For the first time, the Government established what they consider to be a "reasonable" size of retirement savings for an individual. Irrespective of whether $1.6 million is an appropriate amount, the introduction of a limit on the size of retirement savings qualifying for specific tax concessions is an important change in principle in the design of the retirement savings system. This change in principle provides a potential gateway to the removal of structural complexities that were previously in place specifically due to the lack of any ceiling on the size of concessionally taxed retirement savings.

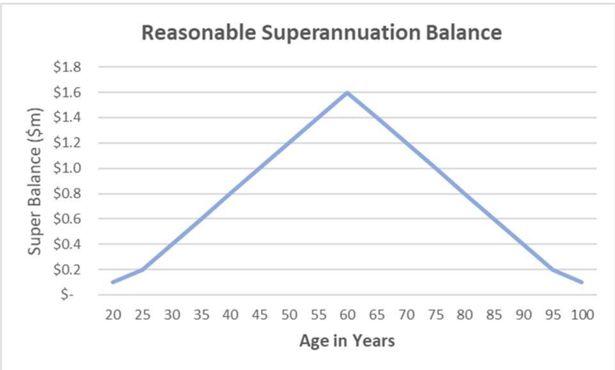
Listed below is a series of potential reforms that could be adopted to simplify the retirement savings system now that the principle of an "adequate" quantum of retirement savings has been established. Inherent in these reforms is the shift in the superannuation taxation obligation from the super fund to the personal income tax regime. The changes also remove limits on contributions and widen the application of reasonable limits on the size of super balances for which concessional tax treatment applies. These proposed changes facilitate both greater simplicity and fairness in the superannuation system; as well as increasing the probability that a higher proportion of individuals will generate adequate retirement savings.

1. ***Consolidate Superannuation and Pension structures into a single "Retirement Savings" vehicle***

The current distinction between account based pensions and superannuation vehicles could be removed, with each becoming a generic "Retirement Savings Product" (RSP). RSPs would be non-tax paying entities, thereby removing the need for any tax accounting to take place inside retirement products. The lack of tax inside a RSP would further increase the probability that individuals will accumulate "adequate" retirement savings. Upon reaching retirement age, individuals would still be free to withdraw any balances from their RSP.

2. ***Apply tax on "excess" retirement balances via personal tax return***

A "reasonable" retirement savings balance would be determined, subject to the age of each individual. Assuming the "reasonable" retirement savings balance for a 65- year-old was $1.6 million, then this reasonable balance would progressively decline for higher ages e.g. the balance of $1.2 million may apply to a 70-year-old. Similarly, younger ages brackets would have lower reasonable balances applied as per the accompanying schematic.



Source: Plain English Economics. Illustrative Only

When a superannuation balance is above the age determined "reasonable" balance, then an "excess" balance exists. This excess balance would be then assessed via an individual's personal tax return. A deemed rate of return would be applied to the excess balance, and this return would be <u>taxed at the individual's marginal rate</u> – irrespective of whether the individual is pre or post retirement. The use of a deemed rate would create certainty over the tax calculation and avoid the need for capital and income accounting. Individuals, at any age, would be free to withdraw RSP balances held above the reasonable balance cap to fund the tax or use for any other purpose.

3. Remove caps on superannuation contributions

Given the presence of a limit on the size of the total pool of concessionally taxed retirement savings, the current complex and burdensome system of capping annual contributions could be totally removed. If the objective of retirement savings policy is to maximise the probability that individuals will accumulate the necessary savings to be self-funding in retirement, then there is little logic in restricting contributions. For some individuals, the immediate contribution of a windfall or inheritance into superannuation represents the only realistic path to the wealth accumulation necessary to be self-funding in retirement.

4. Remove requirement for percentage based withdrawals by retirees.

For individuals above retirement age, the existing requirement to administer the minimum annual withdrawal percentages from pension vehicles would not be necessary as the declining reasonable balance cap will remove any advantage from maintaining large balances in RSPs in retirement. This will improve both the simplicity and equity in the system as small balance holders will not be forced to withdraw from a tax advantaged environment unless they need to.

In addition to significant simplification, the combined effect of the above 4 changes would be to increase the proportion of the population able to accumulate the necessary level of savings for retirement. It would involve a shift in the burden of taxation away from those with accumulation balances below the cap to those with balances above the cap; and address the current inequity whereby some individuals pay a higher rate of taxation on their superannuation income than on other personal income. Any unfairness associated with the retrospectivity of changes could be potentially addressed by applying a lower deeming rate on excess balances for a period of time for those above specified ages.

Individuals with balances above the reasonable balance cap would be neither advantaged nor disadvantaged as to whether excess balances were held within or outside super. As a result, a complex system which creates stress, punitive penalties and a high dependency on financial advice would be replaced by a far simpler system with less scope for errors and penalties.

Integrating HELP Loans Scheme and superannuation

It is proposed that consideration be given to integrating the student HELP loan scheme with the superannuation system. Currently, students and younger workers will often be forced to commence accumulating a superannuation balance whilst concurrently being in debt under the HELP scheme. An alternative approach could be to allow those with HELP loan balances to opt to have their Superannuation Guarantee Contribution (SGC) directed to repay their HELP loans.

There is little inherent logic in building a superannuation asset whilst at the same time holding a debt that balloons with indexation. The taxes and fees associated with superannuation for students and those on low incomes make it relatively unattractive, with those on low incomes benefiting significantly less from the concessional tax treatment applied to superannuation.

The faster repayment of debt facilitated by allowing SGC contributions to be directed to HELP debt repayment may not only improve the financial and psychological health of individuals, but it would also likely increase the collection rate on HELP loans, thereby lowering the overall cost of tertiary education across the wider economy. In addition, the removal of the need to manage large numbers of smaller balance super accounts for students, may reduce administration costs in the superannuation industry.
