Australian Government

A tax plan for our future
Stronger • Fairer • Simpler

TAX FORUM 4-5 October 2011

STATEMENT OF REFORM PRIORITIES

PARTICIPANT NAME AND POSITION

Dr J Barry Ritchie, Chairman Retirees Income Research Group

ORGANISATION

Association of Independent Retirees (A.I.R.) Ltd

STATEMENT OF PRIORITIES

Statement Follows.

Around two or three pages, please. Please address both of these issues:

1. What are your priority reform directions for the tax and transfer system?

2. How are your proposals financed over the short and longer term?

LIST OF ATTACHMENTS

Feel free to attach supporting papers if you wish. Please list them here.

Nil

Association of Independent Retirees (A.I.R.) Ltd

Tax Forum 2011 Statement of Reform Priorities

This position paper describes reform priorities that A.I.R. believes can improve the efficiency of the taxation system as it relates to self-funded retirees.

1. Equitable treatment of retirement savings

Government policy is for superannuation to be the preferred form of savings for retirement. The 15% tax rate (a concession for some) on accumulation is provided through this vehicle. Widespread access to superannuation, through the SG, is relatively recent but is not taken up by significant groups in the economy; for example, many sole traders and owners of small businesses including small farmers.

Many retirees have savings accumulated over some 40 years, and may are drawing these down over some 25 years, long before access was available to superannuation for them. The government recognised this problem in introducing Simpler Super in 2007 and permitted eligible people to transfer up to $1million into superannuation for a limited period. However, a major impediment was capital gains tax incurred in selling capital assets to transfer funds.

The Government has also recognised the particular situation of small business owners, with capital assets tied up for a long period in their business, by allowing them to sell and transfer these assets into superannuation without incurring capital gains tax.

Government policy has been to tax accumulation of savings, whether the savings are accumulated within or outside superannuation. The only difference is that the full marginal tax rate is applied to savings accumulated outside superannuation.

As the SG system has matured drawdown systems and products have become specialised; many superannuation funds, focused on accumulation, have not developed such systems and the transfer from accumulation to drawdown is often not seamless.

Proposal 1.1 *The accumulation phase and the drawdown phase in superannuation should be considered as separate and distinct elements.*

Proposal Cost: *Nil*

The vast majority of retirees use their savings for retirement, whether within or outside superannuation. Savings are used to endeavour to maintain accustomed living standards across a steadily increasing life span. The Prime Minister has acknowledged maintenance of accustomed living standards as a part of government policy.

Maintaining accustomed living standards over an extended period of retirement, 25 years or more, implies careful nurturing of retirement assets, essential spending on maintaining capital items such as a car, home appliances, and home maintenance as well as meeting everyday living costs. As age increases retirement savings are needed for managing health and accommodation risks, often of high cost. And this takes place in a climate of unknown longevity. Any remaining surplus arises from prudent management of longevity risk; it is not deliberately kept for Estate planning.

Government policy removes tax from earnings on assets in taxed superannuation funds being drawn down for retirement. However, all retirees, whether their savings are in superannuation or not, have paid tax on their retirement savings and should be able to access the tax free rules applying to drawdown in superannuation. Present policy is highly discriminatory.

Government desire to make superannuation the preferred form for retirement savings would be achieved in the drawdown phase if people without superannuation could transfer an equitable amount of their after-tax savings into superannuation without cost upon retirement.

Significant amounts of savings outside superannuation are held in the form of property or equities to achieve an adequate return or because the property is a component of business. These after-tax assets, often held for a long period, must be steadily sold down during retirement. Outside superannuation, their sale attracts capital gains tax, which because of the lumpy nature of the asset, also distorts taxable income in the year of sale. Ability to transfer an equitable amount of these assets into superannuation at the time of retirement without tax penalty would avoid the capital gains tax impost presently incurred. One advantage of this model is that funds transferred into superannuation are more readily definable as being used for that purpose.

The use of savings other than for retirement, such as for philanthropy or for Estate Planning, is only available to the very small number of wealthy individuals. Government policy should be directed to making the superannuation system simpler, and corresponding administrative costs lower, for the great majority of retirees. Regulation to contain unethical use or excessive transfer of assets into superannuation should be focussed on the minority trying to take advantage of the intent of the superannuation legislation. The concept of caps on contributions is well established in superannuation and could be applied to transfer of assets into superannuation on retirement.

The amount of tax collected from people over 65, and their number, is declining. It is expected to decline further as superannuation builds. In the financial year ending 2009, only one person in every seven over the age of 65 paid tax, a total of $6.7 billion; one half of this tax came from only 18,000 people with taxable incomes greater than $150,000. While the tax collected from people over 65 has been declining, tax collected from accumulation of superannuation savings has been increasing — $9.3billion in 2011/12 up from $7.2billion in 2010/2011. This rate of increase would significantly offset the cost of allowing people to transfer an equitable amount of their savings into superannuation on retirement.

Proposal 1.2 *Persons without superannuation should be able to transfer an equitable amount of savings into superannuation upon retirement without incurring tax on the sale of assetsto be transferred.*

Proposal Cost: *Cost declining over time as superannuation matures; increase in tax collected from accumulation of superannuation savings more than offsets cost.*

2. Removal of age restrictions on retirees with superannuation

The concept of retirement is no longer that of a period of leisure from a specified age. Financial circumstances and individual interests mean that people over retiring age (the age at which they can access superannuation) may continue work, indeed are encouraged to be active. Further, increasing longevity and individual differences in physical and mental acuity make set ages unrealistic. The extent that work is paid or voluntary does not change the individual's rationale for undertaking it.

The conflict between superannuation rules and union awards when people work as employees over the age of 75 is an example of rigidity of regulation which is inconsistent with the emerging pattern of retirement. Downsizing of the family home when people are over the age of 75 is a further example where retirees with superannuation cannot consolidate their assets within superannuation. The work rule can be readily circumvented by a small group of people with connections to business, but retirees without such access and/or a history of home care rather than work are disadvantaged. These rules simply add to complexity, encourage subterfuge and increase administrative costs with no related benefit to government. No restriction on age or work should prevent people from contributing to superannuation.

Proposal 2.1 *Restrictions on age or work should be removed from retirees with superannuation.*

Proposal Cost: *Nil*

3. Management of financial risk in retirement

Australia's superannuation system places the financial risks associated with investment and longevity with the individual. Risk is compounded by a bias toward equities. Reduction in the value of equities due to market volatility cannot be recovered during drawdown as it can during accumulation. Many retirees do not want the stress associated with managing financial risks; risk aversion also increases with age. Low returns and lack of flexibility from existing annuity type products make them unattractive. Some new products, such as infrastructure bonds and longevity insurance, are emerging.

The Government has indicated that it will not stand guarantor for pension type products. However, in the present volatile market situation individual industry providers may be considered by some to represent further risk to what should otherwise be a valuable support for retirees. Failure of investment would cost government dearly in the provision of additional and otherwise unnecessary pension benefits.

Private industry cannot offer acceptable returns without some support because of the fundamental cost of absorbing investment and longevity risk. Products with a reasonable return are only likely to be provided through government intervention, while maintaining industry responsibility. One solution would be for government to mediate the formation of a fund jointly backed by an appropriate weight of superannuation product providers where retirees may invest and where the investment and longevity risks are spread because of the age range and fund size.

Proposal 3.1 *Government should mediate the formation of a substantial industry fund to reduce investment and longevity risk and provide acceptable returns for retirees who choose to invest all or part of their retirement savings in the fund.*

Proposal Cost: *Minor*

4. Management of market volatility

Substantial losses were incurred by retirees when the Global Financial Crises (GFC) hit stock markets in 2008. While there has been some recovery since then, the value of superannuation funds has still not reached the value prior to the GFC. Present volatility in stock markets has resulted in another large down turn. While over a long period stock markets usually recover, superannuants have to make drawdowns to fund their day-to-day expenses. When the value of invested savings is low, savings are irreparably depleted.

During the GFC, minimum prescribed drawdowns from superannuation were reduced by 50%. In the 2011/2012 year (before the present market downturn occurred) this has been reduced to 25%. The present downturn justifies returning the drawdown to 50% of the original prescribed value.

The events of 2008 and since demonstrate the futility of trying to unnecessarily regulate aspects of the superannuation system. The government objective, attempting to regulate the drawdown rate of superannuation, is seriously in conflict with the right of individuals to manage their retirement needs, which are not drawn down uniformly. For example, many retirees deliberately maintain their superannuation asset as long as possible to manage the risk of major health and other ageing risks. Government should encourage retirees to manage their retirement incomes as carefully as possible, rather than trying to pressure retirees into unreasonable actions.

Proposal 4.1 *Minimum prescribed drawdowns from superannuation should continue to be set at 2010/2011 levels. Government should resist making restrictive regulations which interfere with an individual's right to manage their retirement affairs.*

Proposal Cost: *Insignificant.*

5. Inconsistent tax treatment of personal savings

Under the existing taxation system, very different levels of taxation apply to different savings vehicles (for example, superannuation, investment properties, shares and bank deposits). The AFTS Review demonstrated that the longer a person saves and reinvests those savings the greater is the effective marginal tax rate on the interest earned. Interest has the least favourable tax treatment, in marked contrast to shares which benefit from a 50% capital gains tax discount.

A.I.R. supports efforts to reduce inequities between different types of savings to provide greater flexibility during accumulation and drawdown of savings. It is disappointed that the AFTS review recommendation that interest should receive a similar rebate to capital gains has only been introduced at a marginal level.

Priority 5.1 *Inequities between tax rates for different types of savings should be removed over three years.*

Proposal Cost: *Not known*

Dr J Barry Ritchie, Chairman Retirement Incomes Research Group, Email britchi1@bigpond.net.au