

Retirement Income – Suggested Changes

I am making two separate submissions to the Review of Retirement Incomes, this one covering a few changes to the current system that would make it more fair and equitable and a second larger submission putting forward a new scheme that would tie together the three pillars of retirement income into a more integrated and much simplified whole.

In my original submission to the tax review last year I included a section on some suggested changes to the tax deductibility of super contributions to make the system uniform for all employees and self-employed people. I have repeated that suggestion here.

I have a simple suggestion to overcome the perceived unfairness of the difference in tax treatment of the income stream from a taxed and untaxed super fund. This was the subject of several of the original submissions to the enquiry.

I am also suggesting that we scrap the super co-contribution as it is far too complex for most taxpayers to decide whether they are better off making before or after tax contributions to their super. I also don't believe we should be encouraging those on low incomes to lock away their scant savings in a form they cannot access until they retire.

My last suggested change covers the tax-free status of income for a super fund paying an allocated pension. If this was phased out, so no new tax-free pensions were created, it would make the current system far more sustainable. It would simplify the administration of super funds and reduce the difference in tax treatment of retirement incomes between retirees on allocated pensions and those whose income is from non-superannuation savings.

I am also commenting on the suggestion, put forward in some submissions, that the retirement and pension ages are increased from the current levels because some people are still capable of doing useful work after the age of 65. If this was implemented I feel that it would result in a huge loss to society, as our younger retirees form a pool of fit, useful, skilled and experienced people who help our communities to function and contribute to the quality of life for all of us.

Tax deductibility of Super contributions

Problems with the current system

Under current rules, an individual taxpayer who earns more than 10% of their income as an employee is not allowed to claim a deduction for their own contributions to super. This discriminates against individuals who do some work as an employee and some as self-employed, as they are unable to take advantage of the full \$50k contribution limit. This can be illustrated by the following examples.

John earns \$100k as an employee and can contribute \$50k a year to his super as a combination of employer mandatory contributions (\$9k) and salary sacrifice (\$41k).

Thomas earns \$100k as a self-employed contractor and can contribute \$50k to his super fund and claim a tax deduction for it.

Peter earns \$20k working for an employer and \$80k as a self-employed contractor. The most that Peter can contribute is the mandatory super provided by the employer (\$2k) and part or all of the \$20k as salary sacrifice if the employer is agreeable to this. He is not entitled to a deduction for any further personal contributions because more than 10% of his income is earned as an employee.

I see the current system as unfair to Peter.

Suggested changes

I would like to see a system where all taxpayers are allowed a tax deduction for an amount they contribute themselves that takes their total employer and personal contributions up to the \$50k limit, regardless of how they are employed.

For example in the scenarios above Peter would be allowed a tax deduction for a further \$28k of personal contributions, or for \$48k if he does not salary sacrifice any of his \$20k salary to super. John would be able to salary sacrifice say \$10k and claim a deduction for a further \$31k of personal contributions.

The employer would be required to put the employer contribution amount, including any salary sacrifice amount, on the payment summary. The employee would then know when they lodge their tax return how much they could claim of their own contribution. Most employees would have some idea from their payslips what the shortfall would be and could adjust their personal contributions to suit.

If the employee and employer contributions totalled more than the allowed \$50k, any excess would be treated as a non-deductible personal contribution and would not be claimed in the tax return. This would not be any more complex for the super funds as they currently have to calculate any contributions over the \$50k limit.

The recently introduced tax free status of payments from a super fund has made it more tax effective for individuals to make tax deductible contributions, up to their allowed limit, than after tax contributions. However the system has not made it easy for everyone to do this.

Tax treatment of super income from an untaxed source

Problems with the current system

Income from an untaxed retirement income stream is included in an individual's taxable income, with a 10% rebate attached. Income from a taxed income stream is not included as taxable income.

While the tax paid by the individual is levied to make up for the fact that no tax was paid in the accumulation phase, it does have some flow on effects for the taxpayer in increased rates of Medicare levy and a reduction in the amount of Senior Australians Tax Offset (SATO) available.

Suggested Changes

A simple fix to this perceived inequality of treatment of the income would be to have tax paid as a withholding tax by the fund at the time the payment is made, with the payment then being tax free for the recipient in the same way as for income from a taxed source.

I would suggest a rate of ten or twelve per cent, being an average of the fifteen percent contributions tax that has been paid by taxed funds in the accumulation phase and the zero percent payable on earnings in the allocated pension phase. This tax would be levied on the part of the payment exceeding an amount of \$10k per year.

The tax would be taken from the payment at source and remitted to the ATO by the fund, thus being transparent to the individual receiving the payment. This would result in a reduction in complexity for the taxpayer who would no longer need to declare the income on their tax return or calculate the allowed rebate.

As this withholding tax would reduce the payment slightly for some retirees, it may also result in slightly more government pension being paid to them if they are part-pensioners.

Full pensioners with small amounts of untaxed super pension income would not be any worse off, as the withholding tax would not apply to the first \$10k of the annual payment.

The Superannuation Co-Contribution

Problems with the current system

The current system makes it very difficult for a taxpayer to decide whether they are better off making an after tax contribution to super and getting some benefit from the co-contribution, or making a tax deductible or salary sacrifice contribution.

The co-contribution phases out with increase in income and is only available where the taxpayer has some income from working. Only those on very low incomes get the full benefit, and they are unlikely to have enough spare money to contribute. Working out the best mix of before and after tax contribution to maximise the co-contribution benefit would be beyond the mathematical skills of most people.

The co-contribution makes it appear more attractive for low income earners to put money into super, although these individuals may be better off with this money in a savings account for use in times of need or using it to reduce their mortgage. A possible higher future retirement income is not very useful if you are living on a very low income now. Encouraging very low income earners to save any spare money they do have in a form that they cannot access for years regardless of need, seems to me to be totally inappropriate.

Suggested Changes

The current co-contribution system should be scrapped.

Low income earners would be better served by having an additional government payment into their super regardless of the amount they are able to contribute themselves and unrelated to the amount of employer contribution.

This payment would be the same for all taxpayers with income below the point where the 30% tax rate applies and would phase out above that. The payment would apply to everyone, including welfare recipients, so the cost to do this would probably be higher than the current cost to the government of the co-contribution.

Taxpayers with income in the 30% tax bracket could claim a tax deduction for their additional contributions as in my first suggestion above.

Taxation of Allocated Pensions

Problems with the current system

If the current tax free status of the income of a super fund paying an allocated pension (called here an AP fund) is retained, more and more retirees will arrange their retirement income to make use of them, resulting in a situation where very little tax is paid on the income from the assets held by retirees.

As the population ages, and considering that most people's assets would be highest at around the age they retire, we could have a situation where a large proportion of the income from assets owned in Australia was tax free.

Under the current refund of franking credit system, the AP funds would also be taking tax revenue out of the system by claiming a rebate of the tax paid by companies in Australia. We could reach a situation where AP funds owned a large slice of our listed companies and a significant proportion of company tax revenue was lost to the government in this way.

Assets held as a basis for paying an AP income stream need to be segregated within a super fund, as there is no tax payable on the income from these assets. This results in complexity for the funds, particularly for SMSF's.

It also gives a large disparity in tax treatment of retirees whose income is from an AP and those whose income is from private savings. Many current older retirees no longer have the choice of contributing their savings to super and converting them to an AP, and these retirees receive no benefit from the recently introduced tax free status of super income. If their income is high enough, they also receive no age pension or SATO and pay tax at normal rates.

Wealthy people can transfer a good deal of money into their super funds over a decade or two and my belief is that many wealthy people will do this and it will become a standard and perfectly legal tax reduction strategy, particularly as other tax avoidance options are targeted and closed down.

These people would have to take an income stream from their super fund after they retire, and any unspent money from this would then need to be invested outside of the super system, but these retirees have the option of passing any excess to their children to make contributions to their own super funds, thus retaining the money in a low tax environment.

A couple currently aged 50, for example could transfer \$400k a year between them into their super fund and retire at sixty with a total balance in a super fund of \$4m after ten years. They could then add another \$300k each by bringing forward the allowed two years of after tax contributions giving them \$4.6m. When converted to the tax free pension phase this could give them an income of around \$400k a year after refund of franking credit to their fund. This income would have no tax paid ever, either in the fund or by the recipients, and would have taken back tax already paid by the companies that the fund invested in.

Compare this to a retiree couple with the same \$4.6 m in assets outside of super, who would pay tax of around \$145k in total on a similar income.

There may not be many retirees who could set aside this amount of money, but this example is just to illustrate a point. We need to ask whether we want our retirement income system to allow some very high income retirees to have a huge completely tax free income, while other retirees (and all working people) pay tax at full rates on the same amount of income.

Suggested Changes

Phase out the tax-free status of AP funds, so existing tax free AP funds retain their status but no new ones are created. New income streams could then be paid by a super fund out of their normal assets and income. The income stream would have minimum limits as currently, and would still be tax free to the recipient.

I am not in any way suggesting that the couple in the example above should pay tax on their AP income stream, I am only suggesting that their AP fund should be taxed the same way as it would be if it was a super fund in the accumulation phase. This would result in tax of \$60k being levied on their fund, still much less than the tax paid by the retirees who are outside of the super system, but at least it reduces the gap.

This would vastly simplify the administration of super funds as the assets for the pension would not need to be segregated. It would generate some tax revenue, but would cost most retirees very little as the administration fees on their income streams would be lower and their government pension would increase. It would also allow retirees with some income from working to have their compulsory super paid into the same account as their pension was paid from, reducing the need for, and the extra costs of, two accounts.

It would help to reduce (but not eliminate) the disparity in tax treatment of retirement incomes between retirees on allocated pensions and those whose income is from non-superannuation savings.

I see this change to the taxation treatment of AP funds as essential for the long term sustainability of the current retirement income system. Otherwise we could end up with a society where retirees, regardless of their income, contribute absolutely nothing to the tax system and where all of the revenue needed to fund pensions, infrastructure and services is provided by higher taxes on the income of younger people who are already struggling with the costs of buying houses and raising and educating children.

It is not only the increase in government pension payments for the increasing proportion of retirees to workers that could turn our younger generations into a highly taxed almost slave class. It is also the potential total elimination of tax on the income generated from the assets of anyone over the age of 60.

If we only ever make one change to the retirement income system, this should be it.

Please do not increase the retirement age

There have been some suggestions of increasing the allowed retirement age, currently 60, (retirement at age 55 will soon phase out) and the age at which the pension is paid, currently 65. The argument for this is that life expectancies are increasing, causing a strain on the cost of pensions, and many people are capable of working for longer.

My own view is that both of these ages are appropriate. I see allowing people to retire at 60 and qualify for a pension at 65, even if they are not totally worn out by then, as a really good system with huge social benefits.

Increasing the pension age would leave some older people working beyond their physical capabilities, particularly those in heavy physical or outdoor employment and some trades. This would result in more people claiming sickness or unemployment benefits, thus reducing any saving to the government on pension costs.

Allowing retirement at age 60 rewards those who have worked all their lives and those who have saved by giving them a few years of leisure while they still have the capacity to enjoy it. People can retire gradually if they want to, thus reducing the culture shock of a sudden change in lifestyle.

It helps the tourism industry, the caravanning industry, the camping and fishing industry, the horticultural industry and the home renovation industry.

Allowing people to retire at 60 if they have sufficient super and allowing everyone to access the pension at 65 even if they are not totally incapable of working gives our communities a pool of fit and useful people who are outside the conventional workforce. This is particularly important in our current society where most women work.

Retirees have leisure to interact with and look after grandchildren, forging better relationships between generations. They can help family and friends, and even strangers, in times of crisis. They can grow vegetables and tend gardens, renovate houses, and help with community environmental projects.

The hobby and leisure activities of retirees can enrich the lives of all of us. Even simple activities like bridge or bowling clubs give other retirees social interaction and build networks and friendships. Many retirees are involved in groups, such as the Australian Shareholders Association, that benefit everyone.

Retirees can share their accumulated skills and experience by doing all kinds of unpaid work or volunteer activities in their community, from mentoring younger business people to running miniature railways for the enjoyment of children. They are also free to do research projects and to develop products, ideas and computer software related to their area of expertise in a non-commercial environment.

Having this pool of useful, skilled and experienced people benefits everyone in our society, not just the retirees themselves, and improves the quality of life for all of us.

Forcing people to stay in the paid workforce until they are ready for the scrap heap may save on pension payments and help fund politically attractive tax cuts, but it would result in a huge loss to our communities.

Do we want to become a society where our thinking is dominated by financial considerations, where every aspect of life is arranged to maximise affordability and profits, or a society where the overall quality of people's lives is more important than money.

Conclusion

The suggestions in this submission are for improvements to the current retirement income system that I hope the panel will consider.

I have also provided a second submission to the Review of Retirement Income which outlines a new scheme for retirement income. With only a few quite small changes to the current system, we could have an integrated retirement income system that is simple, equitable and flexible, provides certainty to retirees, vastly reduces administration costs, increases social efficiency, provides incentives to retirees to continue working and above all is sustainable into the future regardless of the proportion of retirees to workers.

I would like to thank the Australian Government for the opportunity to contribute ideas to the Review of Retirement Incomes.

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I am a Tax Help volunteer and a share market investor, but not a tax expert. I am not a pensioner or a retiree.