Association of Independent Retirees (A.I.R.) Limited
ACN 102 164 385

Australia's Future Tax System

Tax Review Submission

October 2008

16 October 2008

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

Association of Independent Retirees (A.I.R.) Limited
Tax Review Submission

The attached Tax Review Submission describes some issues that are of concern to self-funded retirees and which affect their lives and living standards.

They are submitted by A.I.R. in the sincere hope that the Government will accept the need for a more equitable recognition of the current needs of self-funded retirees, in the context of their past and ongoing contributions to the economic and social development of Australia.

The recommendations outlined in this Submission have been developed in consultation with A.I.R. members across all States and Territories. They are intended to assist the Review Panel in reviewing Australia's Future Tax System.

I hope that this Submission will be accepted as positive and supportive of Government policy objectives. Should you require any further information, please contact the following:

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Yours sincerely

Theresa Kot
National President

About the Association of Independent Retirees (A.I.R.) Limited

The Association of Independent Retirees (A.I.R.) Limited is the peak body representing the interests of retirees who are wholly or partly self-funded in retirement. A.I.R.'s members include full self-funded retirees, part-pensioners, and superannuants.

Formed in 1990, A.I.R. is a not-for-profit, non-political, volunteer organisation that is focused on matters affecting the standard of living, health and welfare of retired and partly-retired people.

As well as carrying out research and gathering information that will assist its members in maximising their life opportunities, A.I.R. is committed to educating the wider community (including political parties at all levels of Government) regarding the views and concerns of self-funded retirees.

Summary of Submission

This submission from the Association of Independent Retirees Ltd (A.I.R.) is focused on the following aspects of the Tax Review for partly and fully self-funded retirees over the age of 65:

- reducing the complexity of the tax system for the majority of retirees over 65;
- removing tax transfer churn[1] from partly-funded Age Pension recipients;
- providing incentive for retirees to sustain their assets over their retirement life span;
- linking cut-off limits and offsets to the marginal tax and threshold levels.

The submission assumes that the pre-election proposals from the Government for tax thresholds and marginal tax rates will be honoured.

The following principal features are proposed to simplify the tax system and remove tax transfer churn for partly self-funded retirees over the age of 65.

- Retirees in receipt of a part Age Pension should be exempt from paying income tax. This removes inconsistency between the tax treatment of part age pensioners with taxed superannuation funds and those without, removes tax transfer churn, and dramatically reduces the need for tax returns for about 78% of all retirees.

- The Senior Australians Tax Offset (SATO) should be changed to commence at the upper income level for the part Age Pension (currently $39,130). The maximum SATO amount should be equal to the taxable income corresponding to that income level, currently $6,339. SATO should taper to zero at the upper income tax threshold for the 30% marginal tax rate (currently $75,000).

- The Commonwealth Seniors Health Card (CSHC) upper income threshold for a single person should be set and maintained at four times the full Age Pension (the full Age Pension is currently $14,217 and the corresponding value for the CSHC would be $56,868 under this policy). The partnered upper income threshold should be set and maintained at 1.6 times the single person threshold, as at present.

- On the basis that the CSHC thresholds are restructured as recommended above, the CSHC should be restored to providing assistance with pharmaceutical benefits, hearing aids, and dental care, its original purpose.

- Capital gains should not be taxed for over-65 retirees who have incomes below the upper income threshold for the 40% tax rate.

Throughout this submission retirees whose income is supported by a part Age Pension in addition to their personal income are termed ‘partly self-funded retirees’. Retirees whose income is obtained primarily from their personal income and assets are termed ‘self-funded retirees’. Self-funded retirees may receive Commonwealth Government concessions such as the Commonwealth Seniors Health Card, may be eligible for some tax offsets, and may receive concessions from State/Territory and Local Governments.

The data in this submission is based on that applying at 1 July 2008.

A **Summary of the Recommendations** in the submission is set out below.

1. Managing Assets (Section 2)

a. Tax revenue policy should recognise the need for the majority of retirees, who have only average level income and assets, to sustain their assets over their retirement life span.

2. Tax Transfer Churn and Offsets (Section 3)

a. Tax revenue policy for partly self-funded retirees who do not receive income from taxed superannuation funds should be aimed at simplifying tax regulations and removing tax transfer churn.

b. Partly self-funded retirees should not be required to pay tax on their income.

c. SATO should be changed to commence at the single-income threshold at which the part Age Pension ceases to be paid. Its value should be set at the tax payable at that income threshold (currently $6,339). SATO should then be phased out linearly to cease at the upper income threshold for the 30% marginal income tax rate.

3. Superannuation (Section 4)

a. Present regulations that require a minimum percentage of the assets to be withdrawn from a taxed superannuation fund each year should be removed. Alternatively, if the Government wishes to retain such a requirement, the minimum percentage should be set at the ten-year real return of retail superannuation funds. The real return should be based on the Age Pension indexation parameters.

b. All age-related tests and restrictions placed on taxed superannuation funds that are applicable to retirees over the age of 65 should be removed.

c. Superannuation income streams that are received from taxed and untaxed funds should be assessed separately from other assessable income as recommended by the Senate Economics Report February 2007.

4. Commonwealth Seniors Health Card (Section 5)

a. The upper income threshold used for eligibility of a single person for the Commonwealth Seniors Health Card should be set at four times the single-person Age Pension. The ratio between single and partnered income thresholds should remain at 1.6 times.

b. Extraordinary one-off withdrawals from taxed superannuation funds should not be included in adjusted income for determining eligibility for means tested support, allowances, and concessions, including the Commonwealth Seniors Health Card, as is the Government's intention in 2009. Because of the administrative difficulty of defining extraordinary one-off withdrawals, adjusted income should be based on the average total income of the previous three-year period.

c. Adoption of the model proposed in Sections 1 and 2 would allow the CSHC to be restructured to meet its original purpose, viz. to provide assistance to self-funded retirees with pharmaceutical costs, hearing aids, and dental care.

5. Transfer of Assets (Section 6)

a. For retirees over the age of 65, capital gains tax arising from sales of capital assets held outside superannuation, for whatever purpose, should not be included in taxable income until the retiree's taxable income exceeds the upper income threshold for the 40% marginal tax rate.

6. Encouraging working over the Age of 65 (Section 7)

a. Additional income earned by a retiree from personal work after the age of 65 should not be included in the Age Pension income test.

b. Age-related work tests should not be used to disqualify a person from contributing to a superannuation fund.

c. There should be no compulsion on people to work after the age of 65, as would be affected by raising the retirement age.

1. Introduction

This submission is concerned with the financial security of partly and fully self-funded retirees over their retirement life span. It addresses the Terms of Reference of the Tax Review, namely:

- What major challenges facing Australia need to be addressed through the tax transfer system?
- What features should the system have in order to respond to these challenges?
- What are the problems with the current system?
- What reforms do we need to address these problems?

The Tax Review paper Section 1.2[2] notes that the demographic challenge of our ageing population is profound. A quarter of the population is projected to be aged 65 or over by 2047 (almost double that today). Consequently, spending pressures in areas such as health, Age Pensions and aged care are projected to rise considerably. A.I.R. contends that the needs and expectations of retirees, from their individual perspectives, must be matched with the need to manage these spending pressures if community, social, and economic needs are to be optimised.

Retirees, whether partly or fully self-funded, have a reasonable expectation that they can maintain a standard of living throughout their retirement comparable with that during their pre-retirement. In many cases they have worked to build assets for this purpose and do not wish to see these assets erode over time to the extent that their standard of living reduces unreasonably. Many retirees wish to maintain their independent life style and to minimise their dependence on Government support, but are deeply concerned that their assets may be eroded and not last until the end of their retirement life span. They are afraid that they will then have to become dependent on family, friends, or Government. They need to retain assets for inevitable unexpected medical, living, social, and transport needs.

A.I.R. represents partly and fully self-funded retirees. Its interests are in taxation and other Government policies that will assist the growing number of retirees to manage their incomes to sustain a reasonable standard of living over their retirement life span. The retirement life span is significant; the expected number of years of retirement for a 65 year old male is 17.7 years according to the Income Tax Act table and is even longer for females.

There has been little research into the financial and support needs of individual retirees as they move from a physically active lifestyle early in retirement to a less active lifestyle later in their retirement. Government policies are inadequate and simplistic to address the complex needs of this large group of members of society over the age of 65. This group is characterised at any point in time by a wide range of ages with different needs related to their age and with standard of living expectations as broad as the community at large.

The great majority of retirees have only average incomes. Government taxation policies should not impact negatively on the retirement assets of this group, whether held within or outside superannuation. Government policies should provide incentive for retirees to use their assets wisely, to sustain them over their retirement life span, and to minimise their dependence on Government support.

Policies which cause assets to be depleted leading to greater dependency on Government income support have two effects: they increase Government support costs, and they lower the independence, morale and standard of living of retirees.

Government has a legitimate concern that its taxation and support policies may lead to retirees building assets for estate planning purposes. Generally, it would appear that the Government's point of view is that those who receive taxation relief or income support should have minimum assets remaining at the end of their life.

There is a serious conflict between these two Government policy positions. Present policies are simplistic, grossly disadvantage the majority of retirees, and provide the opportunity for wealthy retirees to misuse the tax transfer system. There appears to be little research and information available to support the development of better policies. Furthermore, only a small minority of retirees have sufficient assets to build excessive assets for estate planning purposes using Government incentives. Policies should be developed to sustain the assets of the great majority of retirees, with specific policies to deal with exceptional cases.

The present Government response, forcing retirees to withdraw a minimum percentage of their taxed fund superannuation assets each year, disadvantages them, and does not meet Government objectives. Policies based on average life expectancy that try to run down retirees' assets, or transfer them into the normal tax paying regime, before they die cannot work because the variation in life expectancy late in life is very high. Similarly, Government policies that impose penalties when assets are managed to maintain investment objectives, or where assets must be drawn down in lump sums to maintain personal capital assets, or meet emergencies, are retrograde.

The May 2008 Federal Government Budget included a proposal to include total annual income from taxed superannuation funds with other income in the determination of adjusted income for determining eligibility for income support, including the Commonwealth Seniors Health Card. Under this proposal, extraordinary (one-off) lump sum withdrawals including personal capital purchases such as replacing a car, home maintenance, or personal emergencies, would add to adjusted income and reduce eligibility for means tested income support. Consequently, additional personal income would need to be expended to maintain the retiree's standard of living, reducing the retiree's asset base. Alternatively, to maintain the asset base, the standard of living would need to be reduced. Each of these choices eventually adds cost to Government in increased Age Pension and other support costs. Retirees do not accept such policies.
A cornerstone of Government policy in managing the ageing population is a maturing superannuation system. It is now accepted that a very high percentage of future retirees will have insufficient superannuation to sustain them over their retirement life span. Consequently, the number of partly self-funded retirees will increase significantly.

Since the 1 July 2007, the tax structure applying to retirees has been split into three distinguishable groups:

(a) Retirees with taxed superannuation funds who pay no income tax on pension withdrawals from their funds (subject to meeting regulatory requirements);
(b) Retirees with untaxed superannuation funds who pay income tax on pensions received from their funds with some tax relief;

(c) Retirees without superannuation who pay income tax on their full income.

Combinations across these groups occur. For example, many retirees in groups (a) and (b) have a proportion of their assets outside superannuation.

Group (a) is expected to have the highest growth rate and to dominate the other two groups in the future. Group (c) is expected to decline as a percentage of total retirees.

The present structure is inequitable. It discriminates against groups (b) and (c) whose ability to sustain their assets over their retirement life span is severely eroded compared with group (a). Many members in groups (b) and (c) are also affected by tax transfer churn.

The tax transfer system is structured so that retirees receiving the full Age Pension pay no income tax. The tax transfer churn is zero. Partly self-funded retirees in groups (b) and (c) pay income tax while receiving some Government support. For example, a retiree with a taxable income of $32,000 pays income tax annually approximately equal to the annual sum of the part Age Pension received fortnightly.

Retirees have only two means of sustaining their personal assets over their retirement life span, investment of accumulated assets or paid work. Issues relating to maintaining personal assets are addressed in Section 2. Tax transfer churn and offsets for partly self-funded retirees with untaxed superannuation funds or without superannuation [groups (b) and (c)] are addressed in Section 3; issues arising from taxed fund superannuation [group (a)] are addressed in Section 4. Issues concerning the Commonwealth Seniors Health Card are addressed in Section 5. Tax issues affecting transfer of assets are addressed in Section 6. Issues relating to working over the age of 65 are addressed in Section 7.

2. Managing Assets

Retirement living needs are generally higher early in retirement when retirees are generally more active, healthy, and looking to enjoy their free time. Whilst, the level of activity and basic food needs tend to decline later in retirement, these needs tend to be replaced by higher medical costs. Thus, the level of income needs to be sustained across the full retirement life span.

Partly self-funded retirees make up about 75% of all age pensioners[3]. However, only about 22% receive a weekly income greater than $100 per week, compared with the ‘free’ income, which full age pensioners are permitted of $69 per week for single pensioners and $60 per week for each partner of a couple. A.I.R.’s 2006 National Survey[4] (with 4,500 respondents, approximately one quarter of total membership), showed that approximately 50% of its members received some form of pension or assistance. The average annual income of all respondents to the Survey was approximately $53,000, about equal to the MTAWE at the time of the Survey. Hence, effective management of the tax transfer system is very important to the great majority of retirees and will be a major challenge facing Australia as the number of retirees increases in the future.

The need to replace capital items such as cars and washing machines increases with time. Even accepting that a car can be kept for ten years (well above the average age of cars in Australia), a car requires at least one replacement during the average retirees' life span of 17.7 years (the A.I.R. National Survey, 2006 showed that over 90% of respondents continued to own a car between 75 and 84 years of age, with 77% continuing to own a car over the age of 85[5]). The availability of a car remains essential if a retiree is to remain independent in their later years, e.g. to access shopping centres and to remain active. Activity in retirement is identified as essential to maintain health and minimise medical costs later in life.

Most retirees own their own home throughout most of their retirement. Household items such as washing machines also have a life less than the average retirees' life span of 17.7 years. To maintain a home over 17.7 years to a reasonable standard requires some capital expenditure (painting, plumbing repairs, etc.). Maintaining the capital value of a house is important to allow downsizing or other accommodation changes to meet retiree needs later in life.

Partly self-funded retirees do not, and will not, have sufficient assets to pay significant tax or build assets for estate planning purposes. Retirees in this category currently represent approximately 78% of all retirees over 65 years of age. Note also that Age Pension or related support is received by over 80% of male retirees between the ages of 70 and 90 and over 85% of female retirees between the ages of 70 and 100[6].

A.I.R. recognises that exemption from payment of income tax is undoubtedly an incentive for people to build assets in superannuation. However, from the point of view of those retirees who have untaxed superannuation funds or who do not have assets in superannuation while they are attempting to maintain a reasonable standard of living over their retirement life span, the present structure is discriminatory. Declining proportions of these retiree groups against those retirees with taxed superannuation funds means that the overall tax revenue take from retirees will decline in the foreseeable future.

Only a small percentage of retirees (22%), presently about 600,000 individuals, fall within the category where Government policies might require measures to prevent estate planning from Government support incentives. The cost of administering regulations for the great majority or retirees to control estate planning impacts for the few far outweighs the benefit to Government. It also impacts negatively on community perceptions by adding administrative complexity. A.I.R. takes the view that regulatory policies should be simplified for the majority of retirees, and that exception type policies should, if deemed necessary, be put in place to meet any Governmental concerns about the small percentage of retirees with very high incomes and assets.

Recommendation

- Tax revenue policy should recognise the need for the majority of retirees, who have only average level income and assets, to sustain their assets over their retirement life span.

3. Tax Transfer Churn and Offsets

As noted previously, the great majority of retirees have relatively low incomes. Approximately 78% of all retirees over 65 years of age receive some form of income support.

Since 1 July 2007, the tax structure of the cohort of partly self-funded retirees has been split into three:

(a) partly self-funded retirees with taxed superannuation funds who pay no income tax on pension withdrawals (subject to regulatory requirements),
(b) partly self-funded retirees with untaxed superannuation funds who pay income tax on pension withdrawals with some tax relief,
(c) partly self-funded retirees without superannuation who pay income tax on their full income.

The characteristics of each group of partly self-funded retirees are shown in Table 1.

Table 1 Asset Characteristics of Partly Self-Funded Retirees

Group	Type of Super	Income Tax	Comments
(a)	Taxed Fund	Exempt	Pension and earnings tax free; minimum age-related annual withdrawal. High growth in members because of Government superannuation policies.
(b)	Untaxed Fund	Liable	Typically Government-related staff;
(c)	Nil	Liable	Unable to access super in the past: e.g. women who were forced to resign to marry or have children, small medium businesses, casual workers. Will decline as a percentage of retirees because of Government policies on superannuation.

Note: *These characteristics apply to all retirees as well as partly self-funded retirees*

Group (a) is expected to have the highest growth in members and to dominate the other two groups in the future. Group (c) is expected to decline as a percentage of total retirees.

The tax transfer system is structured so that retirees receiving the full Age Pension pay no income tax. Thus, the tax transfer churn is zero. Partly self-funded retirees in groups (b) and (c) pay income tax while receiving some Government support, which leads to tax transfer churn.

Table 2 Tax Transfer Churn for Partly Self-Funded Retirees

Taxable Income	Age Pension	Tax Paid	Tax Transfer Churn	Tax Transfer Churn %	Comments
$17,805	$14,217	0	0	0	Max. Age Pension plus 'free' income
$25,867	$8,842	$750	$750	8%	Tax is paid and SATO reduces from this income
$28,000	$4,452	$1,337	$1,337	30%	
$30,000	$3,652	$1,887	$1,887	52%	
$32,000	$2,852	$2737	$2,737	96%	Tax paid approximates Age Pension received
$34,000	$2,052	$3,587	$2,052	57%	
$36,000	$1,252	$4,437	$1,252	28%	
$38,000	$452	$5,287	$452	9%	
$39,130	0	$5,767	0	0	Income limit at which the Age Pension cuts out

***Note:** Figures apply to the 2007/08 financial year. The figures do not include income from taxed superannuation funds.*

Table 2 shows that many partly self-funded retirees pay income tax while receiving Government income support. The level of tax transfer churn is approximately 30% over the income range from $28,000 to $36,000 and over 50% in the income range from $30,000 to $34,000. The tax paid by a partly-funded retiree with a total income of about $32,000 equals the part Age Pension received, or a tax transfer churn of 100%.

Partly self-funded retirees do not belong to the social group who can be expected to contribute tax revenue for redistribution to those in need. They are recipients of this tax redistribution. To require them to pay tax while receiving a part Age Pension is simply a way of the Government appearing to provide largesse to a community group.

Most partly self-funded retirees will depend on Government income support throughout their retirement life span. The Pension Review Background Paper shows that the current average time of receiving income support for retirees is 13.1 years. This is not a situation where people move in and out of Government income support as their family or work situation changes. Instead, the tendency is to become more reliant on Government income support with increasing age. Consequently, there is no need for partly self-funded retirees to be included in the tax revenue system because of possible changes in their circumstances over time.

If tax transfer churn is removed, there would be no need for partly self-funded retirees to prepare tax returns, thereby reducing their administrative burden and Governmental oversight costs. Income and asset tests for eligibility for the part Age Pension provides sufficient test of a retiree's financial position. Preparation of a tax return simply duplicates the process.

A.I.R. submits that tax transfer churn should be removed from partly self-funded retirees by removing their need to pay income tax. The percentage paying income tax is small and reducing as a proportion of partly self-funded retirees. The cost to Government of this unnecessary churning in the tax transfer system is not justified.

One of the Terms of Reference of the Review is directed to simplifying the tax system. In this context, linking offsets and appropriate allowances to marginal tax threshold limits would assist. Offsets, allowances, and concessions would automatically be adjusted to movements in these threshold levels. The principles of this model for partly and fully self-funded retirees are:

- partly self-funded retirees would pay no tax,
- tax transfer churn would be removed, and
- offsets would be linked to marginal tax thresholds.

The Senior Australians Tax Offset (SATO) was introduced to remove the need for full age pensioners to pay tax. Its flow-on effect was to reduce the tax paid by partly self-funded retirees.

A.I.R. proposes that SATO be restructured to commence from the taxable income at which the part Age Pension ceases (currently $39,130) and made equal to the tax payable on that income of $6,339 (the current full value of SATO is $2,220). SATO should then be phased out linearly to cease at the upper end of the 30% marginal tax range ($75,000), a reduction rate of 17.7%, against the current reduction rate of 12.5%. This proposal links SATO to the marginal tax/threshold limits applying to personal income tax revenue.

Table 3 shows the cost to Government, against current costs at various taxable income values, of using SATO to remove the need for partly self-funded retirees to pay income tax, and of phasing SATO out at the $75,000 taxable income threshold.

Table 3 Cost to Government of the Proposed Income Tax Model for Partly Self-Funded Retirees

Taxable Income	Age Pension	Base Tax	SATO	Net Tax	Cost to Govt.	Comments
$17,805	$14,217	0			0	
$30,000	$3,652	0	0	0	$1,887	Approximately middle of the part Age Pension range.
$39,130	0	0	$6,339	0	$5,767	Part Age Pension upper limit
$43,707	0	$7,712	$5,530	$2,182	$5,530	Current SATO upper limit
$50,000	0	$9,600	$4,418	$5,182	$4,418	Current CSHC upper limit
$75,000	0	$17,100	0	$17,100	0	Current threshold limit of the 30% marginal tax range.

Note: *These figures apply to the 2007/08 financial year. Cost to Govt. is the increase over present costs. The figures do not include income from taxed superannuation funds.*

A.I.R. does not have the data or resources to estimate the total cost of the proposal. However, it believes that the cost is reasonable bearing in mind that:

- a substantial and increasing proportion of partly self-funded retirees pay no tax because of their superannuation arrangements, but receive the benefit of the part Age Pension;
- the cost will decrease over time as a proportion of the cost of maintaining the Age Pension;
- the cost could be partly offset by removing the payment of supplements from the Commonwealth Seniors Health Card and returning it to its original purpose, namely to meet pharmaceutical benefit costs, hearing and dental care (see Section 5 of this submission).

Erosion of the asset base for a partly self-funded retiree presently required to pay income tax will inevitably lead to an increase in the percentage of the part Age Pension paid to the retiree and a consequent reduction in independence and standard of living. Eventually, the retiree is likely to become a full age pensioner, which is not in the interests of Government.

Recommendations

- Tax revenue policy for partly self-funded retirees who do not receive income from taxed superannuation funds should be aimed at simplifying tax regulations and removing tax transfer churn.
- Partly self-funded retirees should not be required to pay tax on their income.
- SATO should be changed to commence at the single-income threshold at which the part Age Pension ceases to be paid. Its value should be set at the tax payable at that income threshold (currently $6,339). SATO should then be phased out linearly to cease at the upper income threshold for the 30% marginal income tax rate.

4. Superannuation

It is accepted that assets accumulated in superannuation will become a major part of retirees' assets in the future. It is also accepted that these assets will not cover the full needs of retirees. The proportion of partly self-funded retirees will increase significantly.

APRA 10 year performance figures[7] for taxed superannuation funds show that over the period 1996 to 2006, retail superannuation funds[8] achieved a return on investment to contributors of 5.3%. During that period, the CPI increased at an average annual rate of 2.6%. Therefore, the real increase in superannuation assets based on the CPI averaged 2.7%. Thus, the income available to contributors, if they are to retain the real value of their assets as measured by the CPI, is 2.7%.

A contributor would require a superannuation asset of $211,000 to support an income of $120 per fortnight, which is the 'free' income allowed for each partner of a couple on the full Age Pension. The Pension Review Background Paper shows that only a very small percentage of pensioners report assets at or above this level[9].

Note that the CPI is not regarded as a good indexation measure of the needs of retirees. Over the period 1996 to 2006[10], the MTAWE has been used as a more appropriate measure for measuring costs for age pensioners, as it has increased at a greater rate than the CPI over the period. Hence, the CPI can understate the increase required to sustain retirement assets in terms of the real needs of retirees.

Taxed superannuation fund regulations require that at least 5% (this figure increases with age) of fund assets must be withdrawn each year. Hence, under present regulations, it is not possible to retain the value of superannuation assets over the average term of retirement (a reduction of at least 2.3% per year). The average return for all superannuation funds was 6.7% over the ten-year period. Even if this higher figure is used, there is still a decline in real assets of at least 0.8% per year. Furthermore, - noting for example, the current share market volatility - there is no guarantee that returns will remain at this level. A recent ASIC report shows that returns for the ten-year period prior to 30 June 2008 were significantly lower than those for the period 1996 to 2006[11].

Using a superannuation fund asset of $200,000 as an example (approximating that required to meet the 'free' Age Pension income allowance), using an average CPI of 2.6% (the average between 1996 and 2006), and using the current age-related minimum withdrawal superannuation percentages, the value of the asset at age 90 in 2006 dollars will be approximately $86,000. If two withdrawals of 20% of the assets are made for capital purchases (car), or home maintenance, or emergencies at age 71 and at age 80, the value of the asset at age 90 in 2006 dollars will be approximately $62,000. These amounts at age 90 provide little comfort to a retiree that needs can be met.

Noting that the Pension Review Background Paper shows that the percentage of Age Pension recipients have assets well below $200,000, it is clear that the minimum withdrawal percentages specified in the taxed superannuation fund regulations are too high.

Regulations forcing withdrawal of a fixed percentage of taxed superannuation fund assets presuppose that a retiree can invest the proportion of assets, forced to be withdrawn, outside superannuation, such investment then being subject to the normal taxation regime. Using the above example of a retiree with taxed fund superannuation assets of $200,000, with the amount withdrawn for income purposes of $104 per week (2.7%), and with a required minimum drawdown of 5%, the amount available for investment would be $88 per week ($4,576 per year). This amount is too small to justify a retiree making the effort to invest it other than in a bank.

Thus, the returns would be less than those achieved in superannuation and the policy benefit to the Government is negative. Indeed, the policy has the effect of encouraging a retiree to spend the total amount withdrawn, including the amount that should be used to preserve the retiree's assets. A very high proportion of retirees on superannuation, now and in the future, will not wish to manage investments outside superannuation, other than a relatively small amount in a bank account.

If the minimum withdrawal figure is set at the difference between the average ten-year superannuation fund return and the CPI over the same period, a person with a superannuation asset of $200,000 would have assets in 2006 dollars remaining of $185,000 at age 90. If two withdrawals of 20% of assets are made at age 71 and age 80 respectively, the remaining assets in 2006 dollars at age 90 would be approximately $128,000. A.I.R. submits that this is a more reasonable approach to preserving assets over the retirement life span.

A.I.R. submits that the present regulations requiring a minimum amount to be withdrawn should be removed entirely. Alternatively, if the Government wishes to retain such a regulation, the percentage should be set at the real return on assets of retail superannuation funds based on the index used for indexing the Age Pension.

The superannuation system is in a transition phase and many contributors have not had the opportunity to build superannuation assets over a reasonable period. Instead, they have had to build their retirement assets outside superannuation. During this transition phase access to superannuation should be available to all retirees at any age, including beyond 75. In the future, the number of retirees wishing to contribute to superannuation beyond 75 will become insignificant.

The work test that is currently required for all retirees between the ages of 64 and 75 to allow them to contribute to superannuation is an arbitrary and iniquitous hurdle that does little to encourage people in this age group to continue to work. It simply adds to the complexity of the tax system and encourages attempts to obviate the law. It is a disincentive for retirees between these ages to work. It disadvantages some retirees over others. An example is the case of widowed women who have not worked since marriage, but managed their households. Many do not have access to private business contacts to provide them with work. They are seriously disadvantaged. The work test also distorts the value that retirees give to the wider community, e.g. retirees in this age-group add more value than they receive without the need for a work test (see *The Future of Retirement, HSBC Report, June 2007*).

Retirees who derive income from taxed superannuation schemes, i.e. schemes on which the requisite taxes were paid on superannuation contributions and earnings, are treated differently for taxation purposes than retirees who derive income from untaxed defined benefit superannuation schemes (e.g. Commonwealth, State and Defence Force personnel).

In the case of a taxed superannuation scheme the component of a retiree's income that is derived from the scheme is regarded as having a value of zero for tax assessment purposes. If the retiree has an additional income component that is derived from 'outside' sources that are not within the superannuation umbrella, that outside component is then assessed at normal taxation rates as if it were the sole income for taxation purposes.
In the case of an untaxed scheme, however, the pension stream derived from the superannuation fund is not tax-free. Instead, the pension income is added to the income from 'outside' sources, and the tax payable is calculated. Then, a concessionary tax offset of 10% of the pension is subsequently applied to the tax payable, whose derivation usually involves the application of a higher marginal tax rate, on the combined taxable income.

The anomaly associated with the differing treatments of 'outside' incomes was addressed in the bipartisan *Report of the Senate Economics Committee (dated February 2007)* which recommended that, for equity reasons, the two types of income should be treated separately, viz

> *"3.58 The Committee is of the view that the Government should reconsider the way in which total taxable income is classified for those in untaxed schemes. Instead of combining both a superannuation income stream and additional income to produce a total assessable income, the two types of income should be assessed separately. This would enable additional income received by all superannuation income stream recipients to be assessed for tax purposes from a starting point of zero.*
>
> *Recommendation 4: The Government should consider separately assessing, for taxation purposes, superannuation income streams and assessable income."*

Recommendations

- Present regulations that require a minimum percentage of the assets to be withdrawn from a taxed superannuation fund each year should be removed. Alternatively, if the Government wishes to retain such a requirement, the minimum percentage should be set at the ten-year real return of retail superannuation funds. The real return should be based on the Age Pension indexation parameters.
- All age-related tests and restrictions placed on taxed superannuation funds that are applicable to retirees over the age of 65 should be removed.
- Superannuation income streams that are received from taxed and untaxed funds should be assessed separately from other assessable income as recommended by the Senate Economics Report February 2007.

5. Commonwealth Seniors Health Card

The Commonwealth Seniors Health Card (CSHC) primarily provides access to concessional prescription medicines under the Pharmaceutical Benefits Scheme for retirees with incomes over the income level at which the Age Pension phases out. The CSHC is currently available to a single retiree with an income of $50,000 per annum compared with the income at which the Age Pension is phased out of $39,130 (for couples the figures are $80,000 and $65,624 respectively).

Even though the CSHC is linked with other Australian Government Transfers which attract adjustment for inflation[12], it has not been adjusted since 2001. There are approximately 300,000 recipients of the CSHC compared with nearly 2 million Age Pension recipients, and the cost is approximately 1% of the cost of the Age Pension.

The CSHC was introduced from July 1994. Income test limits were increased in January 1999 and again in September 2001. They have not been increased since. Non-indexation is simply a means of reducing the number of eligible retirees over time and is a clear case of discrimination against self-funded retirees. Because of the impact of illnesses to which the elderly are vulnerable, if the CSHC is not available, the consequent drawdown of assets leads to a reduction of the asset base of the retiree.

The Bills Digest[13], which addressed changes to adjusted taxable income for the CSHC that were announced in the 2008 budget states that: “With the income test limits being set at $50,000 single and $80,000 partnered, the CSHC is now no longer a low-income health card”. A.I.R. rejects this statement.

The CSHC threshold limit has declined in real terms since 2001. If indexed since that time, the partnered income test limit would be over $110,000. It would more closely relate to recent Government means tested cut-off points, which recognise average Australian incomes. For example, recent changes to the private medical insurance subsidy raised the limit at which extra income tax is payable to $150,000 per household. Similarly, the subsidy on installing solar electric panels has an income cut-off of $100,000. Income tax threshold levels have been increased to recognise average incomes of $150,000.

If the CSHC had been indexed for singles since 2001 it would have led to a threshold limit of approximately $70,000, which is close to the upper income threshold for the 30% marginal tax rate, currently $75,000.

A.I.R. proposes that the present relationship between the income threshold limit for couples and for singles of 1.6 should be retained.

As noted previously, the use of capital assets to replace or maintain capital items, or for unforeseen needs, erodes the personal asset base. For taxed superannuation funds, these asset withdrawals appear as income in the proposed adjusted income for determination of means tested support, allowances, and concessions. Eligibility for the CSHC is affected by the proposed changes. To encourage self-funded retirees with income from taxed superannuation funds to sustain their assets, these amounts should not be included in the determination of adjusted income for means testing income support, allowances, and concessions.

A more equitable and reasonable approach would be to use the average income from the fund over the previous three years to calculate income.
The model proposed in Section 3 would allow the CSHC to be restructured to meet its original purpose, to provide assistance with pharmaceutical costs, hearing aids, and dental care. These are the highest priorities for self-funded retirees who are eligible for the CSHC.

Recommendations

- The upper income threshold used for eligibility of a single person for the Commonwealth Seniors Health Card should be set at four times the single-person Age Pension. The ratio between single and partnered income thresholds should remain at 1.6 times.
- Extraordinary one-off withdrawals from taxed superannuation funds should not be included in adjusted income for determining eligibility for means tested support, allowances, and concessions, including the Commonwealth Seniors Health Card, as is the Government’s intention for 2009. Because of the administrative difficulty of defining extraordinary one-off withdrawals, adjusted income should be based on the average total income of the previous three-year period.

- Adoption of the model proposed in Sections 1 and 2 would allow the CSHC to be restructured to meet its original purpose, viz. to provide assistance to self-funded retirees with pharmaceutical costs, hearing aids, and dental care.

6. Transfer of assets

As stated above, the superannuation system is in a transition phase and many retirees have had to build their assets outside superannuation. Despite the availability of superannuation, it is expected that many people in the future will maintain some assets outside superannuation.

Present superannuation regulations exclude investment in residential property, although this exclusion is breaking down through the development of devices such as instalment warrants, which can circumvent this requirement. The original intent of the Superannuation Act has been breaking down. Investment rules are no longer transparent and are now extremely complex. A.I.R. sees this as a breakdown in Government policy consistency, which impacts negatively on the superannuation system.

Many younger working age people invest in rental property. It is an attractive class of investment perceived to be a long term investment with flexibility to manage total investment assets during their working life. Because of capital gains tax requirements, they find it difficult to sell property assets after holding them for some years. Consequently, they find it difficult to transfer assets into superannuation. Therefore, it is likely that many future retirees will have assets within and outside superannuation.

To maintain the integrity of personal assets outside superannuation during retirement, it is highly likely that some of these assets, whether they be in equities or property, will need to be sold and the proceeds invested in other assets. In many cases these assets will have been held for lengthy periods and will have accrued significant capital gains.

Assets are used to produce income to support the retiree over the retirement life span. At some stage, and usually on a number of occasions, some assets need to be sold and converted into income for pensions, for lump sum capital purchases, for major maintenance, for accommodation changes, and for health and other emergencies. These assets were accumulated with after-tax income.

The payment of capital gains tax for retirees on the sale of assets required to meet income needs, to maintain the quality of assets, or for extraordinary one-off purposes, is a major disincentive to good management of assets and of income. Capital gains tax does not apply to assets sold and bought to maintain the integrity of assets, or to pay pensions, in taxed superannuation funds (subject to tax-free regulations).

Superannuation policy recognises that asset sales may be lumpy causing disadvantage in a particular income tax year. For this reason contributors to superannuation are able to spread their contributions over a three-year period.

There is no distinction in the calculation of personal taxable income for retirees as to the purpose for which the capital gain is to be used. Capital gains tax is applied to all capital transactions, for whatever purpose. Capital gains tax distorts good economic management as it causes retiree asset holders to continue to hold poorer yielding assets instead of moving to better yielding ones.

State taxes, such as stamp duty, have the same effect in distorting good economic management of retiree assets. If a retiree wishes to sell a rental property and purchase another of similar value for effective asset management purposes, the sale will attract capital gains tax and both sale and purchase will attract stamp duty and legal costs.

This submission has argued that the great majority of retirees do not hold assets at a level that would be regarded as unreasonable. However, the current tax and means test regulations act negatively and seriously on retirees' ability to manage their assets over their retirement life span.

A.I.R. acknowledges the concern of Government that the purpose of superannuation is not to enable assets to be built for estate planning purposes using Government incentives. It believes that the number of retirees who have sufficient assets, over and above their risk management needs, to make this a concern is small. Linking exemption from payment of capital gains tax to the upper income threshold for the 40% marginal tax rate would be a simple method of limiting misuse of an exemption from capital gains tax that should be made available to the great bulk of retirees.

Recommendations

- For retirees over the age of 65, capital gains tax arising from sales of capital assets held outside superannuation, for whatever purpose, should not be included in taxable income until the retiree's taxable income exceeds the upper income threshold for the 40% marginal tax rate.

7. Encouraging working over the age of 65

The Government has recognised the advantages to the economy and the community of encouraging people over the age of 65 to work. Work creates activity and interest, which is important for the health of retirees. From a national perspective, it is particularly important at a time of chronic skills shortage. Some Government incentives have been made available to encourage people to work, including the Mature Age Workers Bonus.

However, desirable it may be, the data indicates that a very small proportion of people over the age of 65 work. A.I.R. believes that this figure might be understated because many people may not wish to declare their interest in work. There has been little research to discover a) whether the percentage is higher because of hidden or undeclared work, and b) the categories of people over the age of 65 who work or the type of work they undertake. A.I.R. believes that there are a number of reasons that people work after retirement including: maintaining interest in their business, wishing to continue to use their personal skills through working as an employee or developing consultancies, wishing to use work as an activity in retirement, and assisting to maintain income.

A.I.R. supports the Government in moves to encourage people to work during retirement, but does not support any policy that applies pressure on retirees to work, such as raising the retirement age.

One method of changing community and individual attitudes to working after the age of 65 is to change the concept of ‘retiring’ from one where a person is expected to stop work at age 65 to one where people undertake a wide range of activities to meet their individual interests and needs. Age 65 should be seen as an age where people can access certain benefits, such as their superannuation, or the Age Pension, rather than the age where they stop work. The concept is similar to the concept of the transition from work to retirement from age 55 to 65. This concept could be broadened to transition to retirement from age 55 to any age after 65.

Recommendations

- Additional income earned by a retiree from personal work after the age of 65 should not be included in the Age Pension income test;
- Age-related work tests should not be used to disqualify a person from contributing to a superannuation fund;
- There should be no compulsion on people to work after the age of 65, as would be effected by raising the retirement age.

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[1] Architecture of Australia’s tax and transfer system Aug 2008 Australian Government Treasury, Executive Summary, p.xvii. Tax transfer churn is defined as follows: “There are many families and individuals who receive transfers and pay tax in the same year and from one year to the next. This ‘churn’ imposes costs on individuals as well as the administration of the system.
[2] Architecture of Australia’s tax and transfer system Aug 2008 Australian Government Treasury, Section 1.2
[3] Pension Review Background Paper August 2008 Dr Jeff Harmer. Executive Summary
[4] A.I.R. National Survey 2006 www.independentretirees.com.au
[5] A.I.R. National Survey 2006 www.independentretirees.com.au
[6] Pension Review Background Paper August 2008 Dr Jeff Harmer.Chart 20
[7] APRA Celebrating 10 Years of Superannuation Data Collection 1996-2006. Table 8
[8] The return for retail funds has been chosen because a high proportion of contributors come from small businesses or private companies. These contributors are likely to require Government support through the Age Pension.
[9] Pension Review Background Paper August 2008 Dr Jeff Harmer. Executive Summary
[10] Pension Review Background Paper August 2008 Dr Jeff Harmer. Chart 12
[11] Ten-year performance of superannuation funds to 30 June 2008. www.fido.gov.au 1 September 2008
[12] Architecture of Australia’s tax and transfer system Aug 2008 Australian Government Treasury. Table 2.8 Australian Government Transfers in 2006-07.
[13] Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2008, Bills Digest