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Secretary to the Treasury
Dr Ken Henry AC
Chairman Australia's Future Tax System Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

Retirement Income Consultation Paper – December 2008

It has been our experience, based on client feedback, that the Simpler Superannuation changes made under the previous government have been regarded as overwhelmingly positive. There were a number of fundamental changes introduced at the time and client strategies have been re-shaped in light of these changes. These include the tax free nature of superannuation income (once people reach the age of 60 years) and the uncapped ability to withdraw funds in pension phase.

Significant decisions have been taken by clients, in consultation with planners, to better position their retirement plans in light of these changes.

Hence the thrust of our concerns about the current superannuation system, or more particularly, the way in which potential change arising from this enquiry might be handled, is twofold:

- People need **stability** around the key elements of any system, but particularly one as important as, and with the associated longevity of, the retirement incomes system.
- The system should strive as far as possible to be **principles based** rather than prescriptive (granted, this can produce some administrative inefficiency but we contend that this is a small price to pay), with the net result being greater "equity of opportunity" in accessing the various elements of the superannuation system.

In this latter regard, there are some areas of the current arrangements that would benefit from a degree of principles-lead simplification – namely around contribution eligibility, transition to retirement and accessing of benefits.

We have compiled this submission based on the personal circumstances of, and concerns expressed by our clients. The issues raised are very real and the solutions we have proposed are designed to deal with these concerns in a pragmatic and equitable way.

We would appreciate the opportunity to discuss these matters further with members of the Panel or The Treasury

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Submission in Response to the Retirement Income Consultation Paper Prepared by the Panel of Australia's Future Tax System (Dec 2008)

February 2009

AXIOM

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1.0 Executive Summary

We believe that one of the largely overlooked considerations for the retirement income system is the over-riding need for **stability** (which does not appear to have been explicitly acknowledged in the Consultation Paper). People have made informed decisions about their retirement planning based on the legislation of the time. The primary message conveyed to us by our clients and which we in turn seek to communicate to the panel, is to caution against any moves that might pre-emptively dilute current retirement income benefits - particularly any revisions that seek to limit the ability of individuals to withdraw funds in pension mode.

There are also some specific "principle-lead" changes which we would recommend, designed to promote an "**equity of opportunity"** within the current system, namely:

- PAYE employees should be entitled to make **lump sum (or periodic) concessional contributions** (ie tax deductible contributions other than by way of salary sacrificing)
- There should be an additional "event-based" contribution category (similar in nature to the small business CGT limit) to allow the **proceeds of the principal residence to be contributed on a non-concessional basis** into superannuation. This limit would be separate to existing contribution caps and would be accessible by anyone (irrespective of age) selling their principal residence (subject to a lifetime cap of, say, $1million).
- The current transitionary **Concessional Contribution Cap of $100,000** for those aged 50 years and over (currently due to expire in 2012) **should be permanently retained**
- The Transition to Retirement (TTR) provisions should be **available to all persons upon attaining the age 55 years**. In this regard, the current tiered preservation age ranges (55 years for those born before June 1960 to 60 years for those born after June 1964) should be **abolished** for those accessing their superannuation by way of TTR (ie as an income stream).
- The definition of retirement should be simplified to "**ceasing paid work**", with consequential implications for contributions and accessing of benefits.

These recommendations are based on the experiences and concerns of our clients. They would significantly enhance people's engagement with, and confidence in, the superannuation system. We believe that the outcome of their implementation could be significantly higher levels of individuals moving into self funded retirement (and a consequential reduction in reliance on the age pension); together with improvement in the quality of life for many working and retiring Australians.

2.0 A stable retirement income system

There are many virtuous principles outlined in the discussion paper, all of which contribute to a greater or lesser extent to the overall "appropriateness" of the system. But the single most important factor that people look for in a system such as the superannuation system is **stability**. It should be an over-riding consideration in the minds of policy makers. People make long term decisions based around the frameworks of the time and hence they should not be changed without proper consideration of the practical consequences. Where benefits are bestowed and people adapt their retirement planning accordingly, these benefits shouldn't be snapped back at a whim.

Based on our interactions with clients seeking to better manage their wealth outcomes as they approach retirement, stability is probably the single most important issue in the design and management of the system. A change in something like retirement income policy can have and enormous impact on people's confidence in the underlying system and in turn, their level of trust in the Government of the day.

Retirement planning is a long term activity. The investment strategies that underpin it are premised on particular super, retirement and tax laws. The system, therefore, must provide a backdrop of "certainty" against which this planning can meaningfully take place. Our experience has been that clients are very distrustful of governments (of either persuasion), cynically asserting that "that's what they say now, but they'll change it before the next election". **If you want people to have confidence in the retirement income system you need to demonstrate a sensitivity to this need for stability.**

This is not to say that there can never be substantive change, but it needs to be rational (to the individual) and where it represents a potential diminution of currently enjoyed benefits, it needs to be transitioned so that previous retirement plans are not invalidated over night by the latest legislation.

2.1 Unlimited withdrawal from super

Many Australian's have made significant additional contributions into superannuation premised on the currently legislated ability to withdraw lump sums from accumulated superannuation in pension phase. We would estimate, based on an extrapolation of our client base, that the figure of additional discretionary contributions made into Superannuation over the past 18 months (since the introduction of the Simpler Super changes) would run into billions of dollars. All of this money has been contributed on the understanding that it could be withdrawn at any point once the fund was in pension mode.

If people weren't convinced about the merits of superannuation historically, then the fact that they can now potentially receive a tax free income in retirement from accumulated

superannuation savings has certainly sparked their interest. The equally important policy adjunct to this move to provide tax-free income is the change that enabled individuals to withdraw uncapped amounts from superannuation - it is the natural corollary of the tax-free policy. We would contend that if the Government has seen fit to exclude the tax free status of retirement income from the Panel's terms of reference, then the ability to withdraw uncapped levels of funds from superannuation also needs to be removed from the terms of reference.

With retirement income having a tax-free status, individuals now have an even greater incentive to contribute into superannuation. But the natural resistance of those approaching retirement is "what if I need some of the money back". The answer is currently simple - "they can withdraw it". People don't expect to have to withdraw any more money than they need to support their regular lifestyle needs in retirement, but they do get enormous piece of mind knowing that if a situation arises and they need to access a lump sum, then they can do so. It may be for treatment of a very ill family member or to support the business aspirations of a child. They are invariably far from trivial purposes and any additional withdrawals (over and above pensions) are only ever taken reluctantly and after careful consideration of the options. This reluctance is entirely understandable given the tax free nature of the earnings and payments from superannuation, and the inability to contribute back into superannuation at a later date.

It is interesting that there has been some inference about the potential for people to "splurge" their retirement savings on frivolous lifestyle items (eg overseas trips, cars, boats, etc) with a consequence that these individuals then find themselves dependent upon the age pension to support themselves in retirement. Our client experiences couldn't be further from this notion. People who have accumulated significant funds in superannuation are extremely reluctant to "splurge" in their retirement. They tend to live in a manner commensurate with their pre-retirement lifestyle and recognise the value of maintaining as much of their monies as possible inside the concessionally taxed superannuation environment.

We would contend that the people who are more likely to "splurge" their retirement savings and subsequently find themselves dependent upon government welfare (ie age pension) are those individuals with lower superannuation balances. In point of fact, these individuals have always been able to access their retirement funds tax-free (with the previous lump sum tax free thresholds) and hence in reality, the uncapped withdrawal provisions have not lead, and in our experience will not lead, to any accelerated depletion of retirement savings and consequential increased reliance on welfare. Indeed, the policy has resulted in **increased levels of funds being contributed** into privately funded superannuation, potentially reducing any (partial) reliance on the age pension in the future.

The significance of the additional monies that have been contributed into superannuation as a result of the tax free provision and uncapped withdrawal policies should not be under estimated. We have had clients (for example) contribute the sale proceeds from commercial and residential premises, inheritances and other windfalls

into superannuation on the basis of their understood ability to withdraw some portion or all of these funds in the future should the (unexpected) need arise.

We also have clients approaching retirement who have borrowed against their residential homes (on the basis that they would down-size their housing requirements in the short term), to make a one or two million dollar contribution into superannuation, effectively bringing forward the equity contribution from their home that would arise in due course as a result of down-sizing. The financial benefits that accrued from being able to leverage the $1m per person transitional contribution opportunity were significant and an important risk mitigation consideration for these type of strategies was the fact that if (for whatever reason) the client's circumstances changed (for example, that they chose not to down-size or the property market collapsed) they could always withdraw the funds from superannuation (in pension mode) and repay the loan. Clients are obviously advised that legislative and tax laws can and do change, but they have relied in good faith on the Government not reneging on the withdrawal provisions, or at the very least, providing suitable transition provisions if a change were to be contemplated.

It has always been the case that non-concessional contributions could be withdrawn (in total) from retirement pensions and without tax consequences. For many years, as people approached retirement, it was common for large undeducted contributions (representing the down-sizing of residences, inheritances and the like) to be made into superannuation. These undeducted contributions were made against a legislative backdrop that allowed for their full tax-free withdrawal at any point after retirement.

Whilst we are clearly advocating no change be made to the ability of individuals to withdraw monies from privately funded pensions, if, for whatever reason, the panel or the government considered such a move to be desirable, then **equitable transition provisions** must be developed. These might include the continued exemption of all non-deductible (ie non-concessional) contributions; the quarantining of **any** discretionary contributions made prior to the date of any contemplated change, or the categorisation of fund balances at a prospective date being "non-preserved" (for the purposes of uncapped, tax free withdrawals) and any subsequent contributions or fund growth after said date being "preserved".

3.0 Principles Lead Rather than Prescriptive Change

Our desire to see a greater reliance on principle rather than prescription reflects the notion that there should be an "**equity of opportunity**" within the system. All individuals should have the ability to avail themselves of the various provisions of the system and not be precluded simply because of an arbitrary age-based restriction or other limitation.

Many of the principles that underpin our current retirement income system are admirable and well supported by individuals and the financial planning community. However, the problem arises when legislators seek to translate the principles into prescriptive regulation (usually) to provide for ease of administration. Some of the areas where we see an opportunity to remove some of the prescriptivity and revert to principle include:

- Discretionary Contributions – Pay As You Earn (PAYE) tax deductibility of one-off or periodic contributions, together with the maintenance of current transitionary caps for those over 50 years of age
- Special (or event based) Contributions – specifically as they relate to the sale proceeds from the principle residence and increased levels of contributions prior to retirement
- Transition to Retirement (TTR) – universal access to TTR provisions for all workers attaining the age of 55 years (to support changing work/life patterns).
- Retirement – ceasing paid work as a simple method for defining retirement

3.1 Discretionary Contributions

The two areas where we see an opportunity to extend or preserve contribution opportunities are in relation to PAYEs and the pre-retirees:

3.1.1 Pay As You Earn (PAYE)

All discretionary contributions into superannuation should have the opportunity of being tax deductible up to the level of the current concessional thresholds (CCC). The problem with the current system as it relates to PAYEs is that it requires significant premeditation (ie salary sacrificing has to be arranged in advance and is based on an ongoing deferral of consumption or other forms of discretionary savings).

There is no such requirement placed on self employed persons, who are able to await the end of the financial year (or any point up until that time) before deciding upon the level of any concessional and non-concessional superannuation contributions.

Why shouldn't PAYEs have the same opportunity, particularly as it relates (say) to windfalls such as inheritances, lottery win, bonus payments and the like? Why shouldn't it be possible for these receipts (or some portion thereof) to be directed tax effectively into superannuation? Any amount contributed in this way could then simply be included as a deductible expense on the annual tax return. This approach for PAYEs would then align with the current position for the self employed.

3.1.2 Pre-Retirement Contributions

The unfortunate reality about trying to encourage individuals to think about retirement earlier in their working life is that even in the face of the most compelling incentives you care to lay in front of them, people will still leave contributing a large portion of their superannuation needs until late in their working life.

In the absence of potentially mandating higher levels of SG contributions there needs to be an ability for individuals to ramp-up discretionary contributions in the later stages of their working life. In this regard, the current transitionary arrangement, which allows for concessional contributions of up to **$100,000 if aged 50 years of above (due to expire in 2012) needs to be permanently retained.**

There are many reasons (outside of simply apathy) which perpetuate this later stage contribution tendency, most of which revolve around the reality of family cashflows (eg children's education expenses, mortgage payments, etc). With the better part of child-support expenses behind them, with a possible down-sizing of the family residence, the receipt of inheritances and the like, the ability of individuals to direct a significantly increased proportion of their incomes/cashflow into superannuation rises dramatically later in life.

Hence, we see it as imperative that the current (higher) transitionary concessional contribution cap (CCC) of $100,000 per annum be **permanently retained**. Anyone over the age of 50 years should, and indeed needs to, be able to contribute higher levels of their available funds into superannuation.

The extension of this provision would be enhanced with the simultaneous implementation of our previous recommendation that everyone (including PAYEs) be able to claim a tax deduction for any contributions into superannuation up to the level of the CCC.

3.2 Event-Based Contributions

There is currently some limited provision within superannuation regulations to provide for the contribution of the sale proceeds from the family home (ie the non-concessional contributions cap). However, the contributions are capped at $150,000 per annum (with a bring-forward provision of a further 2 years).

We would argue that in the same way that there is specific provision within current laws to allow small business owners to contribute proceeds from their businesses into superannuation, then the case can be made for a similar regime (separate to CCC and NCC) for the proceeds of the sale of the principal residence to likewise be contributed.

A lifetime limit (up to $1m dollars per person) could be applied – this could be accessed on multiple occasions, however it is likely that it would be a one-off transaction. There would be no need for the contribution to be afforded any type of tax deductibility (ie it would be a non-concessional contribution). As indicated above, any contribution made under the “principle residence contribution cap” would be separate to the standard CCC and NCC limits.

As this would be an event based limit, there would be no age restriction limiting when this money could be contributed into superannuation. For example, if someone had been retired for a number of years and was (say) 72 years of age, they could still contribute the sales proceeds from their principle residence into superannuation (up to the $1m limit).

3.3 Transition to Retirement

The transition to retirement (TTR) provisions introduced in 2005 represented a significant step forward in recognising the changes that are occurring around peoples work patterns and life expectancy. With people generally working longer, the TTR provisions provide the ability to wind down from full-time employment over a period of time (particularly for the self employed) or to facilitate a late-in-life career change enabling someone to undertake potentially less demanding or more altruistic pursuits (eg teaching, child care, charitable employment, etc).

Increasingly, people’s lives are overlaid with significant stress, much of which is sourced from their employment situation. For those people who have provided reasonably well for themselves via their superannuation (usually as a direct result of a lot of hard work earlier in their lives), TTR provides an opportunity for them to step away from the treadmill and try something a little different, or to at least slow down the pace associated with their current role.

The TTR provisions contain an obvious economic benefit – extending people’s working lives increases their productive contribution. However, there is an equally important psychological benefit which we would contend adds to the quality and potentially the quantum of people’s lives. Whilst the latter may be difficult to confirm without a longitudinal clinical study, the anecdotal evidence from our client base is that TTR clients sleep a lot more soundly at night being able to work fewer hours or undertaking different types of paid or unpaid work.

We therefore recommend that all working Australian’s should be provided with access to TTR arrangements **from age 55 years**. This would mean the abolition of the current tiered preservation arrangements for those born after 1960 – which effectively lifts

retirement age to 60 years. Attaining age 55 years would only allow access to a **superannuation pension** whilst the tiered preservation provisions could still be applied to lump sum access (although one could argue that taxation levels could be applied to provide a sufficient disincentive for lump sum access at an earlier age).

3.4 Retirement

There seems to be a preoccupation in superannuation legislation with trying to define what exactly constitutes “retirement”; be it in terms of when an individual can access (lump sum) entitlements or make contributions.

The simple matter is that a person retires when they cease employment – not when they reach age 60 years or even potentially 70 years. Increasingly, age is becoming less of a determinant in defining retirement.

Accordingly, people should be able to contribute to superannuation whilst ever they are in employment. If someone is working at 78 years of age, they should be able to contribute to superannuation in order to support themselves in retirement - where they may live up to or beyond the age of 95 years. If it “helps” to have some type of work test then the existing standard (ie 40 hours gainful employment in a 30 day consecutive period within the year) could be applied.

4.0 Conclusion

The changes that have been proposed in this submission are designed to provide greater equity of opportunity for individuals in leveraging the various elements of the retirement income system. The recommendations are premised on the view that the public purse is best served by people privately accumulating as much as is practical to support themselves in their retirement.

The other key message is about the over-riding need to preserve some semblance of **stability** in the superannuation a system. People's enthusiasm for superannuation is in large part premised on the confidence they have that what they are told about the way the system will operate for them in retirement today, will in fact be what they encounter when they actually retire. If change is considered prudent, then equitable transitioning provisions need to apply.