COMBINED PENSIONERS AND SUPERANNUANTS ASSOCIATION OF NEW SOUTH WALES INC.

Serving the community since 1931.

Consumer Protection Awards – 2002, 2003, 2004, 2005

Australia's Future Tax System

Ref. IPA.005/122.002

Australia's retirement income system

February 2009

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

Executive Summary

1. Australia's retirement income system's primary objective should be to provide an adequate income in retirement regardless of an individual's circumstances.

2. The current retirement income pillars fail to provide all retirees with an adequate income. Retirees with the pension as their sole source of income must be provided a Cost-of-Living Supplement to ensure they achieve a modest standard of living.

3. In addition to providing pensioners with no private income a Cost-of-Living Supplement, focus needs to be turned to low income earners and their superannuation during the accumulation phase.

- The Superannuation Co-contribution needs to shift to a 'Superannuation Contribution', provided to low income earners regardless of their voluntary contributions.
- Taxation of superannuation contributions needs to be removed for low income earners, with the cost offset by a higher taxation of high income earners at the contribution phase.

4. The age at which individuals can access their superannuation needs to be reconsidered. An increase to the preservation age for tax free superannuation (60) to be in line with Age Pension age of 65 would encourage high income earners to remain in the workforce, reduce longevity risk, and increase superannuation savings. This move could only be implemented with adequate safety-net provisions for people who need to access their superannuation early due to retrenchment, unemployment, or illness.

5. Age Pension age must remain at 65.

6. Incentives to remain in the workforce should not take a punitive approach. Rather, income earned through employment should be treated more favourably under the income test, similar to treatment of income from superannuation streams.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

1. What objectives are relevant to setting retirement income policy?
Australia's retirement income system's primary objective should be to provide an adequate income in retirement regardless of circumstances.

An adequate income is defined as an amount that provides a modest standard of living and covers the cost of essential goods and services.

The current retirement income system has let down many retirees without large superannuation or personal savings. The Age Pension alone does not provide a true safety net as it was established to do. Retirees who rely on the Age Pension as their sole source of income do not achieve a modest standard of living in retirement, and experience significant financial hardship.

For this reason, defining Australia's retirement income system as having 'three tiers' is problematic, as it assumes that each individual has access to, or possession of, at least two tiers. As the Superannuation Guarantee is in its early stages, and as many retirees or those approaching retirement have insufficient private savings, the three tier description does not accurately reflect current circumstances for many, that is, total reliance on the Age Pension.

Does the current system meet these objectives?
CPSA considers a modest standard of living to be that as outlined by Westpac & Association of Superannuation Funds Australia's (Westpac/ASFA) retirement income budget standards. Currently, a modest income for a single retiree who owns their own home is $19,399 per annum, and for a couple, it is $27,151. In comparison, the current Age Pension is $14,614 for a single person and $24,414 for a couple combined.

The Age Pension alone falls well short of the modest standard of living benchmark. Pensioners are entitled to a small amount of additional income before the income test is applied to their pension. For singles it is $3,588 per annum, and couples combined it is $6,240. While couples with the full amount of additional income allowed under the income test meet the Westpac/ASFA standard, singles still fall short by about $1,200 each year.

There are around 1.5 million pensioners currently in receipt of the full rate pension who do not reach the modest standard of living mark. Most are elderly widows and widowers in their mid 70s, with no means of supplementing their income through employment.

Generally, Age Pensioners in this situation did not have the benefit of superannuation savings during their working lives. Most were low incomes earners, who put savings into the family home, rather than aside for their retirement. Many women did not receive superannuation at all, and/or spent a large amount of time outside of the workforce. Consequently, women had even less financial capacity to save for retirement.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

This situation, to an extent, will continue with the current retirement income system. It is widely acknowledged that even with the full maturation of the Superannuation Guarantee, low and middle income earners will be dependent on the Age Pension in some way. Women generally have lower superannuation balances on retirement in comparison with other employees, which reveals the gaps of the Superannuation Guarantee system. Data from the Australian Bureau of Statistics (ABS) supports this, highlighting that the mean superannuation balances for men in 2007 was $87,000 for men, and $52,000 for women (ABS, 2007, p. 81). This is not to mention people with broken workforce participation or people outside paid employment, who will only partially benefit from super, or not at all.

How should the system be changed to meet these objectives?
First and foremost, the Age Pension needs to provide pensioners who have very little or no additional income a supplement that ensures they reach the modest standard of living benchmark.

The Age Pension must fulfil its role as a safety net. This will require a supplement to the pension ensure that pensioners and carers, who do not have a modest income, get one. A supplement would be paid only to those who need it, to the extent that they need it and would cost $3.2 billion annually.

This measure requires:

- the development and maintenance by government of a Cost of Modest Living Standard for Age Pensioners, Disability Support Pensioners, and Carers. This Cost-of-Living guarantee would provide a floor for all pensioners to ensure that all pensioners meet a modest standard of living. CPSA bases a Cost-of-Living guarantee on budget standards developed by Westpac and the Association of Superannuation Funds Australia. CPSA refers to their ‘modest standard of living’ budget standard, which shows that a single retiree needs an annual income of $19,399 a year, and a couple need $27,151 p.a.

- the payment of an income supplement to pensioners and carers who do not achieve a modest retirement income. The supplement should be provided as either a lump sum, or series of lump sums. This will ensure that no one is disadvantaged as a result of renting privately or publicly or living in a nursing home. Ideally, individuals should be able to choose if they receive the supplement fortnightly, or in a series of lump sums.

This supplement will differ between individuals, as the difference between the cost of modest living standard and the greater of actual and deemed income of pensioners.

While the Harmer Pension Review will address pension adequacy, there are other aspects that tie into the broader tax and transfer system. To supplement retirement incomes, attention needs to be turned to low income employees, or people who do not have the benefit of 40 years in full-time employment.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

The Superannuation Guarantee will not provide low income earners with a sufficient superannuation in retirement to fund a modest standard of living. Even after 40 years in the workforce (which is generally unlikely, as most people do not remain in full-time employment for 40 years), low income earners will receive at least a part-pension, if not the full rate.

Taxation

The Superannuation Guarantee favours middle and high income earners due to its concessional taxation. Contributions to superannuation are taxed at a flat rate of 15 per cent, regardless of an employee's actual income. This allows middle and high income earners to save at least 15 per cent in tax at the contributions phase, which is exaggerated by the provisions made under the transition to retirement rule.

The current tax concessions heavily favour middle to high income earners. Expenditure on tax concessions for the financial year 2007/08 was around $28 billion (Treasury, 2009), exceeding expenditure on the Age Pension by about $2 billion. In its current form, tax concessions allow relatively well-off mature employees to 'churn' through their superannuation savings under the transition to retirement rule. Employees can salary sacrifice earned income into super, and then draw it down again tax free after age 60. As contributions are taxed at 15 per cent, employees can save a large amount of tax on their income. The only limitation (aside from age) is that an employee can draw down no more than 10 per cent of their super balance. Therefore, most taking advantage of this rule are in the middle to high income tax brackets. This effective tax avoidance does not increase an individual's superannuation savings (as they are drawing an income down from their super), and costs the government billions in foregone revenue.

In contrast, a low income earner receives a tax saving of one per cent for their contributions to super. A fairer system would afford low income employees the same tax concession as employees in the higher income brackets. For instance, an employee earning $30,000 a year would have an extra $400 per annum in their superannuation if the 15 per cent contribution tax was removed.

A targeted system would add to low income earners' superannuation to better support them in retirement. The contributions tax for low income employees should be removed in order to boost their superannuation savings, without the requirement of the employee to make an after tax contribution. The cost of this could be offset through a higher taxation of superannuation contributions of high income earners. This could be scaled so that high income earners still receive some concession. For instance, an employee who is taxed at the highest marginal tax rate of 45 per cent would have their superannuation contributions taxed at 30 per cent. A middle income earner would retain their current tax rate for contributions made to superannuation.

Super Co-contribution

Retirement income and tax policy must endeavour to boost superannuation for low income earners. Current measures such as the Super Co-contribution have encouraged middle income earners to make voluntary contributions to their

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

superannuation, yet the same take-up rate has not been seen amongst low income earners. Most low income earners do not have the disposable income to make voluntary contributions. This is shown in ABS data that highlights the main reason for not making a voluntary contribution is a lack of available income to do so (ABS, 2007, p. 88). According to the Australian Taxation Office (ATO) the majority of beneficiaries of the super co-contribution scheme have incomes of over $30,000. People eligible for the super co-contribution with medium incomes have the disposable income available to take advantage of the scheme. Therefore, employees who are most in need of the assistance benefit the least.

The graph below puts forth scenarios of low, middle and high income earners' annual superannuation contributions. While it makes some assumptions, it shows how the system is skewed toward high income earners. Firstly, it assumes that someone on a $30,000 income does not take advantage of the Superannuation Co-contribution due to insufficient disposable income. Secondly, it assumes that a $50,000 income earner does take advantage of the Superannuation Co-contribution, yet makes no salary sacrifice in to superannuation. Finally, it assumes that a $100,000 earner salary sacrifices $10,000 into superannuation.

As government co-contributions are untaxed at the input and drawdown phases, the actual revenue received through superannuation from the $50,000 income earner shown below is less than that of the $30,000 earner. The graph also reveals the stark difference between the high and low income earners' annual superannuation contribution.

Tax paid over one financial year

Gross income	Tax on 9% Super Guarantee contribution	After tax voluntary contribution	Super Co-contribution	Salary Sacrifice	Foregone tax revenue	Government revenue	Annual super contribution
$30,000	$405					$405	$2,295
$50,000	$675	$500	$517			$233	$4,842
$100,000	$1,350			$10,000	$2,500	$1,500	$16,750

A better way to assist low income earners would be to provide the co-contribution regardless of voluntary contributions, maintaining the current income limits.

At what age should an individual be able to access their superannuation, and at what age should they be eligible for the Age Pension?

As mentioned above, the transition to retirement rule allows certain higher income individuals to make considerable tax savings. Access to superannuation benefits at age 55, with super benefits being tax free at age of 60 has created a system whereby high income earners are able to retire earlier (or at least retire in part) and if 60 or over, benefit from concessional taxation at the same time.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

As the Superannuation Guarantee is in its early stages at the moment, most people who can afford to retire before eligibility for the Age Pension are middle to high income earners. Low income earners may select to drawdown their super before age 65 (usually after age 60). However, anecdotal evidence suggests that people do so in lump sums, rather than spreading their superannuation over the course of their retirement.

High income earners on the other hand are more likely to draw down an income stream from their super (whether they remain in employment or not). As a result, high income earners are in a better position to retire, or retire in part, before age 65. On the other hand, low income earners may well have to work up to age 65 because they do not have sufficient savings to reach Age Pension age.

If the superannuation preservation age was placed in line with Age Pension age, two things would happen. Firstly, it would create an incentive to remain in the workforce for higher income earners. Secondly, it would create a fairer retirement income system that would place high and low income earners on a more even playing field. Retaining high income earners in the workforce would encourage retention of a skilled labour force, and boost taxation revenue at the same time. Furthermore, it would increase superannuation savings of this group (which would most likely be ample anyway) and reduce the need to access a full rate pension in retirement.

This move would have to put in place mechanisms to protect people who need to access their superannuation before 65. People who are unemployed, retrenched, or unable to work due to illness or disability should be able to draw down from their superannuation regardless of their age to ensure that they are not placed in financial hardship.

Increase in the age that one can access their superannuation would lessen the risk of outliving ones retirement savings. It is a practical move that could increase workforce participation amongst the 55 – 64 population, in turn augmenting taxation revenue. It would also increase the superannuation balances of those who continued to work and add to retirement incomes in two ways: by decreasing the amount of time in retirement and increasing contributions made to superannuation.

The equity issue is important as the current system further divides people on low and high incomes, as those who must work and those who can afford to retire early. Instead of raising the Age Pension age, more focus should be on discouraging early draw-down of superannuation.

Age Pension age

CPSA opposes any increase in the Age Pension age. Such a move is deemed punitive and in reality, will save the government little in social security expenditure as most Age Pensioners who start to receive the full rate Age Pension at 65 have come from another social security payment.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772

The age that people can access the Age Pension in Australia is higher than many other countries in the OECD. An increase in Age Pension age assumes that individuals are able to remain in the workforce after age 65. 2006 Census data shows that over 900,000 people aged between 55 and 64 were not in the workforce, comprising the largest number out of all the age groups under 65 (ABS, 2006). It is widely acknowledged that most people made redundant are over the age of 50, and often rely on NewStart Allowance before becoming eligible for the Age Pension. This Allowance is significantly lower than the rate of the pension. Any increase in Age Pension age is going to require these individuals to remain on the NewStart Allowance for longer if they are unable to find work.

Workforce participation and the Age Pension
Incentives to remain in the workforce should not take a punitive approach. Many pensioners who are in paid employment find that it is often not worth the effort due to the pension lost under income test. Most pensioners in paid work are employed on a casual or part-time basis, and are often on the 'cusp' of the income test. Single pensioners in particular find that when their pension is reduced they are taking a backward step, even though they are actively trying to boost their income.

On the other hand, superannuation income streams are treated differently, and generally, more favourably compared with earned income under the income test. A better system would be to treat earned income in a similar vein to that of superannuation streams, in order to encourage workforce participation, and not discriminate against pensioners who work and those with income from superannuation.

Conclusion

For the retirement system to be fair and sufficient, the Age Pension must provide a modest standard of living on its own. To boost retirement incomes in the future, superannuation concessions must be better targeted to support low income earners. In addition, measures to support low and middle income earners need to be more passive so that low income earners are not disadvantaged because of a lack of disposable income.

Tax-free superannuation after age 60 needs reconsideration. A fairer system would align the tax-free superannuation age with the Age Pension age of 65, to close a gap between low income and high income earners with more capacity to retire earlier. This would also discourage high income earners salary sacrificing income and withdrawing it tax-free under the transition to retirement rule. The Age Pension age must remain at 65 to ensure that people are not placed in significant financial hardship due to an inability to work or lack of employment, which is most common among the over 50 population. Incentives to work after 65 should focus on a more favourable treatment of earned income, rather than increasing the Age Pension age.

CPSA, Level 9, 28 Foveaux Street, Surry Hills NSW 2010
Phone: (02) 9281 3588 Country callers: 1800 451 488 Facsimile: (02) 9281 9716
Email: cpsa@cpsa.org.au Website: www.cpsa.org.au ABN: 11 244 559 772