Lorraine’s New Retirement Income System

This is my second submission to the Review of Retirement Incomes, the first covered changes to the current system that would make it more equitable and also more sustainable. This second submission puts forward a new scheme for retirement income in Australia.

My suggested new scheme retains the existing three pillars of retirement income but ties them together into an integrated whole that eliminates all of the inequity and most of the complexity of the current system. It increases flexibility in saving for retirement and taking retirement income, reduces social inefficiencies, encourages saving, encourages workforce participation for retirees, and ensures all Australians retire with sufficient income regardless of their financial situation or work history. This would be achieved with little or no additional cost to the government.

The system involves only a few quite simple changes to the current system, so the transition would not be at all difficult. Nobody would be left significantly worse off and most people would benefit. Most importantly the system is perfectly sustainable even with an increase in the proportion of retirees to workers.

I am offering here a lot of suggestions that would work perfectly well as stand alone changes, so please read the whole submission even if you do not like my overall new plan. The system would, however, work best as a complete integrated package that would benefit everyone in Australia, not just our retirees.

I have provided here a summary of the complete system. I will then cover each of the topics in more detail, deal with transition issues and costing, and relate the new system to the objectives and consultation questions in the Retirement Income Consultation Paper.

For the purpose of this submission, a superannuation fund in the accumulation phase is referred to as a super fund, and in the income stream phase as an allocated pension fund (AP fund). Super funds currently pay tax at 15% on all pre-tax contributions received and on all investment income, while AP funds pay an income stream, do not receive contributions and pay no tax at all on their investment income.

Summary

My suggested new retirement income system combines the current government age pension with the superannuation guarantee system to give everyone a fixed retirement pension funded partly by existing government pension expenditure and partly by a proportion of the superannuation guarantee levy that has been contributed over their working lifetime.

Everyone attaining the age of 65 would receive a single non-means-tested pension from a general pool combining the two sources of funding.

Most people would also have some superannuation income from the remainder of their superannuation guarantee contributions and from their own personal contributions to super.

Tax on private savings and tax on AP funds would be brought into line with the taxation of super funds to give a flexible system where all retirement income is taxed equally at source and is tax free to the recipient.

Setting the System up

A new specialised government run Retirement Pension Fund (RPF) would be set up, similar to the existing Future Fund.

The superannuation guarantee (SG) would be increased to 10% from 9%. Half of this amount would be paid into the RPF, up to a maximum contribution cap amount per employee per year. The remainder of the SG would be paid into a private super fund for each employee as currently.

Self employed taxpayers would contribute 5% of their employment or business income to the RPF, again up to a maximum annual amount.

The Retirement Pension

The new Government age pension, called here the Retirement Pension (RP), would be a standard amount paid to everyone over the age of 65 years regardless of income, assets, marital status or workforce participation. The payment would be tax free and SATO would no longer apply.

The RP would be funded by the current government age pension expenditure plus funds contributed through the SG to the new RPF. The RPF would have a continuous stream of new income from the current workforce as well as earnings on its asset base.

All age pension means tests would be eliminated and would never be reintroduced. Retirees who have higher assets and or income would have contributed more of their SG to the RPF over their working lives.

The elimination of means testing would reduce the administration costs of age pensions.

As well as increasing social efficiency by eliminating a lot of non-productive administration work, the new system would eliminate inefficient choices by retirees on investment, lifestyle and housing that are based on maximising the current age pension.

Superannuation

The remainder of the SG would be paid into individual superannuation accounts, as now.

All taxpayers could claim a deduction from their work or business income of up to the current $50k total in super contributions. This could be done by salary sacrifice or tax deductible personal contributions or any combination of both.

Superannuation funds would pay tax at 15% as now, but the tax free status of a super fund paying an allocated pension income stream (an AP fund) would be phased out. All superannuation funds would then pay tax at 15% on all assets including those set aside by super funds to pay income streams. This would simplify super fund administration as income streams would not need a separate account.

Income streams paid from untaxed super funds would have a withholding tax applied before payment, so the income would be tax free to the recipient the same as income from a taxed fund.

Anyone over 60 years of age could take any amount they wanted from their super tax free, regardless of work status.

Anyone with income from employment, regardless of age, would have half of their SG (or self-employment equivalent) paid into the RPF and the remainder into their super fund. They could also make tax deductible contributions to their super fund.

Private Savings

Private savings income would include all bank interest, dividends, distributions from managed funds and trusts and possibly rental income from investment properties.

Private savings income would be taxed at a flat rate of 15%. This would encourage and reward people who saved money before retirement and would bring the tax treatment of the savings income of retirees into line with the tax treatment of super income streams.

Franked dividends would be deemed to have the 15% tax already paid, with no grossing up and no rebate allowed for the remaining 15%. Bank interest and managed fund and trust income would have the 15% tax withheld before the payment was made.

As the tax would already be paid, private savings income would be tax free to the recipient and would not normally need to be declared on a tax return.

Advantages of the new system

The new system would be easy to understand, easy to administer, would give everyone a reasonable basic level of pension income, and would treat all individuals and all types of savings, both super and non-super, in a fair and equitable way.

Individuals who are employed or self-employed for most of their working life would effectively have their Retirement Pension paid from their SG contributions accumulating in the RPF. Those who have not participated in the workforce or with only broken participation over their working lives would have their pension paid, as now, from government revenue. The main difference to the current system would be that the two systems were combined together to give a single fixed payment to the end user.

Under the new system super and non-super savings would be taxed more or less equally, giving individuals maximum flexibility in saving for retirement and taking their income in retirement. Complex financial planning schemes to maximise pension income would become obsolete, giving individuals more flexibility in how they invest.

With no assets or income testing for retirees, administration costs for Centrelink would be reduced giving Centrelink employees more time and resources to give constructive help to those needing it, rather than spending their time processing small changes in financial information.

The new system would encourage older people to remain in the workforce, would reduce stress for pension recipients, would encourage more appropriate housing choices thereby reducing land use and energy consumption, and would result in an increase in social efficiency that would improve the quality of life for everyone in Australia.

Setting the System up

The Retirement Pension Fund

A new specialised Government run Retirement Pension Fund (RPF) would be set up, similar to the Future Fund or incorporated into the Future Fund.

This fund would receive SG money from everyone who earned income from employment, self-employment or a business. Money from the fund would be used to supplement the government expenditure on age pension payments, but at least some of the money received by the RPF would be invested each year to help pay pensions in later years when there may be fewer taxpayers for each retiree.

The RPF could invest the money at their discretion in the same way as the Future Fund. Investments could include infrastructure projects, rental housing projects, mortgages, shopping centres, commercial property, government bonds and listed shares. The fund managers would be free to choose low risk investments rather than being pressured to take high risks to maximise profit. Some or all of the money in the RPF could be invested through private sector fund managers if this was considered a better alternative.

Changes to the Superannuation Guarantee

The superannuation guarantee (SG) would be increased to 10% from 9%. Half of this amount would be paid into the RPF up to a maximum contribution amount per employee per year. This would be paid to the RPF by the employer in the same way as PAYG tax was paid to the ATO.

The remainder of the SG would be paid into a private super fund for each employee as currently. Employees with income of less than $1000 per month would have all of their SG money paid into the RPF. This would avoid processing of very small sums for both employers and receiving funds and would reduce the incidence of 'lost super'.

However I do think it is important for at least some of the SG to be paid into individual super accounts for most workers. This allows those who are employed for most or all of their working lives to have some private super that they can access at 60. This will give these people the opportunity to retire at 60 if they want to, and their super will supplement their income from the RP when they reach 65.

Self-Employed People

Self employed taxpayers would contribute 5% of their employment or business income to the RPF, again up to the same maximum annual amount. This payment would of course be tax deductible.

This would guarantee them access to a Retirement Pension regardless of how much they earned over their lifetime, so would not be too strongly opposed.

Self-employed people whose total income was below the tax free threshold (after allowing for the low income rebate) would not be required to contribute.

Setting a Maximum Contribution Amount

The maximum annual contribution amount would be set at 50% of the current rate of the Retirement Pension annual amount. For example if the RP amount was $18,000 per year, no-one would be required to contribute more than $9,000 per year to the RPF.

On average an individual works for around 45 years and is retired for around 22 years, so having this cap would seem fair to high income earners. Without a cap these people may feel that they were contributing a total amount higher than they were ever likely to receive.

For the first few years either the rate or the cap (or both) could be higher for employees who are currently over 50, so the RPF had extra funds to pay pensions for this group when they reach 65. These people would not have a long history of contributions before they claimed their pension. This would add a small amount of complexity for employers.

Any extra amount above the cap that was inadvertently paid into the RPF by an employer would be refunded into the individual's super fund by the RPF at the end of the financial year.

The Retirement Pension

The new Retirement Pension

The new government age pension, called here the Retirement Pension (RP) would be paid to everyone from the age of 65, regardless of income, assets, marital status or workforce participation. The payment would be totally tax free. SATO would be eliminated.

All means tests would be eliminated and would never be reintroduced. Retirees who have higher assets and or income would have contributed more SG to the RPF over their working lives and the direct cost to the government of paying their pensions would thus be reduced.

High income earners, who would not normally expect any government age pension when they retired, would have contributed enough to the RPF over their working life to fully fund their pension.

To apply for the RP a retiree would need to provide proof of identity, proof of age and proof of citizenship or permanent residency status. They would need to provide bank details to receive the payment and contact details. These details would need to be kept up to date. Centrelink would need to be contacted when a retiree died.

The new system completely eliminates any need for anyone applying for an RP to give Centrelink any private details regarding their assets, their income or their living arrangements.

The new rate

The new pension rate would include all current payments and extra allowances integrated together into one payment to reduce complexity. There would be no separate pharmacy allowance, utilities allowance or any other special payments.

A means tested extra payment may still need to be paid to retirees who rent their home and possibly to retirees who live alone, however every effort would be made to keep extra complexity to a minimum.

If possible the Retirement Pension rate would be increased a little from current single age pension levels, as the contribution from the RPF to pay RP's would make more funds available than currently.

All Retirement Pensioners would receive the same amount, so couples would have two lots of the single amount. This would reduce complexity and also reduce administration costs to Centrelink. Currently a married couple receives less than (for example) two brothers who share a house. This is an arbitrary distinction that is set to become even more complex when same-sex couples are recognised as a couple by the Centrelink payments system.

Having the payment the same regardless of marital status would encourage pensioners to share accommodation, remain in relationships and form new relationships, which would have social advantages and would increase energy efficiency and housing efficiency.

The Pension Bonus Scheme

Currently there is a pension bonus scheme to reward people who work after they reach 65 and delay claiming their pension. This scheme would be eliminated, as everyone would be paid a Retirement Pension at the age of 65 regardless of workplace participation. This would be a cost saving that would contribute to funding the new Retirement Pension scheme.

Superannuation

Contributions

The remaining half of the SG would be paid into individual superannuation accounts, as now.

All taxpayers could claim a deduction from their work or business income of up to $50k total in super contributions. This could be done by salary sacrifice or tax deductible personal contributions or any combination of both.

Taxpayers with income (and therefore SG) from employment could claim a personal tax deduction for contributions that take the total of employer contributions and their own contribution up to the $50k limit. The SG amount that the employer is paying into the RPF would not be included in the allowed $50k contribution amount.

Self-employed people would be required to pay a contribution to the RPF of 5% of their total income from working after normal business expenses. Self-employed people whose total income was below the tax free threshold (after allowing for the low income rebate) would not be required to contribute.

The amount would be fully tax deductible, so the actual cost to the self-employed person would be significantly less than the contribution amount. The SG amount would be paid to the ATO when tax is paid and would be sent on to the RPF by the ATO. This would make payment of the SG simple for these people.

Self-employed taxpayers could then make a tax deductible contribution of up to $50k to their normal super fund as currently.

After tax contributions could be made to super by anyone who wanted to contribute money that they did not want to access before the age of 60, however the new tax treatment of savings, detailed in a later section, would make this less attractive.

It would be pointless for anyone who had only investment income to claim a deduction for a contribution to super, as they would pay contributions tax at 15% and save the same 15% tax on their investment income under the new system for tax on savings.

The Co-Contribution

The super co-contribution would be eliminated. It is currently difficult to calculate and poorly targeted.

The full benefit of the co-contribution is only available to low income earners. Encouraging these people to lock their hard-won savings away until they retire is bordering on the immoral.

Middle income earners who still qualify for some co-contribution benefit are faced with the complexity of deciding whether to make a tax-deductible contribution with the associated tax benefit, or an after tax contribution which will attract some co-contribution, or some combination of the two.

The calculation of the optimal split would be beyond the skills of most people.

Taxation

Superannuation funds would pay tax at 15% as now, but the tax free status of AP funds would be phased out. All super fund income, regardless of whether it was accumulation phase or pension phase, would be taxed at 15%.

No new AP's would be issued. Current AP funds would retain their tax free status at least until the new system was fully established. This would simplify super fund administration as new income streams would not need a separate account with a segregated asset base.

Income stream payments from untaxed schemes would have tax withheld by the fund before the payment is made. The tax would be 15% of any amount over $10k paid during a year. The payment would then be tax free to the recipient in the same way as a payment from a taxed source.

Income streams less than $10k per year from an untaxed source would be exempt from the withholding tax but would still be tax free to the recipient.

All payments from a super fund would then be tax free and there would be no distinction between taxed and untaxed superannuation pension income.

The current transition to retirement system where fifty-five year olds can take some of their super before retirement, or retire early, will eventually phase out naturally. As it is used mainly as a tax-reduction strategy, rather than for its original purpose of allowing these people to change to a part time work pattern for their last few years of work, it is not really working as intended.

Changing the system so that people between 55 and 60 could only take money from their super if they were genuinely reducing their hours of work, say to less than an average of twenty five hours per week, may be a better approach. Allowing access to super before the age of 60 would, of course, still phase out as planned by 2024.

My suggested change to the tax free status of AP funds would make this tax-reduction strategy less attractive.

Even when retirement at age 55 is phased out, anyone who wanted to retire younger than 60 could of course do so if their private savings were sufficient to maintain them until they were able to access their super at age 60.

There is currently a 15% tax levied where the remainder of the assets of a super fund are inherited by a non-dependant. As tax would now be levied on all of the income in all super funds, this inheritance tax would be eliminated.

Income in Retirement

Anyone over 60 years of age could take any amount they wanted from their super tax free, regardless of work status.

Anyone with income from working, regardless of age, would pay the required half of their SG (or self-employed equivalent) into the RPF and could make tax deductible contributions to their super fund. This would apply for as long as a person earned income for working. There would be no cut off age. Retirees who were over 70 could have the remainder of their SG paid to them directly if they had taken all their money out of the super system and no longer had a super fund.

Anyone over 60 could take advantage of the transition to retirement tax strategies, however with the elimination of the tax free status of AP funds, this approach would not work as well. It could be used as a strategy to pay a maximum tax rate of 15% on income from employment and this would encourage this group to stay in the workforce.

For those over 65, the superannuation saved over their lifetime would act as an extra income supplement to the RP and could be taken as needed without affecting their tax liability or their entitlement to the Retirement Pension.

If a person wanted to retire at age 60, spend all of their accumulated super, then live on the RP after they reached the age of 65, this would be entirely their own decision and would not affect their entitlement to the RP.

Retirees would no longer need to arrange their affairs to maximise their age pension entitlement. This would eliminate a lot of artificial schemes and would increase social efficiency, particularly in housing arrangements. This aspect is covered in more detail in a later section on the advantages of the new scheme.

Retirement Age

It has been suggested that the retirement and pension ages are increased from the current levels because some people are still capable of doing useful work after the age of 65.

If this idea was implemented I feel that it would result in a huge loss to society, as our younger retirees form a pool of fit, useful, skilled and experienced people who help our communities to function and contribute to the quality of life for all of us. I covered this in much more detail in my first submission to the Review of Retirement Income.

Private Savings

All income from private savings would be taxed at a flat 15%, preferably before it is distributed, regardless of the type of investment.

Private savings income would include all bank interest, dividends, distributions from managed funds and trusts and possibly rental income from investment properties.

As investment income would generally be taxed at source, it would not need to be included in a tax return unless the taxpayer was claiming deductions for costs.

Exceptions

Very low income earners with total income below the tax free threshold would pay no tax on their savings income and could claim a rebate for any tax withheld. It may be possible to eventually phase this concession out.

Private Savings Income would not include dividends from a private company that was fully or partly operated by the taxpayer. This would be included with business income. Professional investors would be taxed at normal working income rates.

These exceptions are to prevent income from employment or business activities being classified as investment income by high income taxpayers to take advantage of the lower tax rate on savings. Tax rules need to cover any possible loophole that can be exploited, but that does not mean that taxation for normal honest individuals needs to be complex.

Interest and Dividends

Interest income from banks would have the 15% tax deducted as a withholding tax and remitted to the government by the bank. Children's accounts with small balances would be exempt from this tax.

Franked dividends would be deemed to have the 15% tax already paid, with no grossing up required and no rebate for the remainder of the tax paid by the company, currently a further 15%.

Income from managed funds and trust income would have the 15% tax withheld and remitted to the ATO by the fund.

Currently the tax treatment of distributions from some managed funds and trusts is complex, with various components of income taxed in different ways in the hands of the investor, eg foreign income, tax-deferred income. As part of the new system the current complexity of managed fund payments would be eliminated and the 15% flat withholding tax would apply to everything except repayment of capital.

Investment Costs

Small costs such as travel to an AGM, membership of a shareholder's association, or investment newsletters could be claimed as a 15% tax rebate where these costs were less than the total investment income. Anyone wanting to claim this rebate would need to lodge a tax return stating their total investment income and the rebate amount they are claiming. A minimum of $200 in costs would be required before a claim could be lodged to save the processing of small amounts.

Anyone borrowing to invest could also claim the rebate for their interest costs but only up to an amount equal to their net investment income with no grossing up for tax withheld. Any excess costs could be carried forward or could reduce capital gain, but could not be deducted from income from working.

Individuals would be given the choice of treating some or all of their investments as an investment business and paying tax at normal working rates on the income and capital gain. Excess costs could then be claimed against other working income.

Investment Property

There are two approaches to taxing income from Investment properties owned by individuals.

The first approach would be to treat rental income as normal investment income. The rent would be taxed at 15%, and interest and costs could be claimed against the rental income and any future capital gain, but not against income from working.

The second approach is to treat all investment property ownership as a business, due to the more active role of the investor or their agent. The business owner would pay tax at normal business rates, including capital gains tax at the full rate.

If the property was owned by a syndicate, it would be set up as a company and tax would be paid at the full company tax rate. Income paid to the individual investors would be tax-paid private savings income as for a franked company dividend.

While current policy is to encourage individuals to own rental properties in Australia, it is difficult for an individual to actually make a reasonable return on their assets from renting out a house. If you borrow the money then the rent is unlikely to cover the cost of the interest and the running costs of the home. If you own the house outright, then you would probably get a better return with the money invested in other asset types than you would get from renting the house out. Most property investors rely on eventual capital gain to make any profit.

This is because the cost of capital is normally greater than the rent received for the property. If this was not the case, then it would be cheaper for people to borrow the money and buy a house themselves than to rent the same house. Most tenants are renting because they cannot afford to buy.

The only exception would be for up market private rentals, where a tenant is prepared to pay a rent slightly higher than the true cost of owning a home because they only want a place to live on a temporary basis, eg while working in an area or while another house was being built for them.

It may be better for the community if rentals at the lower end of the market were mainly owned and managed by government, community organisations or specialist companies, leaving only top end rentals for private individuals. This would increase efficiency as rents are currently effectively subsidised by private individuals with the hope of eventual capital appreciation. This raises price expectations and flows on to real price increases as investors ask higher selling prices to make a profit. It also ties up capital in investment housing that could be invested in more productive ways. And last but not least this inefficient current system decreases government revenue with the losses reducing the tax that the owners would otherwise pay on their employment income.

Rentals at the lower end of the market could be run much more efficiently on a larger scale basis than individuals owning a few houses. The homes would be grouped and probably smaller, which would save land area and energy use, and the management and maintenance would be much more efficient. Children could be catered for with a communal safe play area rather than individual gardens.

Capital Gains Tax

Under the new system capital gains tax would be simplified and would not apply to assets held for more than five years. This concession would apply only to individuals and super funds.

A capital gain on an asset held for less than one year would be taxed at the full 15%. A gain on an asset held for two to three years would be taxed at 10%. A gain on an asset held for four to five years would be taxed at 5%. Gains on assets held for longer than five years would be tax free.

Capital losses could be offset against gains and could be carried forward for five years.

It may be possible to make all capital gains tax free for retirees, to simplify tax returns for older people. Or there could be a capped tax free amount of capital gains, so no tax is paid by retirees on gains of less than $10k total in a year, for example.

Low Income Earners

A possible exception to the flat 15% tax on investment income would be for very low income earners with total income below the tax free threshold. These people could apply for a rebate of the withheld tax on their investment income, thereby retaining the current tax status on investment income for these people, except that only 15% tax on franked dividends would be refundable.

It must be remembered, however that changes in bank interest rates have far more effect on the interest income of this group than levying a 15% tax with no exceptions would have. These people would also currently pay the 15% contributions tax on any SG paid in for them and their accumulated super is taxed at 15% in their fund.

This exception could probably eventually be phased out.

The rebate of tax paid on investment income for low income earners would not apply to Retirement Pension recipients.

Bank accounts held by children up to the age of sixteen on a genuine basis would not have the 15% tax withheld from the interest.

Effect on Bank Accounts

The banks could easily restructure their accounts to suit the new system. Accounts paying very low rates of interest would be less viable with the increased administration overhead for the bank. However as the interest on most of these accounts amounts to less than $1 per year, totally eliminating interest on them would save costs for the bank and probably would also be a blessing to the customers who need to account it. It would increase efficiency for both the bank and the customer.

Deeming accounts would become obsolete for retirees. However deeming accounts are actually great for pensioners, allowing them to keep their savings in a single account with their day to day money and earn interest. This gives a simple, easy to use product for people with reduced financial ability. It would be very sad to lose this.

Deeming would no longer be applicable to retirees with the new non-means-tested RP. However it could be a government requirement that banks would still provide an account for retirees with minimal fees and giving a reasonable rate of interest on that part of the balance over $2000, with no interest for the amount below this. This would then allow retirees to still keep all of their money in a single account.

The interest rate on the new accounts would probably be lower, as the deeming rates are usually high compared to the rates banks offer to non-pensioner customers. The more realistic interest rates might allow the banks to extend this type of account to all customers. This would be hugely simplify and improve banking for everyone.

Advantages of the new system

Simplicity

The new system would be easy to understand, easy to administer, would give everyone a basic level of pension income, and would treat all individuals and all types of savings, both super and non-super, in a fair and equitable way.

Individuals who are employed or self-employed for most of their working life would effectively have their Retirement Pension paid by their SG contributions accumulating in the RPF. Those who have not participated in the workforce or with only broken participation over their working lives would have their pension paid, as now, from government revenue. The main difference to the current system would be that the two systems were integrated into a single simplified payment system for the end user.

The new system completely eliminates any need for anyone applying for an RP to give Centrelink any private details regarding their assets, their income or their living arrangements. To apply for the RP they would need only proof of identity, proof of age and proof of citizenship or permanent residency status.

When a person reaches the age of 65, they would receive a tax free Retirement Pension, normally some tax free superannuation income, probably some investment income (with the tax already withheld) and possibly income from employment or self-employment as well.

Tax would be much simpler for retirees than the present system. The RP would be totally tax free. Super income streams and investment income would be tax free, as tax would have already been paid on these.

Only the income from employment or self-employment would be taxable. No other income would normally need to be declared on a tax return unless a deduction for investment income costs was being claimed or the retiree had some taxable capital gain. The RP recipient would benefit from the normal tax free threshold on the income from working. This would eliminate any need for the SATO.

Currently a married or de-facto couple receive less combined pension than two single people (eg a brother and sister or two friends) who share a house. As all pension recipients would receive the same amount, this complexity would be eliminated.

Equity

Once the system was fully established all retirees would receive the same level of RP regardless of their income, their assets, their workforce participation past and present or their living arrangements.

Most would have an additional payment from their super fund and some private savings income which would be taxed at source at the same rate as their income from super.

Everyone who was working would have the opportunity to make a tax deductible contribution to their super up to the allowed annual amount if they can afford to do so.

Private savings income would be taxed at the same 15% rate as income in a super fund. This would apply to everyone regardless of age.

You can't get a system much more equal than that.

Currently the difference in tax treatment of super and savings in retirement is far too high. For example a retiree with savings income from accumulated assets is taxed at normal rates where their income is too high to qualify for the SATO, yet a retiree with the same assets in an AP fund will have all the income on the assets totally tax free.

Under my new system the tax for both retirees would be the same. The retiree with the AP fund would have tax withheld from it and the tax for the retiree on private savings income would be reduced.

Certainty

My system will give everyone certainty that they will receive an adequate pension in retirement regardless of their workforce participation, their ability to save and their asset position at retirement.

The current system leaves the individual retiree to deal with risks associated with investing their super and deciding on a strategy to make their money last as long as they do. I do not think this decision making is appropriate for most elderly people or within their capabilities.

There is always a risk for these people that if they get it wrong they will lose their income but still not qualify for a pension. Assets locked up in funds which have suspended distributions or redemptions, for example, are still considered as assets by Centrelink. Under my system there will never be any anomalies that can leave any Australian without sufficient income but unable for means test reasons to claim a pension. I believe that this aspect alone will make this system acceptable to all Australians.

There is also currently stress on pensioners when they lose a partner and go onto a single pension. The allowed assets and income for a single pensioner is much lower than for a couple, resulting in a huge drop in income for some pensioners when a partner dies rather than just a transition from a married couple pension amount to a single pension amount.

By doing away entirely with means testing, my new system eliminates all of this risk and stress for retirees. Everyone would get an RP, and any other income for retirees will increase their standard of living without ever putting their basic needs at risk.

Retirees would no longer need to arrange their affairs to maximise their age pension entitlement. All RP recipients would know exactly where they stand in regard to pension entitlement and tax issues. This would eliminate a lot of artificial schemes and would increase social efficiency.

This would also eliminate retirees hiding money around the house to avoid their pension being reduced. This leaves them vulnerable to theft and fraud. The fact that at least some of our retirees do hide cash indicates that many of our pensioners lack the understanding required to run their affairs efficiently. Even under the current system all pensioners would always be better off with the money in a deeming account.

My new system would also save stress on retirees, who are faced with a hugely complex system at a time when they are facing a diminished capacity to deal with complexity. People who are planning to retire and apply for a pension are more or less forced to seek financial advice under the current over-complex system. This leaves them vulnerable to being given unsuitable advice by unscrupulous members of the finance industry who are more interested in their own commissions than the affairs of their clients. While most financial planners are honest souls, we do still have a lot of problems in the community with less than honest ones.

Complex financial planning schemes to maximise super payments and age pension income would become obsolete. Financial planners who currently service retirement income recipients would be available to do more productive work.

Flexibility

All types of savings would be taxed more or less equally, giving individuals maximum flexibility both in saving for retirement and in taking their income in retirement. Retirees with their money in super would be taxed at exactly the same rate as those with income from non-super investments.

Anyone currently in the workforce or approaching retirement who did not consider that the RP would be adequate for their needs in retirement would have the opportunity to contribute to super or save for themselves. Their options would be easy to understand and their decisions would not be distorted by complex tax considerations.

Very few retirees would be required to lodge a tax return. The exception would be those in paid work and those with a taxable capital gain.

Efficiency

With no assets or income testing for retirees, administration costs for Centrelink would be reduced giving Centrelink employees more time and resources to give constructive help to those needing it, rather than spending their time processing changes in financial information.

Retirees would no longer hold onto houses and gardens that are larger than they need in order to retain assets in the non-assessed family home. This would make larger homes with gardens available to families with children, release inefficiently used land for development, and increase the demand for smaller homes which take less land area and less energy to maintain. This would result in more efficient use of available land and housing in the community.

Money released by retirees downsizing homes would be available for investment in Australian companies and Australian Infrastructure projects. It would also help support the economy by creating higher demand for services for the retired. It would encourage retirees to free up assets to enjoy a higher living standard. This in turn would increase employment levels and tax and GST revenue for the government.

Without the current means testing retirees would also be free to use any spare funds to help other family members, eg to help a grandchild travel to study at an overseas university or to buy a home. Currently retirees are still deemed to own the money they give to family members for five years with only a small amount per year allowed to be gifted in this way.

The new system would be a huge encouragement to older workers to stay in the workforce as their workforce participation would have no impact on their RP, their ability to take their super, or the tax on their investment income. Anyone who continued to work would be contributing to the system via tax on their income and their SG contribution to the RPF.

On a society wide basis, any reduction in time spent on non-productive administration work can release human and monetary resources to provide more goods, better housing, better infrastructure and better services in areas that actively improve the standard of living for people in the society.

Improvements in social efficiency will eventually be reflected in better lifestyles for all Australians.

Sustainability

As time passes, the accumulated contributions to the RPF should fully fund the RP for those who have contributed for their whole working life, while those with broken work patterns will still be subsidised by the government.

The tax on AP funds will help to contribute to the amount available to pay the RP. Without this change to the taxation status of allocated pensions, more and more retirees will make use of them, resulting in a situation where very little tax is paid on the income from the assets held by retirees.

Under the current refund of franking credit scheme, the AP funds providing these pensions would also be taking tax revenue out of the system by claiming a rebate of the tax paid by companies in Australia. We could reach a situation where a significant proportion of company tax revenue was lost in this way.

My new system is sustainable in the long term while the current system is not.

How the new RP system would be funded

Pension Payments

The current government expenditure on the age pension would be retained and would be added to funds from the RPF to pay the new pension.

The RPF would have a continuous stream of new SG income from the current workforce as well as investment income from accumulating assets.

The tax free status of AP funds would be eliminated, so the earnings on all superannuation funds would taxed at 15%, increasing the revenue base.

Tax on Private Savings Income

The reduction in the tax on private savings income both before and after retirement would be compensated for by the retention by the government of more company tax with the change to the franking credit system, and the fact that all interest income would now be taxed at source, making it impossible for savers to avoid paying tax on it.

Cost savings for the new system

The elimination of the Super Co-contribution and the Pension Bonus Scheme would save some money for the government.

There would be a considerable saving in the administration costs of age pensions as they would no longer be means tested.

Increased workforce participation

Under the new system people could take their super from age 60 regardless of whether they were still working. This would encourage those over 60 to stay on in the workforce either full or part time, giving more tax revenue to the government and further payments of SG into the RPF. Those over 65 who chose to work would still receive the full RP, so these people would also have less incentive to retire from the workforce.

Increased Social Efficiency

The RP would increase social efficiency, as retirees would be less inclined to have assets tied up in large means-test-exempt houses, and this would release more money into the economy with a corresponding increase in investment, employment and GST revenue.

Funding on an individual basis

The mix of funding would not be done on an individual basis within the RPF, as all the sources of income would be pooled to pay the RP and the source of individual funding would be totally transparent to both the RP recipient and the RPF.

The underlying funding for the RP would still, however, be similar to the present system. Those with little or no work history would have their pensions funded as now from the government. Most workers who had contributed to the RPF would be paid with a mix of government revenue and RPF funding. Higher income earners who had contributed more SG for most of their working life would be paid entirely from the RPF.

Current recipients of the government pension would continue to be funded by the government although they would still be paid the RP through the RPF. Current part pensioners and self-funded retirees who would now qualify for the full RP would be funded by SG contributions from current workers, by cost savings, by the elimination of the super co-contribution, by the reduction in the tax benefit of franking credit and by the taxation of AP funds including their own.

Those who currently have a very high balance in their AP fund would pay more tax on the income in their fund than the RP they would receive, so the new system would not be subsidising these people.

Cost Estimate

We currently have around five people of working age for everyone over the age of 65. If on average four of them are actually working and the average wage is around $30k, then ongoing contributions from the SG to the RPF would amount to an average of $1500 per worker giving $6000 paid in each year for everyone eligible for the Retirement Pension. This would fund around 35% of the amount required to give everyone an RP.

Currently around 50% of those over 65 get a full pension and about half of the rest get a part pension, so the extra from the SG being paid into the RPF should fund the extra needed to give everyone a non-means tested pension. That is without considering the extra revenue from the cost savings outlined above.

This is only a rough estimate, and does not allow for the RPF retaining some funds to build up an asset base for investment, but does indicate that my system would be financially viable from the beginning and sustainable in the longer term.

It is possible that it may cost the government more for the first few years as current retirees would be eligible for the RP although they have not contributed to the system, and the transition has to be made in a way that ensures no-one is seriously disadvantaged. But in the longer term it would be perfectly sustainable.

Transition Issues

The scheme would need to be phased in over several years. Here is one possible way this could be done, although detailed costing would be needed.

Set up the RPF and eliminate tax free AP's

In the first two years the RPF would be set up and SG contributions would be made for all employees and by self-employed people. This would give the RPF a kitty to start the new system.

No new tax free AP funds would be set up. Instead retirement income streams would be paid by super funds from their normal assets, on which the income is taxed at 15%.

Tax on private investment income

The new system of withholding tax on private savings income would apply from year three and would apply to individuals and super funds.

Most super funds would obtain much of their income from managed investment schemes, listed companies and bank interest. Once the system was up and working all of these sources would have the tax already paid on them, leaving most funds with only contributions tax to pay.

Existing AP funds would also have the tax pre-paid on most or all of their income and would thus be brought into the system automatically. Any income generated within the AP fund that was not covered by the withholding taxes would be taxed from year four.

Paying the new pension

The new Retirement Pension payment (combining all benefits into a single pension and paying everyone a fixed amount regardless of marital status) would start from year three.

To phase out means testing there would initially be four rates of RP. These would be set at one quarter, one half, three quarters and one whole of the new pension amount. All current part pensioners would have their pension rounded up to the closest new pension rate.

Any existing part pensioner who could show that their assets or income had changed could be upgraded to the rate they would have received under the old system. Any existing self-funded retiree who would have qualified under the old system could apply for an RP at the rate appropriate for their circumstances.

All new applicants turning 65 would be paid the new pension at the rate for their circumstances with a minimum of the lowest rate paid to everyone.

In the following year all pension recipients not on the full rate would go up to the next rate, and all current self-funded retirees would be paid the new RP at the lowest rate. Each year the rate would go up a level for anyone not on the full rate. At any time anyone in receipt of a part RP could be upgraded if their circumstances changed.

At the end of year six of the new system all retirees over 65 years of age would be on the full RP amount. There would be no further part rate pensions and all means testing would be totally eliminated.

Any self-funded retiree who did not wish to be part of the system would have the option of never putting in an application for the RP.

Relating this Scheme to the Consultation Questions

I will attempt to relate my suggested new scheme back to the objectives for a retirement income system and the consultation questions raised in the Retirement Income Consultation Paper. To save time and space I will not repeat the questions here, as they can be easily referenced, I will only give my response to them.

The retirement income system should be broad and adequate.

My scheme gives every Australian a basic retirement pension amount at the age of 65 regardless of their workforce participation and without complex rules. My integration of the tax treatment on superannuation and savings, with both having a flat 15% tax rate, allows individuals maximum flexibility to save extra funds for their retirement.

The system should be acceptable to individuals.

I consider that my scheme would be acceptable to the majority of people. Most people would be happy to exchange half of the super guarantee for the assurance of an adequate pension whatever their workforce participation through life or financial position in retirement.

There will never be any anomalies that can leave any Australian without sufficient income but unable for means test reasons to claim a pension. I believe that this aspect alone will make this system acceptable.

I think that most people would understand that their SG money was actually eventually paying their pension and that if that had been left in the private superannuation system, as now, their government pension would have been reduced. The proposed new retirement pension is just an integration of super paid through the SG system and the current government age pension, combined to give a single simple universal payment for all Australians over 65.

Employees would have some, but not all, of their SG diverted to the new Retirement Pension Fund, but this would have absolutely no effect on their take home pay and I do not think it would be resented. The annual cap on the amount would make it acceptable even to higher income earners.

Self-employed people would need to pay some of their income into the new fund, however most would just take this from the amount they currently put into superannuation. Many of those who do not currently contribute to super would welcome a scheme that arranged this for them and gave them access to an assured income in retirement.

People may need to be persuaded that they can have confidence in the system, as most people have seen a lot of change in the treatment of superannuation and the government age pension over their working life, however this problem would be the same with any changes to the current system.

The system should be robust and deal with investment, inflation and longevity risk.

My system deals with all of these risks in a very positive way. Even if a person's superannuation and private savings investments collapsed entirely, they would still get the basic RP amount. The RP would be indexed to cover inflation risk as the current government age pension is now. The RP would be paid for the remainder of a person's life, however long they live. And it would be certain, it would be paid to every Australian citizen or permanent resident who is over 65 and still alive.

It should be simple and approachable.

My system is simple enough that most people would easily understand most aspects of it. Giving everyone over 65 a fixed rate of pension is about as simple as it gets.

All forms of savings and retirement income are taxed equally, giving individuals greater flexibility in how they save for retirement and how they take their income.

The RP would be entirely tax free and super and investment income for retirees would have the tax already paid, leaving only the tax on work income and possibly capital gains to be put on a tax return.

The elimination of complex means tests gives people the freedom to deal with their assets in a way that suits them.

It should be sustainable

My system is sustainable as most people's RP would actually be paid out of their SG contributions over their lifetime.

It still leaves the same pool of superannuation money available for investment, except that more would be in the government run Retirement Pension Fund and less with private fund managers. The inclusion of the self-employed in the superannuation system would see a more funds coming in.

The Retirement Pension Fund could invest in infrastructure projects, rental housing projects, mortgages and commercial investments without the managers being pressured to make high risk investments to maximise profit. It could even be invested through private sector fund managers.

The new system of a flat tax on savings would encourage people to save and invest and at the same time would reduce the tax paid by higher income earners with a potential increase in consumer spending by these people.

Overall I do not think my changes would have any negative effects on the economy, only very positive ones.

Q1.1

The first objective of the retirement income system must always be to ensure that everyone in its targeted age group has enough to live on without undue financial stress.

The second is to make the system as simple as possible to allow it to be understood by the majority of people, particularly allowing for the reduction in capacity that comes with increasing age.

The third is to make it fair, so that everyone with the same income and accumulated assets is treated more or less equally regardless of how their assets are arranged.

I consider that my suggested new retirement income system achieves all of these goals perfectly.

Q2.1

Individuals wholly or partially excluded from the SG system are served very well with my new system, as there is absolutely no discrimination in RP payments based on past contributions to the RPF. All RP recipients are treated exactly the same.

RP applicants will need to give Centrelink proof of identity, proof of age and proof of citizenship or permanent residency. They will need to give contact details and a bank account number for payment of the RP. These details will need to be kept up to date. There will be no requirement to give any asset or income information or any information on personal relationships, past working patterns or past contributions to the RPF.

Q2.2

I do not have any concrete suggestion of what the new pension amount should be in monetary terms, or the best way to index it to allow for inflation, although I do feel that the current amount is too low for those relying solely on an age pension.

My new system will give a basic amount to everyone that hopefully could be at least slightly higher than the current age pension, while still allowing those who have some super or private savings accumulated during their working years to benefit from a higher income amount.

My system offers a huge amount of flexibility for retirees accumulating and accessing this extra income.

Q2.3

The role of government should be to set up and oversee a robust and stable system that will give everyone a realistic but reasonable income in retirement. The system needs to be universal, easy to understand, it needs to encourage savings and reduce the likelihood of individuals being exploited by unscrupulous operators. It also needs to be independent of political party manipulation and not changed on an *ad hoc* basis for political point scoring.

People need to have confidence in the system, so they can assume that the rules applying now will still apply when they retire, which may be decades into the future.

Q3.1

The current SG system and the current concession give some scope and flexibility for those saving for retirement and those who are retired, but I think we could do a lot better. There are still a lot of anomalies in the current retirement income system that need addressing.

My new system addresses all of the anomalies and gives the maximum possible scope and flexibility to savers and retirees.

Q3.2

The differences in tax treatment of super and savings in retirement are far too high. For example a retiree with savings income from accumulated assets outside of super is taxed at normal rates where their income is too high to qualify for the SATO. Yet a retiree with the same assets in an AP fund will have all the income on the assets totally tax free.

There are also differences in the tax deductibility of super contributions depending on whether a person is employed or self-employed. I have outlined these in my original submission to the tax review and in my first submission to the Retirement Income Review in which I covered some suggested changes to the current system.

Allowing the current tax free status of AP funds is probably not sustainable into the future as more and more retirees will set up their affairs so that no tax is payable at any stage on their income. This will place an undue burden on younger people who are trying to buy their houses and bring up their children as well as paying income tax to subsidise well off retirees.

My new retirement income system, outlined here, creates a totally sustainable system with everyone contributing something to the overall system and taking a fair payment when their turn comes to retire.

Q4.1

In my first submission on retirement income I have outlined my reasons for objecting to any rise in the age at which people are allowed to access their super and their government pension, currently 60 and 65. I am happy for retirement at age 55 to be phased out. Allowing people to retire while they are still fit and active has huge social benefits that improve the quality of life for all of us. Our younger retirees form a pool of fit, useful, skilled and experienced people who help our communities to function and contribute to the quality of life for all of us.

I reiterate here that I believe it would be a great loss to our society if people were forced to work until they drop.

Q4.2

The current system leaves the individual retiree to deal with risks associated with investing their super and deciding on a strategy to make their money last as long as they do. I do not think this decision making is appropriate for most people or within their capabilities, particularly with increasing age. There is always a risk for these people that if they get it wrong they will lose their income but still not qualify for a pension.

By doing away entirely with means testing, my new system eliminates this risk and stress for retirees. Everyone would get a pension and any extra super or investment income will increase the retiree's standard of living without ever putting their basic needs at risk.

Q5.1

The current system is vastly too complex for retirees. The assets and income tests are confusing, and encourage people to stay in the means-test-exempt family home long after this is no longer socially desirable.

Most pensioners are unable to calculate or even understand fully the implications of gaining extra income with both the loss of social security benefits and the extra tax to be taken into account. This discourages retirees from doing paid work or saving and investing money. The deeming provisions encourage retirees to invest in risky investments promising a rate higher than the deeming rate, or at the other extreme, to hide money under the mattress.

My new scheme completely eliminates most of the complexity for retirees and all of the artificial investment strategies that can be so unproductive and inefficient on a community wide basis and can cause individuals undue stress and worry.

I do not like the system of retirees taking out reverse mortgages on their homes to help fund their retirement, mostly because older people are less able to assess whether the product is suitable for their situation, leaving them subject to exploitation, and partly because it restricts their ability to sell up and move to a smaller home later if they choose to do so. While it may be possible to transfer the reverse mortgage to the new home, it would vastly complicate an already stressful situation for a retiree who is moving house.

The current complexity for workers is probably okay as most of the work and complexity associated with the SG is born by employers. We do need a better system for keeping people in contact with their super, but otherwise I think the current system is workable.

Q6.1

The age pension serves as a safety net for those unable to support themselves and as an income supplement for those with some super. My new system combines these two aspects into a universal payment, eliminating means testing with no extra cost to the government. My system would easily be sustainable into the future. Eventually everyone who retires would have contributed to the RPF, via the SG, for their whole working life and the assets retained by the RPF would be continually increasing.

Q6.2

The current system does affect the workforce participation choices of older people. Free access to super for those aged 60 to 65 is only possible if they are retired, and there are restrictions on contributing to super for retirees who don't work at all. Over 65's lose pension income if they are still in the workforce or get no pension at all, only the promise of a possible pension bonus when they do retire.

Changing the current rules so that all those over 60 could access their super, and there was no work test for those over 65, would eliminate decisions based solely on these criteria.

My new suggested scheme would encourage older workers to remain in the work force at least part time as their income would have no effect on their Retirement Pension.

It would also reduce the likelihood of younger people being taxed at higher rates in the future to fund the pension system.

Q6.3

I am not absolutely sure what this question is asking, but I assume it means would financial planning advice help retirees to make better use of their assets to gain a higher income. The answer to this would have to be ‘yes’ if the advice was good advice and the service was affordable and was run on a fee-for-service basis not a commission on investment basis.

However the elimination of means testing and a unified tax system for all forms of retirement income would allow most retirees to make much better decisions themselves on asset allocation, housing, how they spend their money and whether they continue in the workforce.

Conclusion

I have outlined here some ideas that would make the retirement income system simpler, fairer to everyone and easier to administer. The changes I have suggested are not large and could be easily implemented. While many of my ideas would work well in isolation, together they would give Australia a beautifully integrated retirement income system that was simple, efficient, equitable, flexible and easily funded. It would result in a better lifestyle for all Australians.

My scheme for retirement income cuts out all of the complexity of the current system, provides certainty to retirees, vastly reduces administration costs, increases social efficiency, provides incentives to retirees to continue working and above all is sustainable into the future regardless of the proportion of retirees to workers.

I would like to stress that I am not a tax expert and I may have overlooked some aspects of the current system when devising this new one. I am quite happy to put more thought into any of the ideas here, to discuss them with the panel or to do any calculations that would assist in costing them.

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

Lorraine Graham