The Institute of
Chartered Accountants
in Australia

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AFTS Secretariat
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Dear Secretariat,

Australia's Future Tax System Retirement Income Consultation Paper

The Institute of Chartered Accountants in Australia ('the Institute') welcomes the opportunity to make a submission to the retirement income system consultation paper. The Institute is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 58,000 of today's and tomorrow's business leaders, representing some 46,000 Chartered Accountants and 12,000 of Australia's best accounting graduates who are currently enrolled in our world-class post-graduate program.

The Institute addressed this Consultation paper by inviting a number of Institute members who have extensive professional and personal experience and expertise in the area of retirement incomes. These included SMSF administrators and auditors, financial planners, accounting firm partners and directors and superannuation technical consultants.

The discussion and suggestions raised at this forum is the basis for the details outlined in this submission.

The Institute has addressed a selection of the consultation questions which it believes it is most appropriate to provide comment on. In addition has provided additional comments in regards to issues that are believed to be of value to this consultation process.

The Institute would like to clearly state that that consistency and simplicity of the retirement incomes system is paramount. This should be considered in light of some of the suggestions and recommendations outlined in this submission which are the basis for future policy development.

1. The Retirement Income System

Q1.1 In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?

Summary:

- Three pillars is a lifetime framework, not a retirement phase only framework
- Broaden and mandate compulsory superannuation contribution accessibility
- Development of a "lifetime" means test
- Assess age pension eligibility in terms of lifetime contributions and savings patterns
- Review linkage between age pension and associated benefits
- Review of home ownership implications

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The Institute wishes to raise 2 significant issues in regard to this review. Firstly, of critical importance is the need to ensure that the review provides confidence in the whole retirement system. A key focus to the success of the retirement income system is to encourage individuals to fund their retirement. It is imperative that any changes do not create a lack of confidence in the system. The current economic conditions have reduced many consumers belief in their superannuation. A recent survey commissioned by the Institute found 65% of people did not believe that the 9% SG contributions would be adequate for their retirement, in fact only 50% believed superannuation would be there main source of income in retirement. The objective of simplicity will be an important component to ensure individuals' understanding grows and thus builds their confidence in the system. This will result in Australians taking a greater responsibility for the funding of their retirement.

Secondly the Institute would like to raise that while the taxation of superannuation benefits are not part of this review process a holistic approach should include consideration of this component and the impact it could have.

The Institute supports the Government's three pillar retirement income system comprising of the Government funded age pension, compulsory superannuation guarantee contributions and voluntary savings. Individually they are fundamental to Australia's retirement income system. However they are not achieving the government's objectives.

Within this framework, the Institute considers that the voluntary savings component should be expanded further and can become a considerably larger component of Australia's retirement income funding system.

In addition the Institute is of the opinion that the three pillars should not be viewed in isolation about retirement. The Government's current retirement income policy is focused on outcomes at retirement For example, the age pension eligibility means tests take into account an individual or a couple's assets and income at the time of application for benefits. It disregards other factors including an individual's earnings, savings and expenditure patterns.

Rather the framework should have a "whole of life" approach. Irrespective of your time of life the three pillars are a framework that would apply across the whole system of social security. The funding of income and the provision of a safety net is appropriate to all individuals irrespective of their time in life, whether it is in retirement or when unemployed. This "whole of life" approach would include the means testing and calculation of Centrelink benefits throughout your life not just at the end at retirement. These assessments could be based on an individual's income, savings, contributions and assets over your lifetime.

The Institute agrees with the Government's stated objectives but considers that a sound retirement income policy should take a lifetime approach to investment and retirement savings with the following additional objectives:

- To encourage and provide incentives for long term voluntary savings outside the mandatory superannuation guarantee contribution system.
- To encourage individuals to take personal responsibility for retirement savings
- Self-funding should be the key objective. It is important that self-funded retirees should not be disadvantaged and be given access to subsidised benefits on retirement.
- To instil public confidence in the retirement income system that is workable, equitable and sustainable

2. The Broad and Adequate Retirement Income System

Q2.1 As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?

Compulsory superannuation

The compulsory superannuation "pillar" of the government's retirement income system is critical to ensure all individuals have a form of savings that can be their main source of income in retirement or that can subsidise their age pension payments.

The compulsory superannuation system should be an opportunity available to all individuals, further consideration should be given as to how to broaden this system.

It is recommended that the mandated compulsory superannuation be spread across a wider range of individuals. There are many inequities where individuals do not fall into the compulsory superannuation net, or more specifically during their lifetime fall out of the net including those who stop work for various reasons – be it voluntarily or not. When individuals fall outside of the current compulsory superannuation system it can result in significant changes to their long term saving patterns, impact their retirement expectations and potentially increase age pension costs to the government.

Opportunities are available to include mandated savings for the self employed and others who currently are outside the compulsory superannuation net. The compulsory superannuation system should include the self employed where it could be mandated that they contribute the equivalent, for example, 9% of their gross income up to the contribution caps.

Others to be included would the independently wealthy who should be required to contribute to superannuation. This would ensure the issues associated with divesting assets during ones lifetime, and then reliance on the age pension would not be as significant. This would result in all individuals having a level of savings available in retirement. As many individuals do not save or take responsibility for their retirement as they should the mandating of superannuation contributions would be an opportunity and of value to individuals who receive a windfall such as an inheritance.

Where an individual involuntarily or voluntarily falls out of the SG contribution net for example becoming unemployed/ redundant there should be a framework for these individuals to continue to be under a form of mandating to have superannuation contributions. This would ensure although work patterns have changed a level of contributions continue in to superannuation. This would assist individuals to continue to contribute and meet their long term retirement goals.

Q2.3 What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

The Government has a wide ranging role and responsibilities in regard to assisting individuals meet their retirement expectations. The role and responsibilities of government should remain the same over an individual's lifetime irrespective of an individual's income, however the components of the role will vary.

The government has a critical role in developing a simple, consistent framework that encourages and incentivises individuals to make voluntary contributions/ savings and yet provide a safety net for individuals who are unable to support themselves. The role of the government is to ensure the framework is equitable to all individuals irrespective of their income or asset levels.

Education

A core role of the government is to develop a simple but broad education framework for individuals. Education for individuals includes developing an understanding of their retirement needs, alternatives and the importance of taking further responsibility for their current financial position and future retirement. This is currently a major responsibility of the Financial Literacy Foundation initiative.

Any changes to the retirement income system will not achieve the appropriate outcomes without buy in and understanding by individuals – this will be a significant challenge for government. One that will require specific focus is the younger individuals who have different experiences and views in terms of work, savings and lifestyle patterns. As a result the education process which must commence early for example thoroughly integrated into to the schools will be a long term generation issue. An individual's lifestyle must include having a responsibility for their finances. The benefits of this are both for the individual and government expense in the future.

3. An acceptable Retirement Income System

Q3.1 Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?

The superannuation guarantee contribution percentage – adequacy

Compulsory superannuation guarantee contribution is one of the pillars of the Government's retirement income policy. The widely held view is that superannuation guarantee (SG) at 9% currently is not sufficient to fund retirement income.

However, the adequacy of SG is not a separate issue as the optimum percentage depends on the interaction of many factors including the taxation policy and the voluntary savings incentive in force.

The taxation of superannuation has an important impact on SG funding – changes to the taxation of superannuation will impact on the end benefits. For example, if Australia adopted a no tax on entry and no tax on fund earnings approach, the savings on tax will significantly increase retirement end-benefits and a lower SG percentage may be adequate.

An increase in voluntary savings incentives will also lessen the SG burden so that a further increase in SG percentage may not be warranted. (In addition, consider the disincentive that may exist when reviewing for example the 15% marginal tax rate of low income earners and the superannuation earnings tax rate.)

An increase in SG also has other social and economic implication, depending on how the increase in SG is to be funded. Theoretically, SG contribution is an employer obligation. However in practice, many remuneration arrangements are packaged. This often results in the SG burden falling on the employee. The social and economic implication has to be taken into consideration.

Recommendation

The SG percentage at 9% is not sufficient on its own to fund retirement income. However, any increase in SG percentage can only be assessed on determination of any retirement income reform to be implemented, including taxation of superannuation and voluntary savings incentives. These measures will have an impact on savings patterns including voluntary superannuation contributions and superannuation end-benefits.

4. A Robust Retirement Income System

Q4.1 At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

The Institute does not have a definitive view in regards to the appropriate age for access to superannuation and the Age pension, it is suggested that the gap between the two will encourage individuals to voluntarily self fund.

Q4.2 What is the role of the individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

Longevity risk is an ongoing concern of an ageing population.

The age to access superannuation and the age pension age have definite impact on retirement savings pattern. In addition, the mode in which superannuation has to be taken also affects the sustainability of an individual's superannuation. Currently there is no mandating or specific incentives to take an individual's superannuation benefit as a long term pension.

Generally, the bigger the gap between the superannuation preservation and age pension age, the more incentive there is to save. Taking benefits as an income stream will also prolong the savings in superannuation and therefore the funds that can be used to support retirements. This will in turn reduce dependence on the age pension.

Recommendation

- The age pension age should be increased in line with increase in life expectancy in accordance with the ABS current Life Tables.
- The preservation age to be retained with the flexibility to withdraw a capped non-commutable transition to retirement income stream. Access to this income stream should be set at age 55 and not in accordance with preservation age, which is currently in force.
- Tax incentives to be put in place to encourage fund members to take benefits in the form of an income stream or to put a cap on the amount of superannuation that can be withdrawn as lump sum.
- This may include the compulsory superannuation component of an individual's superannuation being linked to a compulsory pension benefit only.

6. A sustainable Retirement Income System

Q6.1 The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?

The primary role of the Age pension (and other social security benefits) is to provide an adequate safety net for those Australians who are unable to provide for themselves. The Age pension should not be framed so as to provide additional benefits to those who are well place to fund themselves through their retirement or at other times of their life.

The Age pension and other social security benefits received by an individual should be a reflection of their lifetime contribution to superannuation, income and savings patterns.

A lifetime means test

There are a number of anomalies and inequities with the current means test. The current system can be improved to make the means test more equitable and to encourage self-funded retirement. An important aspect is to ensure the means test takes into consideration an individual's income and saving over a lifetime.

Recommendation

- The means test should be revised to take into account an individual's earnings, savings and expenditure patterns on an on-going basis.
- To be equitable and based on a "lifetime" approach framework, it is considered that the principal home exemption should be reviewed and all assets be taken into account in the assets test. .

Additional Comments

Home ownership

Home ownership is viewed by many individuals as an important form of savings outside superannuation system. In addition it is seen as a high priority focus for many individuals. Choices often have to be made by individuals between making voluntary superannuation contributions or to pay off the home mortgage.

Further the focus on home ownership has also developed an inequity in terms of Centrelink benefits and means tests. For example the home is an exempt asset. As a result individuals may be asset rich, income poor and receive the age pension. At the same time consideration must be given to individuals preference of where to live without forcing individual's to sell their homes. However if you want to live in a large house there are conditions in terms of age pension. Another issue for government consideration is accessing an individual's superannuation to fund home purchase.

There are 2 consideration the Institute would recommend be reviewed.

A further condition of release to be included is to allow a one-off lump sum withdrawal to finance home mortgage repayment when a person reaches preservation age.

It would be necessary to set terms and conditions to allow individuals to access their superannuation for a home purchase. For example there would have to be a maximum limit/ percentage that could be withdrawn from superannuation to purchase a home. (This would stop excessive pressure on house prices.) An alternative or complementary condition for release of superannuation for home purchase may be to have a condition that individuals have to be contributing at a level higher than the SG compulsory contributions. The objective is to encourage voluntary savings and at the same time ensure a component of superannuation savings continues.

When considering a lifetime approach to social security benefits including the retirement income system, the family home and its impact needs to be reviewed. The issue of the home being exempt for Centreline purposes could be addressed by possibly including a portion of the value of the home as part of the assets test. This as an option has become more realistic as there are now products that can access the value of the home to assist individuals with living expenses eg reverse mortgages.)

While this may be a complicated approach it would deliver benefits on many levels to both individuals and the cost to government. The most significant challenge will be the ability to value the home in a consistent and fair manner – considerations may include that X% of the value of the home which is over the median house price.

Aged pension and Health subsidies

One of the main challenges in regards to the age pension system is that for many individuals it is seen as a "right" to receive the age pension. One of the key drivers to individuals obtaining the age pension is to be able to obtain the benefits associated with the heath card subsidies. As a result the current system unintentionally encourages individuals to divest assets to reduce their assets so as to receive a range of health subsidies. These subsidies can be financially very beneficial. An inequity exists where wealthy individuals who are in a position to fund themselves actually receive benefits, thus a cost to government. The removal of or change to the associated benefits received by individuals would result in a saved age pension cost.

With the ageing population, the Government should review the issue of health and pharmaceutical assistance as potentially a separate measure from pension security. The entitlements to the age pension allows the individuals to access the Age Pension Card with a host of assistance for prescription medicine and other benefits.

This is an urgent issue as Australia's population ages and health benefits are becoming an increasing cost to government

Recommendation

To review the health care issue as a separate measure from social security fringe benefits and to put in place a program to provide pharmaceutical and other assistance to older Australians including self-funded retirees. The means test, if any, should be expanded and not to be aligned with the social security means test.

A possible solution to this current situation is to introduce a tiered system to access the health subsidies (and other benefits) associated with the age pension. For example where an individual receive between 75% and the full aged pension they are in receipt of the full health card and associated benefits. Where the individual receives between 50 and 75% of the age pension they receive 75% of the health card benefits and where individuals receive less than 50% of the age pension they receive 20% of the benefits associated with the health care card.

Such a solution would be a disincentive to individuals to divest their assets so as to receive the associated benefits that receiving even $1 of the age pension provides.

Annual contribution caps disincentive

The current annual contribution caps implemented as a result of Superannuation Simplification is costly and difficult to administer. The cap, on an annual basis, coupled with the punitive approach to cap excess is a disincentive to voluntary savings in superannuation. It is a barrier to those who wish to make voluntary one-off contributions from for example, the sale of assets or inheritance. Expatriates have also experienced difficulty in repatriating superannuation accumulated overseas into superannuation in Australian due to the stringent contribution cap. The $450,000 upfront non-concessional contributions can only be made on rolling three-year basis.

Recommendation

It is recommended that a lifetime cap for everyone should be implemented. This lifetime cap is different from the old system of reasonable benefits limit as it is not based on a lump sum or pension benefits approach.

A lifetime cap for all regardless of employment status will be equitable. It will also encourage people to fund contributions early in life. In addition, it will be possible to make contributions at more economically viable times and contribute less when it is less feasible to do so. A more flexible system will encourage voluntary savings in superannuation.

Superannuation taxation reform

Our current system adopts a tax on entry and tax within superannuation approach. Tax is imposed on contributions and on fund earnings. Generally there is no tax on exit where a person who reaches age 60 and above.

As stated at the beginning of this submission the Institute understands that the issue of taxation on superannuation benefits is not part of this review, however the Institute would like to reiterate that a holistic and lifetime approach should consider its impact. It is considered a more equitable and flexible system to adopt an EET approach. The EET approach taxes only on exit and there is no tax on contributions and fund earnings - this provides significant incentive to use superannuation as a voluntary savings framework. It is also aligns with the Institute's "lifetime" approach to the three pillars of the retirement income system.

Should there be any queries on this submission, please contact in the first instance Mr Hugh Elvy, the Institute's Head of Financial Planning and Superannuation on 02 9290 5564 or at hugh.elvy@charteredaccountants.com.au

Yours sincerely,

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