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Submission to the Retirement Income Review

From: SA Superannuants

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Introduction

This submission is made on behalf of SA Superannuants (the Association), an organisation representing people in receipt of untaxed-source defined benefit pensions paid from South Australian and Commonwealth superannuation schemes. These pensions differ in important ways from the more common taxed-source retirement income streams (defined benefit or account-based).

Most untaxed-source pensions have larger gross amounts than would be the case if the same amount of contributions, and earnings, backing them were held in the taxed-source superannuation environment. Working in the opposite direction to this advantage are the facts that the pensions are not eligible for the 15% tax offset prior to age 60 and remain taxable income after age 60 with a 10% tax offset then available. Other taxable income (including age pension) is added to the superannuation pension and taxed at the marginal rate for the combined income. The medicare levy is also payable on untaxed-source defined benefit pension income throughout retirement.

The untaxed-source status of South Australian and Commonwealth defined benefit pensions has been mandated by the respective governments with members given no choice in the matter. For many members, in receipt of the pensions today, membership was compulsory at the time they joined the schemes in the 1970s, as was a personal contribution from after-tax income. There was little or no vesting of benefits and employees leaving government service before the prescribed retirement age received only their personal contributions plus a small interest rate. They received no employer component to go with the refund of their personal contributions. Once compulsory membership of the South Australian pension scheme was relaxed many people opted not to join. Others who had been compelled to join earlier sought the right to leave.

After closure of the scheme in 1986 came compulsory super for all Australian employees and with it full vesting of both the member-funded and employer-funded component of the pensions. Today the Association acknowledges that the untaxed-source defined benefit pensions of its members represent a good return on their investment. But we consider that the common assertion of the pensions being generous by community standards does not stand up to close examination when all three pillars of the retirement income system are taken into account along with taxation differences. The Association would say that South Australian untaxed-source pensions are ***'Good, but not better than the Superannuation Guarantee.*** The basis for this view is set out in a document that can be opened by clicking
https://www.sasuperannuants.org.au/wp-content/uploads/2020/03/good-but-not-better.pdf

The submission following aims to give a perspective on Australia's retirement income system reflecting the experience of people receiving untaxed-source pensions. The Association hopes that the submission will assist the panel in its deliberations on adequacy, equity, sustainability and cohesion of Australia's existing retirement income system.

Consultation questions

Question 1: *Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?*

The Mercer Retirement Income index compiled for June 2019 ranks Australia's retirement income system as third best out of 37 countries. The countries ranked above Australia were Denmark and the Netherlands. The Mercer index has the three sub-indices Adequacy, Sustainability, Integrity and they have weightings of 40%, 35% and 25% respectively. The scores out of 100 on the individual sub-indices for Denmark, The Netherlands, Australia and New Zealand are shown in the table. The combined and weighted scores are also shown along with one of the grades A, B+, B, C+, D, E.

Country (grade)	Adequacy	Sustainability	Integrity	**Combined Score**
The Netherlands (A)	78.5	78.3	88.9	**81.0**
Denmark (A)	77.5	82.0	82.2	**80.3**
Australia (B+)	70.3	73.5	85.7	**75.3**
New Zealand (B)	70.9	61.5	80.7	**70.1**

The figures in the Table suggest that Australia's system is already highly effective. For the two countries ranked above Australia retirement income is taxable and so it might be worthwhile the panel investigating the impact that tax-free status for most Australian superannuation income streams has on each of adequacy, equity, sustainability and cohesion. New Zealand has a universal (not means-tested) age pension system and this is something people whose means disqualify them from receiving an age pension payment often advocate for Australia. The implications of moving to a universal age pension for Australia might be something useful for the panel to investigate. However, the Association itself supports a means-tested age pension and sees it as the bedrock of Australia's retirement income system.

Question 3: *In what areas of the retirement income system is there a need to improve understanding of its operation?*

Taxation: it is a common experience for members of the Association to be challenged when they say that they are paying tax and the medicare levy. Many retirees in receipt of taxed-source (tax-free after age 60) income streams believe that anyone still paying tax and medicare levy in retirement must have a very large income. On page 4 of the Consultation Paper, referring to the age pension, we read

> 'It is a taxable payment, however the seniors and pensioners tax offset (SAPTO) raises the effective tax-free threshold for eligible older Australians above the rate of the Age Pension.'

This implies that SAPTO eliminates tax on age pension income and most Australian retirees, including those who have relatively large superannuation incomes, know that their own age pension payments are received tax-free. Hence the common assumption by people that any retiree paying tax and the medicare levy must be much better off than they are. The reality is that once an untaxed-source superannuation pension exceeds the modest level of about $35,000 p.a. the person receiving it will pay tax and the medicare levy on their combined income.

The justification for superannuation tax concessions: it is also common for people to express resentment when they notice a decline in their superannuation account balances during retirement. They see the situation as one in which they are being forced to use their capital, as well as the earnings of that capital, to fund their retirement when they should be able to retain most of the capital until death no matter the age at which death occurs. However, as the Consultation Paper states

> 'Minimum drawdown rules for superannuation mandate the withdrawal of a certain percentage of assets from superannuation each year. These rates increase as a retiree ages and are designed to ensure that superannuation is used for its intended purpose of providing income in retirement.'
>
> Consultation Paper, p. 25

The Panel could consider ways in which people might be brought to understand that the tax concessions for saving through the superannuation system justify those savings being used to reduce reliance on the age pension.

Question 11: *What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?*

The Association considers the benchmarks set by ASFA (Singles: Modest lifestyle, $27,913 p.a., Comfortable, $43,787 p.a. Couples: Modest, $40,194 p.a., Comfortable, $61786 p.a.) as appropriate for the Panel to use in judging the adequacy of tax-payer support that is currently being provided, through taxation concessions and means-testing arrangements, for all three pillars of the retirement income system.

Figure 4, on page 14, of the Consultation paper is an indicator that the level of public support given to high income/high wealth individuals, by superannuation tax concessions, is greater than that given to low income/low wealth people by the age pension. This is to be expected given that, over a working lifetime, the difference between marginal income tax rates and the maximum superannuation tax rate of 15% increases until income reaches $250,000 p.a. Then in retirement large superannuation account balances pay no tax on earnings and can receive unused franking credits worth as much as age pension payments being made to lower income/lower wealth individuals.

Question 12: *What evidence is available to assess whether retirees have an adequate level of income?*

The ASFA benchmarks are above the maximum age pension payments ($24,268 p.a. for a single person and $36,582 for a couple) and below the income or asset level that eliminates age pension payments altogether. Information provided about the benchmarks, particularly the 'Comfortable', benchmark, are convincing evidence that retirement incomes from about $35,000 p.a. to $45,000 p.a. for singles and about $50,000 p.a. to $65,000 p.a. for couples will deliver a reasonable standard of living. Support for retirees from the superannuation tax concessions and age pension cover, and extend beyond, these ranges.

The Consultation Paper provides the following information on the current value of superannuation held by Australians.

> 'Between 2013-14 and 2017-18, average household wealth held in superannuation increased by around 16 per cent to $374,000 for individuals aged 55 to 64 (ABS 2019a).'
>
> Consultation Paper, p.23

When a superannuation account balance value of $374,000 is entered into the ASFA retirement calculator (http://www.superguru.com.au/ExternalFiles/calculators/retirement-tracker/#/) for a couple aged 67 the calculator returns a retirement income value of $58,636 p.a. with the recipients receiving $35,978 p.a. in age pension. If half this amount is entered for a single person the calculator returns retirement income of $35,272 p.a.

These numbers suggest that the retirement income system is delivering adequate incomes for a significant fraction of retirees and that this fraction is going to increase.

Question 14: *What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?*

The Association draws the Panel's attention to the valuing of defined benefit pensions for transfer balance cap purposes. This valuing is done by applying the factor of 16 to the annual pension value regardless of the recipient's age. Sixteen would be a high valuation factor for a defined benefit interest even when the pension commences at age 60. To have it applying to the pensions of older people seems both unfair and unnecessary.

The legislation authorising application of the Transfer Balance Cap is the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016.* In its *Division 294-Transfer Balance Cap* this act states that the object of the Division is to 'limit the total amount of an individual's superannuation income streams that receive an earnings tax exemption.' Applying a valuation factor of 16 to defined benefit pensions of the same amount being received by both a 60-year-old and an 80- year-old is, in effect, a false claim that the pension of the 80-year-old is backed by the same amount of assets receiving an earnings tax exemption as is the case for the pension of the 60-year-old. Clearly there is a much smaller set of assets backing the pension, and receiving an exemption from the earnings tax, in the case of the 80- year-old.

Defined benefit pensions cannot be cashed in except in prescribed circumstances and so they do not have an asset value that the pension recipient can realise as is the case with account-based pensions. However, the Association accepts that it is fair for them to be assigned a value for Transfer Balance Cap purposes otherwise people receiving them would be able to have more assets backing income streams that are exempt from earnings tax than people with account-based pensions. In this matter much of the concern the Association has is with the precedent set by valuing a defined benefit pension using a valuation factor unrelated to age. We request the Panel to consider recommending to the Government that actuarial, age-related factors be used in the valuation of defined benefit pensions for Transfer Balance Cap purposes.

Question 18: *What should the Panel consider when assessing the sustainability of the retirement income system?*
Question 19: *What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?*
Question 24: *What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?*

According to the Consultation Paper:

> 'Research has shown that many households in retirement are net savers (i.e. their income is greater than their expenditure) (CEPAR 2018a, p. 22). In addition, superannuation balances are forming an increasing part of bequests. There are a number of possible explanations for these behaviours, many of which are rational on the part of the individual. However, where individual choices place pressure on public finances, they affect the sustainability of the retirement income system.'
>
> Consultation Paper, p. 24

There are several matters affecting the long-term sustainability (and fairness) of the retirement income system that the Association believes the Panel should investigate or recommend for investigation. These matters are:

a) Taxation of non-superannuation income. When taxed-source superannuation income became tax-free in 2007 the change went further than just reducing tax payable on superannuation to zero. It made the superannuation income non-taxable income and other taxable income (including age pension) became taxable as if it was the only income. The Association asks the Panel to recommend to the Government that it use Centrelink data to estimate the cost to tax revenue of

i. allowing age pension and other taxable income to be taxed separately from superannuation income.
and/or
ii. making age pension tax-free for all recipients

b) Exemption of taxed-source superannuation income from the medicare levy. The large part of superannuation contributions are paid from before-tax income which avoids the medicare levy and it is not payable on any earnings. Most payments to retirees from the superannuation system are also not subject to the levy. Given that money going into the system and the earnings of that money do not provide medicare levy it seems inappropriate that payments from the system also escape the levy. The Association asks the Panel to recommend to the Government that it use Centrelink and tax office data to estimate the cost to medicare levy revenue of exempting taxed-source superannuation payments from the medicare levy.

c) Refunding of unused franking credits to superannuation accounts that are funding pensions. A superannuation account that is funding a pension is exempt from tax on its earnings. That account delivers no tax to the government and it seems odd that the account is able to receive a full refund of franking credits when it is not a tax-paying entity.
In effect the tax office is providing non-means-tested income support to the account holder by paying to him or her, each year of retirement, the tax that the company paid in that same year on the franked dividends that went into the account. It is reasonable for unused franking credits to be refunded to a taxpayer in order to ensure that tax is not paid twice on the same income. But refunding of unused franking credits to superannuation accounts that are tax exempt does not avoid double taxation, it is no taxation at all on income.

An alternative that would avoid double of taxation of franked dividend income is to make this income tax-free for the recipient. The Association asks the Panel to recommend to the Government that it use tax office data to estimate the current cost to tax revenue of the refunding of unused franking credits to superannuation accounts backing pensions and compare that cost to the cost of making franked dividend income tax-free to all recipients whether working or retired.

d) Abolition of the work test for non-concessional contributions made by people aged over 65
Many retirees report dissatisfaction with the low interest rates on bank account deposits and the fact that those rates are lower than the main age pension deeming rate. The Association believes that removal of the work test for non-concessional contributions made to superannuation by people aged over 65 could be a win-win move for both retirees and government revenue. The basis for this view is set out in a document that can be opened by clicking
https://www.sasuperannuants.org.au/wp-content/uploads/2020/03/work-test.pdf

e) The extent to which the Newstart allowance is being used for retirement income support prior to age pension age. The fact that applicants for the Newstart allowance are not required to provide information on superannuation assets that they or their partners hold allows the possibility that individuals with large, unpreserved superannuation accounts are using the Newstart allowance for income support when they have actually retired and have no intention of seeking paid employment. The Association asks the Panel to consider recommending that applicants for the Newstart allowance be required to report the amount of unpreserved superannuation to which they have access. This will provide the government with information about the total amount of money being paid to people in this position and allow an informed judgement to be made about whether changes are justified. The Association supports an increase in the Newstart allowance for all recipients. Its suggestion that unpreserved superannuation held by applicants for the allowance be recorded is not being made to disqualify people from receiving it when they need to do so. The purpose is to collect information that helps ensure that the allowance works fairly for people of all ages.