Association of Independent Retirees (A.I.R.) Limited
ACN 102 164 385

Australia's Future Tax System

Pension Review Submission

September 2008

26 September 2008

Pension Review Submissions
Reply Paid 7101
Canberra BC ACT 2610

Dear Dr Harmer

Association of Independent Retirees (A.I.R.) Limited
Pension Review Submission

The attached Pension Review Submission describes some issues that are of concern to self-funded retirees within the Terms of reference of the Review and which affect their lives and living standards.

They are submitted by A.I.R. in the sincere hope that the Government will accept the need for a more equitable recognition of the current needs of self-funded retirees, in the context of their past and ongoing contributions to the economic and social development of Australia.

The recommendations outlined in this Submission have been developed in consultation with A.I.R. members across all States and Territories. They are intended to assist the Review Panel in reviewing Australia's Future Tax System.

I hope that this Submission will be accepted as positive and supportive of Government policy objectives. Should you require any further information, please contact the following:

Dr J Barry Ritchie
Chair, A.I.R. Retirement Incomes Research Group
Home phone - (07) 5537 2137
Email - britchi1@bigpond.net.au

Yours sincerely

Theresa Kot
National President

About the Association of Independent Retirees (A.I.R.) Limited

The Association of Independent Retirees (A.I.R.) Limited is the peak body representing the interests of retirees who are fully or partly self-funded in retirement. A.I.R.'s members include full self-funded retirees, part-pensioners, and superannuants.

Formed in 1990, A.I.R. is a not-for-profit, non-political, volunteer organisation that is focused on matters affecting the standard of living, health and welfare of retired and partly-retired people.

As well as carrying out research and gathering information that will assist its members in maximising their life opportunities, A.I.R. is committed to educating the wider community (including political parties at all levels of Government) regarding the views and concerns of self-funded retirees.

Summary of Recommendations

This submission from the Association of Independent Retirees (A.I.R.) Limited is focused on the following aspects of the Pension Review for fully or partly self-funded retirees over the age of 65:

- managing personal assets over a retiree's retirement life span to retain quality of life and minimise dependency on income support;
- appropriate levels of income support and allowances; and
- structure of concessions and entitlements to improve the efficiency of the retiree support mechanism.

A summary of the Recommendations in the submission is set out below.

1. Managing Personal Assets (Section 1)

- **a.** Government allowances, concessions, or other entitlements should be structured to assist in retaining the real capital assets of partially funded retirees over their retirement life span.
- **b.** Income arising from the need to use capital assets for extraordinary purposes should be excluded from the calculation of income for means testing income support, allowances, and concessions for people over the age of 65.

2. Superannuation (Section 2)

- **a.** Minimum superannuation withdrawal rates for pensions, to avoid tax on superannuation earnings and pensions, should be set at a level that retains the asset base of the contributor within superannuation. The withdrawal rate should be set at the ten-year real return on assets of retail superannuation funds less a percentage reflecting the difference between the Male Total Average Weekly Earnings (MTAWE) and the CPI over the 10 year period.
- **b.** Commonwealth Superannuation and Defence Pensions should be indexed consistently using the same formula as is used to adjust the Age Pension.

3. Appropriate Level of Income Support (Section 3)

- **a.** The appropriate level of the Age Pension should undergo review at intervals of five years.
- **b.** The present indexes for escalating the Age Pension should be retained in between the review periods.
- **c.** Impact of costs of living on fully or partly self-funded retirees should be included in the review of the Age Pension. Means tests, taper rates, and other Government regulations impacting on assets should be adjusted to compensate for cost increases or imbalances.

4. Concessions and Allowances (Section 4)

- **a.** The Commonwealth Seniors Health Card (CSHC) should be indexed.
- **b.** The proposed determination of adjusted income for means tested support, allowances, and concessions should be modified to remove income from the sale of assets outside superannuation, or from additional withdrawals from superannuation, for the purpose of replacing capital assets or managing emergencies. Adjusted income should be based on the lowest income year of the previous three-year period.

5. Matters involving other Departments or Jurisdictions (Section 5)

a. Reciprocal public transport entitlements (Section 5a)

Seniors' Card Holders should be provided with reciprocal public transport entitlements between States and Territories.

b. Preventative Support Measures (Section 5b)

Government support should be expanded to enable retirees, with incomes at least equal to the cut-off for the Commonwealth Senior Health Card, to be assisted to remain in their own environment.

c. Access to the Medicare and Pharmaceutical Benefits Scheme Safety nets (Section 5c)

Access to the Medicare Safety Net and the Pharmaceutical Benefits Scheme Safety net for single retirees who are not in receipt of an Age Pension should be set at 60% of the requirement for couples or families.

Introduction

This submission is concerned with the financial security of fully or partly self-funded retirees over their retirement life span. In particular, it addresses the needs of retirees who rely on the income support system for part of their income. It addresses the Terms of Reference of the Pension Review, namely:

- the appropriate levels of income support and allowances;
- the frequency of payments;
- the structure and payment of concessions or other entitlements.

The Pension Review is one component of the wider Tax Review. There is inevitably some overlap between the effect of tax and of income support and allowances. This overlap has been kept to a minimum in this submission.

A.I.R. represents fully or partly self-funded retirees. Its interests are in Government policies that will assist the growing number of retirees to manage their incomes to maintain a reasonable standard of living over their retirement life span. The retirement life span is significant with the expected number of years of retirement for a 65 year old male of 17.7 years according to the Income Tax Act table; for females it is even longer. The average duration of current recipients on Age Pension support is 13.1 years[1].

The great majority of retirees have relatively low incomes. 77% of all retirees over 65 years of age receive some form of income support[2]. Over 80% of men between the ages of 70 and 90, and over 85% of women between the ages of 70 and 100 receive the Age Pension and related support[3].

Partially self-funded retirees make up about 75% of all age pensioners. However, only about 22% receive a weekly income greater than $100 per week, compared with the 'free' income for the full Age Pension of $69 per week for single pensioners and $120 per week for couples.[4] A.I.R.'s 2006 National Survey[5] with 4,500 respondents (approx. one quarter of total membership), showed that approx 50% of its members received some form of pension or assistance.

A cornerstone of Government policy in managing the ageing population is a maturing superannuation system. It is now accepted that a very high percentage of future retirees will not have sufficient superannuation to be able to rely solely on their personal assets over their retirement life span. The number of partially-funded age pensioners will increase significantly.

There has been little research into the financial and support needs of individual retirees as they move from a physically active lifestyle early in retirement to a less active lifestyle later in their retirement. Government policies are inadequate and simplistic to address the complex needs of a large group of members of our society over the age of 65. This group is characterised at any time by a wide range of ages with different needs related to their age and with standard of living expectations as broad as the community at large.

Retirees, whether partly or fully self-funded, have a reasonable expectation that they can maintain a standard of living throughout their retirement comparable with that during their pre-retirement. In many cases they have worked to build assets for this purpose and do not wish to see these assets erode over time to the extent that their standard of living reduces unreasonably. Many retirees wish to minimise their dependence on Government support but are deeply concerned that their assets may not last until the end of their retirement life span. They are afraid that they will become dependent on family, relatives, friends, or Government. They need to retain assets for unexpected and unforeseen medical, living, social, and transport costs.

The great majority of retirees have only average incomes with low levels of assets. It is most cost effective for Government to structure income support, allowances, and concessions, at a level which provides incentive for retirees to use their assets wisely across their retirement life span. Policies which cause assets to be depleted leading to greater reliance on income support have two effects: they increase the cost to Government of support, and they lower the morale and standard of living of retirees.

Managing personal assets is discussed in Section 1 and the role of superannuation in managing assets is discussed in Section 2. Issues affecting the appropriate level of income support are raised in Section 3. Matters affecting allowances including the Commonwealth Seniors Health Card are raised in Section 4. Some concessions and policies that have a strong bearing on the support needs of retirees, and matters involving other Government departments or jurisdictions are raised in Section 5.

1. Managing Personal Assets

Retirement living needs are generally higher early in retirement when retirees are generally more active, healthy, and looking to enjoy their free time. Basic food needs tend to decline with age from about 75 onwards. However, these needs tend to be replaced by higher medical costs. Income needs to be maintained across the full retirement life span.

The need to replace capital items increases with time. Even accepting that a car can be kept for ten years (well above the average age of cars in Australia), a car requires at least one replacement[6] during the average retirees' life span of 17.7 years. The A.I.R. National Survey, 2006 showed that over 90% of respondents continued to own a car between 75 and 84 years of age, with 77% continuing to own a car over the age of 85. The car remains essential to access regional shopping centres and to remain active. Activity in retirement is identified as essential to avoid high medical costs later in life.

Household items such as washing machines also have a life less than the average length of income support of 17.7 years. To maintain a house (most partially-funded retirees own their own home) over 17.7 years to a standard where downsizing is a practical possibility against increasing real housing costs requires some capital expenditure (painting, plumbing repairs, etc).

Use of capital assets to replace or maintain capital items, or for unforeseen needs, erodes the personal asset base. To encourage retirees to maintain their assets, these amounts should not appear as income for taxable income tax purposes or, as proposed, for inclusion in adjusted incomes for means testing income support, allowances, and concessions.

The CPI is not regarded as a good measure of the needs of retirees. The MTAWE is used as a more appropriate measure and has increased at a greater rate than the CPI over the 10 year period. Hence, the CPI understates the increase required to maintain retirement assets in terms of the real needs of retirees.

There is little recognition in Government policy of the need to preserve retirement assets over the retirement life span. Policies, such as those applying to superannuation withdrawals, and recent changes to the Commonwealth Seniors Health Card, which base income on annual income from all sources including withdrawals from superannuation for capital purposes or emergencies, contradict this need.

Recommendations

- Government allowances, concessions, or other entitlements should be structured to assist in retaining the real capital assets of partially funded retirees over their retirement life span.
- Income arising from the need to use capital assets for extraordinary purposes should be excluded from the calculation of income for means testing income support, allowances, and concessions for people over the age of 65.

2. Superannuation

Government policy and actions have been directed to increasing the amount of personal assets held in superannuation.

APRA 10 year performance figures[7] for superannuation funds show that over the period 1996 to 2006, retail superannuation funds achieved a return on investment to contributors of 5.3%. During that period, the CPI increased at an average annual rate of 2.6%. The real increase in superannuation assets averaged 2.7%. Thus, the income available to contributors, if they are to retain the real value of their assets, is 2.7%. A contributor would require a superannuation asset of $231,000 to support an income of $120 per week, the ‘free’ income allowed for each person of a couple on the full Age Pension.

The Pension Review shows that only a very small percentage of pensioners report assets at or above this level[8].

Superannuation regulations require that at least 5% (increasing with age) of assets must be withdrawn each year. Under present regulations, it is not possible to retain the value of superannuation assets over the average term of retirement (a reduction of at least 2.3% per year). The average return for all superannuation funds was 6.7% over the ten-year period, still leading to a decline in real assets of at least 0.8% per year. Furthermore, there is no guarantee that returns will remain at this level. A recent ASIC report shows that returns for the 10 year period to 30 June 2008 are significantly lower than those for the period 1996 to 2006[9]. Decline in assets due to forced withdrawal is cumulative leading to a rapid decline in real income over time.

Using a superannuation fund asset of $200,000 as an example (approximating that required to meet the 'free' Age Pension income allowance), using an average CPI of 2.6% (the average between 1996 and 2006), and using the age-related minimum withdrawal superannuation percentages, the real value of the asset will be approximately $86,000 at age 90. If withdrawals of capital for capital purchases (car) of home maintenance, or emergencies of 20% of the value of the asset are made at age 71 and age 80, the real value of the asset will be approximately $62,000. In real terms these values at age 90 provide little comfort that a person's needs can be met.

It can be argued that a retiree can invest the proportion of assets, forced to be withdrawn under the present regulations, outside superannuation, such investment then being subject to the normal taxation regime. Using the above example of a retiree with superannuation assets of $211,000, with the amount withdrawn for income purposes of $240 per week, and with a required minimum drawdown of 5%, the amount available for investment would be $84 per week ($4,310 per year). This amount is too small to justify a retiree making the effort to invest it other than in a bank. The returns would be less than those achieved in superannuation and the policy benefit to the Government negative. Indeed, the policy has the effect of encouraging a retiree to spend the amount that should be used to preserve the retiree's assets. A very high proportion of retirees on superannuation, now and in the future, will not wish to manage investments outside superannuation, other than a relatively small amount in a bank account.

As stated above, the CPI is not regarded as a good measure of the needs of retirees.

Commonwealth and Defence Force Superannuation pensions are indexed for inflation at the CPI rate whereas, since 1997, Age Pensions have been tied to MTAWE and are indexed in line with the *greater* of movements in the MTAWE or the CPI.

Two Senate Select Committees (in 2001 and 2002) have recommended that the CPI index used for Commonwealth and Defence Force superannuation pensions be replaced by a wage-based index such as MTAWE.

Much angst would be relieved from retirees who consider that they are unfairly treated - especially those who live on marginal incomes and whose quality of life would be beneficently affected by a small financial increase - if all pensions were indexed at the Age Pension rate.

A.I.R. recognises that consistency in indexation would result in a relatively minor cost to the Federal Government's budget, but it believes that this would be more than compensated for by the increased confidence among all retirees that they are being treated fairly and equitably.

Recommendations

- Minimum superannuation withdrawal rates for pensions, to avoid tax on superannuation earnings and pensions, should be set at a level that retains the asset base of the contributor within superannuation.
- The withdrawal rate should be set at the ten-year real return on assets of retail superannuation funds less a percentage reflecting the difference between the MTAWE and the CPI over the 10 year period.
- Commonwealth Superannuation and Defence Pensions should be indexed consistently using the same formula as is used to adjust the Age Pension.

3. Appropriate Level of Income Support

The standard of living of a partially funded retiree depends crucially on the level set for the full Age Pension. An increase in the full Age Pension automatically increases the income from the part Age Pension, but only for that part of total income. The lower the percentage of Age Pension in total income the greater this anomaly will appear. There is no opportunity to raise the personal income component without eroding the asset base.

A.I.R. believes that the method of determining the appropriate level of the full Age Pension is flawed. There has been a substantial increase in basic living costs impacting directly on retirees from the introduction of the GST. Although an allowance was made at that time, it has proved to be inadequate and requires review. Although MTAWE was introduced as a better measure than CPI, it has not fully catered for increases in costs. For example, climate change and scarcity of water resources has caused a dramatic increase in water and electricity costs. It is submitted that indexes can never fully compensate for actual cost increases. Reviews need to be undertaken at regular intervals to establish a base from which indexes can then be applied. It is recommended that the notional period between reviews should be set at five years.

Alternative measures of disadvantage for self-funded retirees have been developed. The Pension Review Background Paper[10] shows that self-funded retirees have been disadvantaged against the Age Pension over the past five years, quote:

> "ABS has also developed more recent indexes for 'Other Government Transfer Recipient', 'Self-Funded Retiree' and 'Employee' households. Over the past five years, some ALCIs have increased more rapidly than both the CPI and the Age Pensioner ALCI. ......The Self-Funded Retiree ALCI grew by 14.4 per cent over the period, which was less than the growth of the CPI and the Age Pensioner index."

In reviewing the appropriate level of income support, A.I.R. believes that the impact of increasing costs of living also needs to be reviewed for partly and fully self-funded retirees. This review should be based on protecting the asset base for retirees by modifying means tests, taper rates, and other Government regulations that impact on assets, such as minimum withdrawals from superannuation.

Recommendations

- The appropriate level of the Age Pension should undergo review at notional intervals of five years.
- The present indexes for escalating the Age Pension should be retained in between the review periods.
- Impact of costs of living on partly and fully self-funded retirees should be included in the review of the Age Pension. Means tests, taper rates, and other government regulations impacting on assets should be adjusted to compensate for cost increases or imbalances.

4. Concessions and Allowances

The Commonwealth Seniors Health Card (CSHC) primarily provides access to concessional prescription medicines under the Pharmaceutical Benefits Scheme for retirees with incomes over the income level at which the Age Pension phases out. The CSHC is available to a single retiree with an income of $50,000 per annum compared with the income at which the Age Pension is phased out of $39,130 (for couples the figures are $80,000 and $65,624 respectively).

Even though the CSHC is placed with other Australian Government Transfers which attract adjustment for inflation[11], it has not been adjusted since 2001. There are approximately 300,000 recipients of the CSHC compared with nearly 2 million Age Pension recipients, and the cost is approximately 1% of the cost of the Age Pension.

The CSHC was introduced from July 1994. Income test limits were increased in January 1999 and again in September 2001. They have not been increased since. Non-indexation is simply a means of reducing the number of eligible retirees over time and is a clear case of discrimination. The loss leads to reduction of the asset base of the retiree.

The Bills Digest[12] addressing changes to adjusted taxable income for the CSHC announced in the 2008 budget states that: “With the income test limits being set at $50,000 single and $80,000 partnered, the CSHC is now no longer a low-income health card”. A.I.R. rejects this statement.

The CSHC has declined in real terms since 2001. If indexed since that time, the income test limit for single retirees would be approximately $70,000, close to the upper income threshold for the 30% marginal tax rate. For couples, the indexed value would be approximately $110,000. This value would more closely relate to recent government means tested cut-off points, which recognise average Australian incomes. Recent changes to the private medical insurance subsidy raised the limit at which extra tax is payable to $150,000 per household. Similarly, the subsidy on installing solar electric panels has an income cut-off of $100,000. Income tax threshold levels have been increased to recognise average incomes of $150,000.

Non-indexation is simply a means of reducing the number of eligible retirees over time and is a clear case of discrimination. The loss leads to reduction of the asset base of the retiree.

Use of capital assets to replace or maintain capital items, or for unforeseen needs, erodes the personal asset base. These amounts appear as income in taxable income and in the proposed adjusted income for determination of means tested support, allowances, and concessions. The Commonwealth Seniors Card is affected by the proposed changes. To encourage retirees to maintain their assets, these amounts should not appear as income for taxable income tax purposes or, as proposed, for inclusion in adjusted incomes for means testing income support, allowances, and concessions.

A more equitable and reasonable approach would be to use the lowest income from investment, whether from within or without superannuation, over the previous three years to calculate income.

Recommendations

- The Commonwealth Seniors Health Card (CSHC) should be indexed.
- The proposed determination of adjusted income should be modified to remove income from the sale of assets outside superannuation, or from additional withdrawals from superannuation, for the purpose of replacing capital assets or managing emergencies. Adjusted income should be based on the lowest income year of the previous three-year period.

5. Matters involving other Departments or Jurisdictions

5a National Reciprocal Public Transport Entitlement

Every State and Territory in Australia has a Seniors Card that is available to its senior citizens for use within the issuing State or Territory.

Whilst individual States and Territories may offer particular concessions to their cardholders, all of the schemes classically have four things in common:

(i) all Cards are made available, free of charge, by a given State or Territory to their retirees upon reaching a certain age;

(ii) all offer concessions on the fees charged for travel on public transport in urban areas and on entrance fees to Museums and National Parks;

(iii) all offer local business discounts; and

(iv) none of the benefits associated with having a Seniors Card are legally available to Senior Citizens who live outside the issuing State or Territory.

The A.I.R. National Survey 2006 indicated that over one-quarter of its members travel interstate every year to visit relatives and friends or, simply, ‘to see Australia’. Retirees visiting cities from afar are disadvantaged in that, for example, they do not have access to their motor cars, and must use public transport - for which they must then pay a much higher cost than would be paid by local retirees.

Retirees living in regions close to State and Territory borders are continually frustrated by their inability to access lower-cost public transport facilities after they have crossed into another State or Territory.

The non-availability of transport concessions often results in personal embarrassment for elderly retirees who are under the impression that their Seniors Cards are valid for use on public transport throughout Australia.

In its *Plan for Older Australians*, published in the lead-up to the Federal Election, the ALP stated that, if elected, it would provide $50m over four years toward the provision of national reciprocal transport entitlements for Seniors' Card holders, and would negotiate with the State and Territory Governments to ensure that national reciprocal public transport concessions for seniors are in place by no later than 1 January 2009.

Recommendation

- Seniors' Card Holders should be provided with reciprocal public transport entitlements between States and Territories.

5b. Preventative Support Measures

A.I.R. supports recent government initiatives to assist older retirees to remain in their own environment as long as possible. This environment may be their home where they have lived for many years, or it may be somewhere they have moved to relatively recently for reasons including loss of one partner, or the need to downsize.

There is less cost for Government to provide assistance than to force people to move into Government supported accommodation. Assistance should include:

- financial support including household rates, water rates, and electricity, and
- physical support for matters beyond their physical capacity including assistance with cleaning, with minor house and garden maintenance, with modification of accommodation to cater for disability, and with meals.

Some aspects of this support are provided by State and Federal Departments. These aspects include physical support matters. However, there is a need for a more comprehensive approach to this issue including financial support, which might be more appropriately provided by the Department of Families, Housing, Community Services and Indigenous Affairs. A.I.R. believes that a review of the support needs of older retirees to remain in their environment needs to be conducted to take in all matters such as those raised above.

Recommendation

- Government support should be expanded to enable retirees, with incomes at least equal to the cut-off for the Commonwealth Senior Health Card to be assisted to remain in their own environment.

5c. Medicare and Pharmaceutical Benefits Scheme Safety Nets

Currently, the eligibility criteria for the Medicare Safety Net and for the Pharmaceutical Benefits Scheme Safety Net are the same for single persons as for couples and families. Taking the pension allowances into account, this means that single self-funded retirees who are not in receipt of an Age Pension are discriminated against.

Many self-funded retirees are widows or widowers who are not in receipt of an Age Pension, but are at the stages of their lives when they need expensive and sustained medical attention. It is unreasonable that these retired 'singles' should have to spend the same amounts as couples before they are eligible for safety net support.

Concessions should be available on an equitable basis and A.I.R. proposes that access to the safety nets for single retirees who are not in receipt of an Age Pension should therefore be set at 60% of the requirement for couples or families.

Recommendation

- Access to the Medicare Safety Net and the Pharmaceutical Benefits Scheme Safety net for single retirees who are not in receipt of an Age Pension should be set at 60% of the requirement for couples or families.

[1] Pension Review Background Paper August 2008 Dr Jeff Harmer. Section 2.1
[2] Pension Review Background Paper August 2008 Dr Jeff Harmer. Executive Summary
[3] Pension Review Background Paper August 2008 Dr Jeff Harmer. Chart 20
[4] Pension Review Background Paper August 2008 Dr Jeff Harmer. Chart 25 and Chart 27
[5] A.I.R. National Survey 2006 www.independentretirees.com.au
[6] A.I.R. National Survey 2006 www.independentretirees.com.au
[7] APRA Celebrating 10 Years of Superannuation Data Collection 1996-2006. Table 8
[8] Pension Review Background Paper August 2008 Dr Jeff Harmer. Executive Summary
[9] Ten-year performance of superannuation funds to 30 June 2008. www.fido.gov.au 1 September 2008
[10] Pension Review Background Paper August 2008 Dr Jeff Harmer. Section 2.1.8
[11] Architecture of Australia's tax and transfer system Aug 2000 Australian Government Treasury. Table 2.8 Australian Government Transfers in 2006-07.
[12] Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2008, Bills Digest