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

Submission to the

Advisory Panel on the Economic Potential of Senior Australians

October 2011

31 October 2011

Ms Vicki Wilkinson, Secretary to the Panel
Advisory Panel on the Economic Potential of Senior Australians
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Ms Wilkinson

Submission

The Chair of the Panel, Everald Compton AM, at the Tax Forum, expressed interest in the views of the Association on the impact of superannuation on encouraging greater participation from senior Australians in building Australia's economy.

The attached submission sets out some issues, particularly associated with the Term of Reference:

> "improving workforce participation and investing in the skills of senior Australians to help businesses and community groups tap into an active and engaged talent pool of senior Australians"

The points 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 Advisory Panel in its work.

I hope that this Submission will be accepted as positive and supportive of the Panel's objectives. Should you require any further information, please contact the following:
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Yours sincerely

John Wenban
National President

Executive Summary

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

Founded 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.

This submission reflects the views of partly and fully self-funded retirees who have experience in managing their affairs during retirement. As such they have a clear understanding of the issues that affect their capacity to live a fulfilling retirement, and can provide pragmatic and realistic inputs into the work of the Panel.

The submission sets out issues particularly associated with the Term of Reference:

> "improving workforce participation and investing in the skills of senior Australians to help businesses and community groups tap into an active and engaged talent pool of senior Australians"

The ability to take part in developing Australia's economy through paid work is of particular importance to senior Australians over the prescribed retirement age as they try to manage their retirement assets to maintain their standard of living during retirement and to cater for unknown health and other maintenance costs. Disincentives to work in a flexible manner at various stages during retirement can cause stress, impact negatively on health, and add to the need for additional age pension and government welfare support throughout their retirement years.

This submission addresses issues in superannuation that act as a disincentive to senior Australians to play an active role in the economy of Australia and reduce their call on welfare funds in retirement.

Recommendations

Recommendation 1

As an incentive to undertake paid work senior Australians over the prescribed retiring age should have the flexibility to elect whether (i) to take earnings from working (under normal taxation provisions) exempt from superannuation provisions applying to persons under the prescribed retiring age or (ii) to place some or all of the earnings into superannuation under normal salary sacrifice rules including access to superannuation co-contributions. The decision should be an individual one taking into account personal preferences, available incentives, and income tax consequences.

Recommendation 2

All industrial awards should be required to provide for this flexibility for senior Australians over the prescribed retiring age.

Recommendation 3

The accumulation phase of superannuation should be separated conceptually from the retirement phase and appropriate regulations should be developed for the retirement phase which are simple and encourage retired persons to manage their retirement income through the superannuation vehicle.

Recommendation 4

The need for a retired person to nominate whether superannuation payments incurred through paid work should be added to the accumulated proportion of retirement assets or used to commence a new pension should be removed.

Recommendation 5

The definition of a pension should be modified to remove the inability to add to the assets supporting an existing pension.

Recommendation 6

Existing contribution caps are unlikely to act as a disincentive for senior Australians seeking paid work.

Recommendation 7

The gainful employment test and age-related barriers (presently 75 years) should be removed from the superannuation regulations.

Recommendation 8

Contributions made to pension assets throughout a financial year should be added to assets calculated at 1 July of that financial year for the purposes of determining minimum drawdown pension amounts.

1. Introduction

Hundreds of thousands of Australia's workers are disinterested in superannuation with many lost accounts. At their working and maturing stage of life future retirement is a low priority. The story changes when people retire. Now they have to make a choice between the extent they want their quality of life to be above a basic level and the effort needed to earn income to support that quality of life. Development of incentives and removal of barriers are both equally important measures to encourage senior Australians to earn additional income. Superannuation is one of the barriers.

The concept of a retirement age at which people cease to work is changing into a continuum determined by individual needs and aspirations. Two critical stages when people have a concentrated interest in their retirement assets can be identified: when people are facing retirement, and when they have had a decade of experience in retirement. In both stages people are trying to develop strategies to maintain their standard of living including continuing or returning to the workforce.

Government recognises that the compulsory Superannuation Guarantee (SG) will not provide sufficient funds to individuals (or couples) to meet their retirement needs. Investment returns in the pension phase, because of investment volatility and longevity risk management, are lower than those enjoyed in the accumulation phase exacerbating the shortfall in returns from accumulated savings. To reduce the gap the SG contribution is being raised from 9% to 12% and the retiring age (effectively the age at which people can gain access to their superannuation assets) is being increased to 67.These initiatives will still leave a gap between income available and whole-of-life needs.

Government has stated that its preference is for superannuation to be the preferred form of saving for retirement. The number of people retiring with superannuation from the SG is increasing rapidly and a majority will use the superannuation system for managing that component of their retirement income outside the part- or full-age pension.

The focus of this submission is on the large demographic group of senior Australians with modest retirement funds who will not have sufficient funds to achieve a reasonable life style without government pension and welfare support. This group is disparate in its interests and capabilities. It is to be expected that most people in the group will not wish to work full time for a major part of their retirement but will wish to find a balance between retirement interests and the need for financial security.

This submission addresses issues in superannuation that act as a disincentive to senior Australians to play an active role in the economy of Australia and reduce their call on welfare funds in retirement.

2. SG Regulatory Barriers and Employment

Many awards in industries suitable for senior Australian employment require SG to be paid even when the employee is over the prescribed retirement age (presently 65 or its equivalent for females). Thus, the SG is paid into an employee's superannuation fund even though access to it is difficult without complex arrangements within the fund as set out in following sections.

Even where there is no legislative compulsion some awards still require the SG to be paid. Award conditions override the 75 year age barrier in some cases even though superannuation regulations normally prohibit such payments.

Senior Australians over the prescribed retiring age should have the flexibility to elect whether (i) to take earnings from working (under normal taxation provisions) exempt from superannuation provisions applying to persons under the prescribed retiring age or (ii) to place some or all of the earnings into superannuation under normal salary sacrifice rules including access to superannuation co-contributions.

The decision should be an individual one. For example, if taxable income is likely to be zero, then transferring earnings into superannuation and incurring 15% tax on those earnings may not be chosen as an option. However, personal preference to build superannuation assets, or incentives to add to superannuation such as the co-contribution may override the loss due to tax.

Provision of this flexibility for the individual would provide a significant incentive to encourage senior Australians to contribute to the economy through paid work.

All awards should be required to provide for this flexibility for senior Australians over the prescribed retiring age.

Employment of senior Australians over the prescribed retiring age in small business and similar industry sectors would be enhanced because of the incentive to employ those who do not want to take superannuation; the significant superannuation administrative burden on small business would be reduced.

Because of administrative complexities, some employers may see the requirement to provide flexibility as a disincentive to employ senior Australians over the prescribed retiring age. However, the increased opportunities for employment in small business and larger businesses with more sophisticated HR systems would more than compensate for this group.

Recommendation 1

As an incentive to undertake paid work senior Australians over the prescribed retiring age should have the flexibility to elect whether (i) to take earnings from working (under normal taxation provisions) exempt from superannuation provisions applying to persons under the prescribed retiring age or (ii) to place some or all of the earnings into superannuation under normal salary sacrifice rules including access to superannuation co-contributions. The decision should be an individual one taking into account personal preferences, available incentives, and income tax consequences.

Recommendation 2

All industrial awards should be required to provide for this flexibility for senior Australians over the prescribed retiring age.

3. Relationship between accumulation of assets and use in retirement

Senior Australians over the prescribed retiring age, managing their retirement income, have to face a number of complex barriers which impinge on their decisions about undertaking paid work. Some barriers arise because of the regulatory relationships between accumulation of assets and use in retirement.

The focus of government interest has been on accumulation of retirement assets. Many changes have been introduced to make that part of the system more efficient. However, use of accumulated assets for retirement has not received the same attention.

Because of the emphasis on issues related to integrity and robustness of the system for accumulation of assets, and the sheer size, and corresponding power, of large superannuation organisations who have dominated the discussions, the retirement component of superannuation has been driven by the needs of the accumulation system even though it is not appropriate for the management of assets in retirement. The needs of retirees for simplicity in accessing their funds, including additional contributions, has been largely ignored. The existing retirement component is inflexible and contains many restrictions and complex administrative processes which act as disincentives to senior Australians contributing to Australia's economy, and to using the superannuation system as the preferred form of managing assets and savings in retirement.

Recommendation 3

The accumulation phase of superannuation should be separated conceptually from the retirement phase and appropriate regulations should be developed for the retirement phase which are simple and encourage retired persons to manage their retirement income through the superannuation vehicle.

4. Retirement Phase of the Superannuation System

A superannuation fund is identified as being (a) in the accumulation phase, where capital is being accumulated for the future payment of a retirement pension, or (b) in the pension or drawdown phase where the capital is being used for the purpose of paying a pension, or (c) a combination of the two. A retiree taking a pension may make additional contributions from working or from assets accumulated outside superannuation within limits specified under the Superannuation Industry (Supervision) Act.

After a person retires, the separation of assets into those which are used to pay a pension or pensions and those which are still interpreted as being in the accumulation phase arises because of the different tax treatment applying to each. Earnings from funds used to support a pension or pensions are tax free, whereas the earnings from those not used for that purpose are taxed at 15%. A retired person may nominate the proportion in each category. The simple decision is to nominate all funds as being used for pension purposes.

However, age-related minimum drawdown conditions are specified which apply only to the pension proportion of the assets. The balance between the minimum amount of pension to be taken from the fund and the minimum amount of assets that will incur tax on the earnings at 15% must be a decision for the retired person.

Paid income that attracts a compulsory SG payment from the earnings must be nominated to be added to the accumulated proportion of the retirement assets (attracting 15% tax on the earnings) or used to commence a new pension (attracting no tax). A retired person must be familiar with this model to make a reasoned decision and such a decision can act as a disincentive to undertake the work in the first place.

There are other solutions to managing the taxation differences between accumulation and pension assets that would be simpler to administer and simpler for senior Australians to understand and manage. For example, placing an age-related cap on the amount of superannuation assets that would be earnings tax free would allow removal of the complexity associated with the need to define accumulation and pension components of assets.

Recommendation 4

The need for a retired person to nominate whether superannuation payments incurred through paid work should be added to the accumulated proportion of retirement assets or used to commence a new pension should be removed.

5. Definition of a pension

The definition of a pension[1] prevents the capital supporting a pension being increased after the pension has commenced. A retiree with a pension, who wishes to make further contributions whether from working or otherwise, has three options:

(1) Commence an additional pension immediately following the contribution;
(2) Roll back the original pension and commence a new pension with the total amount. A recent ATO draft ruling defining when a pension commences or ceases, if adopted, would make this option very difficult to achieve other than at the end of a financial year[2];
(3) Have the contribution placed into an accumulation account (existing or new) in the fund.

A retiree with an account-based pension, working and having SG contributions made to the superannuation fund, would expect to be simply able to add the contribution to the assets supporting the existing pension and draw these down when and as required without the need to have to determine how these funds are to be used. It is clearly a disincentive for a person to have to manage the complexity arising from the definition.

It is acknowledged that adding to an existing annuity-type pension may not be possible but these types of pension are rare. If the pension definition were changed, future development of new annuity type products to protect from longevity risk would be quite likely to provide a means of making additional contributions.

Each of the three options not only adds to complexity but adds to fees charged and costs of administration. Where a retired person undertakes part-time work it is quite likely that the fees charged will be a very high proportion of the SG contribution. The consequences of the definition are:

[1] Meaning of pension (Act, s 10): A benefit is taken to be a pension for the purposes of the Act if (a) it is provided under rules of a superannuation fund that (i) meet the standards of subregulation (9A); and (ii) do not permit the capital supporting the pension to be added to by way of contribution or rollover after the pension has commenced.

[2] Draft tax ruling TR 2011/D3 issued on 13 July 2011 proposes that cessation of a pension during a financial year should be interpreted to be that the pension did not commence on 1 July of that year but that the assets should be considered to be in the accumulation phase during that financial year.

- For a person with a pension from a large superannuation fund and making a contribution, the fund has to keep either an accumulation account in addition to a pension account for the person, or establish a number of pension accounts, or carry out a complex accounting procedure to commute the pension, add the contribution, and commence a new pension[i].
- The administrative process in SMSFs is complex: minutes are required, notes to the accounts have to be properly prepared, and contributions may need to be segregated from other investments.
- Large APRA funds face the administrative burden of establishing additional member accounts with a consequent charge on the retiree making the contribution.

Recommendation 5

The definition of a pension should be modified to remove the inability to add to the assets supporting an existing pension.

6. Contribution Caps

These contribution caps, in general terms, allow concessional contributions (from working and after 15% tax) up to $25,000 per year indexed. They also allow non-concessional contributions (an individual's after tax funds) up to $150,000 per year indexed. These caps are unlikely to be a barrier to work.

Recommendation 6

Existing contribution caps are unlikely to act as a disincentive for senior Australians seeking paid work.

7. Work and age tests in superannuation

The gainful employment test requires that a person between the age of 65 and 74 must work part-time for a minimum of forty hours over a continuous thirty day period in a year to be able to make either concessional or non-concessional contributions to his/her fund. This test can exclude a significant number of employment avenues such as a regular part-time position of one seven-hour day per week, occasional part-time work such as in State and Federal elections and survey work such as market surveys and census.

The age limit of 75 for contributions to superannuation prevents people over the age of 75 from contributing to superannuation unless they work under an industrial award which allows such contributions. Life expectancy increases mean that there are many active persons over the age of 75 who can make an economic contribution. While it can be argued that the inability to contribute to superannuation is not a restriction on such employment because the income can be banked, it is a disincentive to many retired persons who see superannuation as the means of managing their retirement incomes. They see it to be discriminatory to their position in society and see the accumulation of additional superannuation assets as critical with over ten years of active life remaining. The maximum age of 75 for contributions to superannuation should be removed to recognise the increasing life expectancy and the ability of older Australians to contribute meaningful to the Australian economy and to have the right to contribute to superannuation to allow them to use superannuation as the preferred vehicle for managing their retirement savings..

Recommendation 7

The gainful employment test and age-related barriers (presently 75 years) should be removed from the superannuation regulations.

8. Minimum Drawdown Requirements

Superannuation regulations require that a specified age-related minimum amount of assets must be drawn down each year from assets used to pay a pension — 5% at age 65 to 74, increasing to 14% at age 90 and above[3].

The amount is calculated based on the assets at 1 July of the related financial year. Where these assets are held in assets such as equities the value can change markedly up or down during a financial year. However, the asset value at the commencement of the financial year remains the value for calculation purposes.

If contributions are added during a financial year (quite allowable under the framework) a question can arise as to how to calculate the minimum drawdown figure relative to the new total assets.

The procedure is a reasonable approximation applying only in the financial year in which the contribution is made and corrected in the next financial year. It removes the need to re-calculate the assets applying to the existing pension at the time the contribution is made (a time consuming and costly exercise) or the need to commence a new pension. The procedure also allows regular contributions from employment (such as fortnightly) to be added simply.

Recommendation 8

Contributions made to pension assets throughout a financial year should be added to assets calculated at 1 July of that financial year for the purposes of determining minimum drawdown pension amounts.

9. Conclusion

This submission addresses issues in superannuation that act as a disincentive to senior Australians to play an active role in the economy of Australia and reduce their call on government funds in retirement.

Provision of flexibility of choice for senior Australians over the prescribed retiring age as to whether or not to transfer earnings into superannuation would provide a significant incentive for them to undertake paid work. This flexibility would increase opportunities for employment in small business and related industry types.

The existing structure and regulations pertaining to the retirement component of superannuation act as a disincentive for senior Australians over the prescribed retiring age to obtain paid work to support inadequate superannuation assets and to contribute to the

[3] The minimum drawdown figures were halved for some years following the GFC, have been reduced by 25% for 2011/2012, and return to the specified value from then on.

economy of Australia. The regulations inhibit retired persons from using superannuation as the preferred vehicle for managing retirement incomes.

The recommendations made in this submission indicate changes that would markedly reduce complexity and assist in removing disincentives for retired persons to undertake paid work.

There is no resultant tax effect of the proposal to change the definition of a pension as the existing, but complex, procedures allow contributions to be immediately converted to an additional pension without tax being incurred on earnings in the fund. Caps to concessional and non-concessional contributions already set the taxation limits for contributions and it is not proposed that these be changed.

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[i] Members of large APRA funds, intending to take a pension based on their total assets, often need to rollover their total assets into a fund providing suitable pension products – the need to then set up an accumulation fund for the purpose of adding contributions may be difficult.