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

Age Discrimination in Superannuation

Submission to

The Hon Susan Ryan AO
Age Discrimination Commissioner

December 2011

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 advice on age discrimination.

This submission addresses issues in superannuation that cause discrimination among retirees and sets out some recommendations that could assist in reducing such discrimination.

Recommendations

1. That a clear distinction should be drawn between the accumulation component of superannuation and the drawdown component, which should be defined to commence upon retirement.
2. That all retirees, no matter whether they accumulated their retirement assets within superannuation or outside superannuation, should have access to a specified tax-free component of their assets after retirement, at least to the same extent as applies for those with superannuation.
3. That, if it is necessary to commence a superannuation fund to access the tax-free component, the sale of assets to be transferred should be exempt from capital gains tax.
4. That the Government review the drawdown phase of superannuation as to its value, cost-benefit, and discriminatory nature.

1. **Introduction**

Compulsory superannuation (SG) in Australia is widely held to be one of the best retirement savings systems globally. Superannuation had been available for public administration personnel, the defence forces, and senior corporate staff for many years. Later, SG extended superannuation to employees in the private sector.

Superannuation provides one of the means for people to accrue assets during working life to sustain them during retirement. Retirement assets have two quite distinctly different components: accumulation of assets, and drawing down of those assets in retirement. The number of years over which superannuation can be accumulated has not increased markedly over time; whilst retiring age has increased, the age at which people commence work has also increased because of longer time spent in education. However, the number of years spent in retirement has increased dramatically and now stands in excess of twenty five years. Hence, the ability to accumulate sufficient assets to sustain a person (or couple) during retirement has not kept pace with retirement needs. People who do not have access to superannuation, or have already retired without superannuation, are seriously discriminated against because of the differing income tax regulations applying between those who have superannuation and those who do not.

A large group of working people are excluded from the SG system because it is limited to employees in an employer/employee traditional work structure. This group numbers well over one million of the 11.4 million workforce and includes industry sectors such as SME owners, farmers, sole traders and consultants. The SG system is inappropriate for these sectors because they initially have low free cash flow and rely heavily on early building of assets needed for the business, the asset becoming available to support retirement income later in life.

Government has stated that its preference is for the SG system to be the preferred form of saving for retirement. However, the SG system is based on the traditional employer/employee relationship structure. It is unrealistic to expect that the working environment can be changed to force all working people to work within this traditional employer/employee relationship structure. Therefore, for superannuation to be the preferred form of saving for retirement, it is the superannuation system that needs to be modified to allow access to those excluded for whatever reason.

A large group of retirees were excluded from superannuation during their working life. One important example is the large number of women in the public services, defence forces, education, health, and banking sectors who were forced to retire on marriage. Superannuation was not available to many men and women employees; the reason for introduction of the SG. Retired women, totally dependent on the superannuation income from their spouse during retirement, suffer serious discrimination on the death of their spouse because of the work rules in superannuation.

Because of the sheer size of assets accumulated through the SG and delegation by Government to the private sector superannuation industry for management of these assets, Government has taken an active role in the regulation of the accumulation component of the industry. The same degree of interest has not been shown, either within Government or within the industry, in the drawdown component. However, the number of people retiring with superannuation from the

SG is now increasing rapidly. Further, because of inadequate retirement assets retirees are being forced to consider full or part time work and are being encouraged by Government to do so as a means of reducing skill shortages. As experience is being gained with the drawdown component, serious questions are arising about the inequity of restrictive drawdown pension regulations and regulations governing contributions during retirement.

The greatest area of discrimination against those without superannuation lies in the regulations that allow earnings on the assets used to support a superannuation pension to be tax free whereas income from assets accumulated outside superannuation are taxed at full marginal tax rates. A.IR believes that it is possible to remove this area of discrimination and improve the already excellent superannuation system in Australia. One method is to allow people without superannuation to contribute a prescribed amount upon retirement to commence a superannuation fund. Another method is to review the drawdown phase of superannuation as to its value, cost-benefit, and discriminatory nature.

2. **The Australian Compulsory Superannuation Model**

The Australian compulsory superannuation model (SG model) is highly regarded globally. It has proved successful in building the retirement savings of many persons.

The SG model is based on compulsory contribution of a set percentage of an employee's wages, presently 9%, collected by the employer and contributed to a nominated superannuation fund. Consequently, it is generally available only to a person in an employer/employee relationship.

The SG model is not common globally. Many countries use a retirement model based on payment of an age pension to all their retired inhabitants. This pension is added to total personal income for tax payment purposes. Unlike the Australian model, this model is inclusive for all retirees. Further, it does not place a cost on productive activity such as in small business.

Income tax is paid on the 9% SG compulsory contribution at 15%. The medicare levy of 1.5% is not included. This is a slight concessional rate for those in the marginal tax bracket of 15% and a more significant concession for those with higher marginal tax rates. Persons with a taxable income at a level where they are exempt from tax are penalised. The Government has provided some relief for this group. The concessional tax rate has been set in recognition of the compulsory nature of the SG.

Income tax is not paid on the assets used to support a pension in a taxed fund[1]. This is in contrast to payment of full marginal tax rates on income from assets held outside superannuation and is a major inequity for those persons who do not have superannuation.

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[1] A taxed fund has before-tax contributions taxed at 15%. Untaxed funds are those predominantly in the public service where government employees have not paid tax on the contributions. Withdrawals from these funds are taxed at full marginal tax rates less a 10% offset amount.

The model is based on the principle that if tax is paid on the accumulation of retirement savings, then drawdown should be tax exempt. Other models provide for no tax to be paid on accumulation and then taxed on drawdown. Alternatively, as proposed by the Henry Tax Review, a reduced tax rate can be set for assets accumulated for retirement and the same rate set for drawdown of the assets (7.5%).

Many employees work in a number of jobs for different organisations throughout their working life and, because of the nature of the SG model, have multiple superannuation accounts. Consequently, the SG model is account based and data on the actual number of persons with retirement savings is unknown. Hence, it is not possible to determine the number of working persons excluded from the SG model from membership data.

3. **Structure of the Workforce as it relates to savings for Retirement**

In August 2011 the workforce, full and part time, was 11.34 million.

An important area of employment is small business where small business owners rely on building the assets of the business to provide for their retirement income. In 2006 there were 1.93 million small businesses in Australia[2]. Of these, 1.17 million were single person businesses. The majority of small business owners are not wealthy; about 1.35 million earned less than Average Weekly Ordinary Time Earnings (AWOTE).

Many small manufacturing/retail businesses are asset poor in their early years, struggling with mortgages on their homes and extreme shortage of capital. It would be counterproductive to compel these small business owners to contribute to the SG model in their early development years.

In 2011 there were 121,000 farms dedicated to agricultural production. Most farmers have their assets tied up in the farm and most do not contribute to superannuation because of income volatility and low cash flows.

A Survey of independent professional workers[3] in 2010 showed that more than 1 million were independent professional workers (iPros). Generally these businesses require few capital assets but have good cash flows after their business is developed. Many build retirement assets through investment in small size residential, commercial, and industrial property because they feel more comfortable with long term low volatility investments. Investment in these areas of property is difficult within superannuation.

The construction industry contains many sole traders. The industry is characterised by its project nature where tradesmen move from project to project as projects are completed. The industry has moved from employing its own staff to contracting. Tradespeople, as sole traders, see variety of work and flexibility as more attractive than working in a formal employer/employee relationship, often not available to them in any event.

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[2] Small Business Fact sheet
http://www.innovation.gov.au/Section/AboutDIISR/FactSheets/Pages/SmallBusinessFactSheet.aspx Cited 22 Nov 2011

[3] Rules Fail Contract Workers, Christopher Jay, Australian Financial Review, 4 November 2011

ABS Statistics for August 2011 give a guide to the percentage of people who do not have access to the SG model. Approximately 76% of employed persons were employees. The remaining 24% were made up of employers, own-account workers, and contributing family workers. It can be concluded that up to 24% of the labour force do not have access to the SG model.

Many persons in the above sectors do not, and cannot reasonably be expected to, contribute to the SG model. This is not to say that many do not build their savings during their working life for use in retirement under their own volition. These persons are defined as self-funded retirees. They are denied access to the benefits available in retirement for those with compulsory superannuation.

4. **Use of funds in retirement**

The objective of superannuation is for a person to accumulate assets and to draw these down to fund their retirement.

A couple with an average living standard based on one partner working at the average income of about $63,000 (the MTAWE[4] in 2011) and a replacement rate in retirement[5] of 75%, requires an asset of about $1.2 million to maintain that income allowing for inflation[6]. This asset level is about the threshold for a couple to receive a part age pension under the asset test. The reality is that a person working for forty years at the MTAWE income each year can only accumulate about $300,000 in superannuation with an SG of 9%, or $400,000 with an SG of 12%. They must rely on a part age pension in addition to their superannuation pension for the duration of their retirement.

A similar couple without access to superannuation is worse off because the couple is required to pay full marginal tax during both accumulation of assets and also drawdown in retirement. The asset required to fully fund their retirement increases from $1.2 million to about $1.5 million but the amount that can be accumulated decreases from about $300,000 to about $280,000[7].

Persons over 65 paid $6.7 billion in tax in 2008/2009, 5.8% of all personal tax. This was paid by 405,000 of the 3 million persons over 65. About half of the tax was paid by only 18,000 persons with a taxable income greater than $150,000 (the bottom of the highest marginal tax rate in 2008/2009). About half of those paying tax were part age pensioners (210,000), who contributed only 7% of the tax revenue.

Persons over 65 fall into the following categories:

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[4] MTAWE is Male Total Average Weekly Earnings and is the measure used to determine the value of the age pension (presently 27.5% of MTAWE)

[5] Replacement rate is the percentage of the working salary at retirement assumed necessary to maintain the equivalent standard of living assuming no income tax is paid. Note that the income tax paid on a taxable income of $65,000 is about 20% of the gross wage.

[6] The Henry Review uses long term accumulation interest rates of 6 or 7% and long term CPI of about 3%. The net interest rate to maintain the capital asset in real terms is about 3 to 4%. The higher return does not allow for lower interest rates on annuity type products to cover longevity risk. The figure of $1,200,000 is based on the higher risk return of 4%.

[7] Assumes that the couple without superannuation invests 9% pa of the MTAWE and pays full marginal tax at 18%.

- Those with a full age pension or DVA service pension (about 1.5 million or half of those over 65)
- Those with a part age pension (about 860,000 or 29% of those over 65). Of these 210,000 paid tax. Those paying tax may be:
  - Ex-public servants with an untaxed fund pension who pay a reduced tax amount (perhaps 5% of the 210,000[8]);
  - Persons without taxed fund superannuation, or with part of their assets in taxed fund superannuation, or with part of their superannuation funds maintained in the accumulation mode.
- Those with the Commonwealth Seniors Health Card (CSHC). (275,000). Of these about 41,000 paid tax. It is likely that many holders of the CSHC have taxed fund superannuation because their superannuation pensions are not included in determining eligibility. Those without superannuation are less able to access the CSHC , because all their income is included in determining eligibility causing discrimination.
- The remainder number about 322,000 of whom about half pay tax. This implies that about half have taxed fund superannuation. Some of the remainder will have untaxed super which is taxed at a concessional level. Of the number paying tax, 18,000 paid tax at the top marginal tax rate.

The number of persons paying tax has steadily reduced since the introduction of Simpler Super from 1 July 2007, when earnings on assets used to pay pensions from taxed funds became tax free and the pension did not have to be included in taxable income. Tax revenue has also steadily reduced.

Providing universal access to the taxed fund tax free drawdown conditions will further reduce the number paying tax and tax revenue unless the existing drawdown component of the SG model is changed. However, the effect will be virtually offset by an equivalent saving in part- and full- age pension expenditure. It is acknowledged that there is a timing difference.

5. **Proposal**

AIR believes that all persons in retirement should have access to the incentives that exist for those with taxed fund superannuation to manage their retirement income responsibly. This would remove a major area of discrimination and assist in minimising the impact of increased age pension costs on Government. It strongly believes that this area of discrimination should be removed.

The drawdown structure separates funds used to drawdown a pension (the earnings of which are tax free) from the remainder of a person's superannuation funds. These are considered to be still in the accumulation phase and are taxed at 15%. Although the legislation provides the ability for people in retirement to make additional contributions through work or from after-tax assets, as a means of

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[8] ABS Statistics 6291.0.55.003, Detailed Quarterly Statistics Aug 2011, Table 06 Employed persons by industry Subdivision and Sex shows approx. 6% of employed persons were public administration and defence. This ratio has been assumed to hold for persons over 65. Note that not all public administration personnel have untaxed funds because of changes in superannuation. However, retired persons are more likely to have a higher proportion of untaxed funds than working persons.

managing their retirement assets and income, the regulations have been designed to limit the opportunity to do so through work and age tests.

The work test prevents contributions (from work or from after-tax funds) by a person between the age of 65 and 74 unless they engage in paid work for 40 hours in any 30 days in a year. This regulation is discriminatory in that some retirees can gain easy access to work through personal contact or family businesses, while others, particularly women who managed their family without working, have no access to and are not trained to undertake employment. Often casual or part-time jobs are available but at a rate less than the prescribed minimum.

The age test prevents contributions after the age of 75. In recent times however, where award conditions remove the age barrier, the award condition overrides the regulation. The Government has just announced that it will remove the age barrier for all SG contributions but has not stated its position on after-tax contributions.

Separation of pension assets from accumulation assets has led to confusion and complexity in the way in which additional contributions can be managed. For example, it is not possible, under existing regulations, to add contributions to the assets used to support an existing pension.

AIR believes that it is possible to modify the present drawdown legislation to allow all persons access to a tax free drawdown of pensions up to a specified level. This modification recognises that all persons have accumulated their retirement assets either by paying the full marginal tax rate outside superannuation, or the concessional rate of 15% within superannuation.

An alternative model arises from the fact that the purpose of compulsory superannuation is to provide retirement assets. Regulation of the method of utilising these assets is an entirely different concept. Indeed the present regulations do little to encourage people to use these assets wisely to cover their retirement life span. The existing regulations force people to withdraw a minimum amount of assets in direct opposition to the principle of managing assets wisely. Further, there is no upper limit to the amount that can be withdrawn at any time. Review of the effectiveness of superannuation as a mechanism for regulating drawdown of assets to meet Government policy objectives and review of the cost-benefit to Government and to individual retirees of the present drawdown system may well show that an alternative is preferable. Discrimination could be removed far more easily and efficiently by allowing all retirees to self-manage their retirement assets in a competitive investment environment and with a defined tax-free mechanism to equate to the present tax-free pension incentive.

Recommendations

1. That a clear distinction should be drawn between the accumulation component of superannuation and the drawdown component, which should be defined to commence upon retirement.
2. That all retirees, no matter how they accumulated their retirement assets, should have access to a specified tax-free component of their assets.
3. That, if it is necessary to commence a superannuation fund to access the tax-free component, the sale of assets to be transferred should be exempt from capital gains tax.

4. That the Government review the drawdown phase of superannuation as to its value, cost-benefit, and discriminatory nature.