SUBMISSION 62

House of representatives Standing Committee on Economics, Finance and Public Administration
Submission No: 62
Date Received: 10.01.06
Secretary:

The Committee Secretary
Standing Committee on Economics,
Finance and Public Administration
Parliament House
Canberra ACT 2600

INQUIRY INTO IMPROVING SUPERANNUATION SAVINGS OF PEOPLE UNDER AGE 40

Dear Committee Secretary

Attached are further notes that I wish to submit to the inquiry into improving superannuation savings of people under age 40.

The committee may find that some of my suggestions and concepts in this submission are the same as my previous submission (57). My knowledge and perspective of this topic has been gained only from personal experience and reading financial literature and thus incorrect use of assumptions, means test and taxes may have occurred.

My Suggestions in summary are as follows

- ABIRT – Age Based Income Replacement Target
- Access to Undeducted Contributions above ABIRT
- Access to Salary Sacrificed Amounts above ABIRT
- Employer Contributions taken as an income stream only
- Greater access to super above Lump Sum RBL
- Less Tax to super above Lump Sum RBL
- Smaller mortgages significantly increase available voluntary savings
- Stop re-contributing of employer contributions.
- Housing counted under the means test.
- HECS Debt repayment incentives.

Your Sincerely

Christopher Moore

Terms of Reference

1. Barriers and\or disincentives to contribute to superannuation
2. Current incentives in place to encourage voluntary superannuation contributions
3. Improving their awareness of the importance of saving for their retirement

Disincentives

- Home ownership – extra repayments make more money than investing in other taxed vehicles like shares.

- Everyone's advice is always Negative Gear Property

- Family

- HECS Debt

- Undeductable amounts - loss of access for a rainy day. No point putting any in if you cannot get any out for an emergency.

- Young people will need to watch that they don't go over the RBL lump sum. So why should I put more in when I am forced to take 50% as an income stream and slogged 38.5% tax if withdrawn.

    - My 9% employer contributions will be approximately 69% of Lump Sum RBL at age 65. With an extra 4% contribution I will have 100% of Lump Sum RBL at age 65.

    - Accessing amounts over Lump Sum RBL are heavily taxed compared to amounts below Lump Sum RBL.

    - I will be making sure I wont be adding that extra 4%.

- Financial Planners in the media advise not to add contributions at a young age because things may change.

- I will save the majority of my retirement savings through managed funds. It allows access at any time. I can also get a tax deduction if I negative gear.

- As I understand, I cannot make a tax deductable contribution to super a few weeks before 30 June each year, if I am expecting to have a large capital gain from my managed funds, which is my preferred savings vehicle.

Current Incentives

- Co-contribution
- Super earnings are taxed at only 15%.
- Salary Sacrifice
- Super Choice

Problems with Super

- Baby boomers are taking out super (deductable portions) and re-contributing it as undeducted contributions. The tax payed to take this out costs the government 2 to 3 times in extra pension payed out over the life expectancy of the retiree.
    - Say a retiree pays $30,000 tax if $200,000 is taken out. If this is re-contributed as an undeducted contribution, the government then has to pay $63,000 extra pension over the life expectancy of the retiree.
- A baby boomer currently has the opportunity to take super money and use it to upgrade their house at the expense of the taxpayer.
    - A retiree with a $500,000 house in Sydney and $250,000 in employer contributions would be entitled to a $252 per fortnight pension if using an annuity. This baby boomer can take their super by paying $37500 tax and buy a nice place up the coast for $700,000 and live off the full pension $494 per fortnight. The cost to the government is an extra $62,500 in pension over the life expectancy of the retiree.
- The current means test and access to super leaves this door open for abuse. If housing was somehow counted within the assets test, this retiree should not be entitled to an increase in pension.

15-30 Age Bracket

- Early repayment of HECS debt could provide a payment into a super fund. Usually a 15% discount is available on early repayment. A further % discount or fixed dollar amount could be given and payed to a super fund.
- Or a 2 for 1 deal. Every $2 early repayment is $1 the government will pay into a super fund.
- Students from Department of Housing families would find it difficult to save anything in their first few years of employment, let alone pay any extra HECS Debt off, or make extra super contributions. So this would need to be taken into account.
- Retain the Co-contribution. More advertising towards teenagers of a free $1500 if you pay $20 per week into super. And this will be accessible if you keep your balance above the ABIRT. (Age Based Income Replacement Target) (*See Page 7*).

Reduced House Prices Increase Available Voluntary Contributions

- Greater regulation of house prices as a ratio to AWOTE or a Housing Affordability Index.
- Increase "Home Purchase" as a % of the CPI Index (Currently only 7.8%)
- Reduced incentives for negative gearing housing. - At the peak of the house price boom in 2003, lending for investors equalled lending for existing homeowners at 45% each. Yet in 1991 lending for existing homeowners was at 75% compared to Investors at 12.5% of the market.

In the new AFR Investor Magazine Dec 2005 Edition on Page 28, A graph of Home Affordability from Dec 1984 to Dec 2004, shows that on average **23%** of median household income buys a median priced home. In Dec 2004 the affordability was at **29%** of income. Meaning that if a house currently priced at $475,000 in Sydney was lowered to 23% of median household income it would be valued at $376,000.

Example

1. Buying a $475,000 house with a $50,000 deposit

Paying off a $425,000 mortgage over 30 years @ 7%p.a. requires $2827 per month. **No money is available for saving**.

2. Buying a $376,000 house with a $50,000 deposit

Paying off a $326,000 mortgage at $2827 per month requires only 16years. If the repayments were then invested at $2827 per month over 14years at 7% p.a. this would result in $793,700 or **$327,000 in today's dollars available for saving**.

Of my total assets at retirement, I estimate that $450,000 will be employer contributions, but I will have lost roughly $327,000 in extra mortgage payments.

If house prices could be reduced from 29 % to 23% of median household income:

- Pension entitlements for current age pensioners will not be affected.
- A young typical Sydney couple could have an extra $327,000 available to contribute to income producing assets at retirement and be entitled to a small pension, rather than an extra $118,000 tied up in non-income producing assets and be entitled to a full pension.

If retirees were to draw down 20% equity of their home to provide extra income, the total value of the house will nearly owe the bank by age 100. Leaving nothing to their children. Essentially using reverse mortgages, retirees are paying the banks to access income.

Whereas the extra $327,000 cash would provide a three times greater income and only a small age pension. It also means that the full value of the house can be left to the children, thus easing the burden to them and future governments.

My calculations estimate that if the average sized mortgage of $220,000 were reduced by 10% or $20,000 an extra $50,000 in today dollars could be available for voluntary contributions.

As a rough guide on average for every $1 increase in a mortgage, $2.50 in today's dollars is lost for future savings.

The Government must realise the extent of the sensitivity of higher house prices on available savings for retirement.

Recent house price increases have almost offset the future value of employer contributions at retirement for first homebuyers.

Age Based Income Replacement Target (ABIRT)

- Age Based Targets for each Age Group.
- Access to Undeducted Contributions and Salary Sacrificed amounts above ABIRT. (Maximum $12,000 per year)

I believe if small achievable stepped targets are set for each age group, they may embrace it. Over the first few years of their employment they will start to develop a curve of their savings and be able to measure their performance against the ABIRT curve. Then they can make a more accurate decision if they want to use co-contribution and salary sacrifice to reach a particular goal.

If the government want young people to contribute considerably extra to super, access to this money above a target balance should be allowed to provide flexibility to meet the changing work environment.

Proposed Age Based Rates for 2006

Age	Target Balance
18	$2,500
20	$5,698
25	$22,006
30	$41,860
35	$66,010
40	$95,386
45	$131,119
50	$174,585
55	$227,457
60	$291,770
65	$370,000

It is assumed that $370,000 at age 65 provides 75% replacement rate of the current average income of $50,000 using a Market Linked annuity under the current 2006 income test.

The numbers are calculated using a $35,000 salary from age 18 to 65, with only 9% contributions earning 8.2%. For 2007, simply increase each number by 4% or the same as the RBL increases.

<u>Example</u>

At nearly age 30, my current super balance of $28,600 is made up of all employer contributions. If I had salary sacrificed roughly 10%, for the past 7 years, my balance would be approximately $60,900. The table above shows that at age 30 the target would be $41,860. Meaning I would have $19,040 or $16,184 after 15% exit tax to draw down on. Any undeducted contributions would not be taxed if available.

1. The concept provides young people a benchmark as to what they will have in retirement. They can then decide to make adjustments using the current incentives, to improve their desired retirement lifestyle.

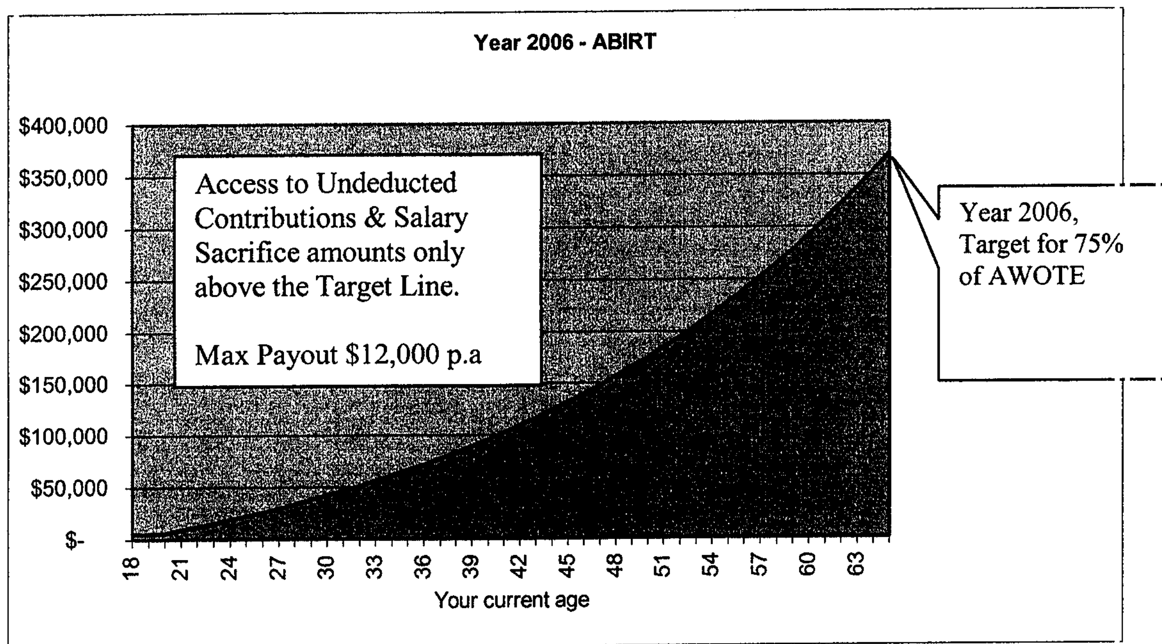
2. The concept provides flexibility to those who want to use the super system to save more than just the minimum.

3. The maximum $12,000 payout is designed to be similar to a pension, so as not top be abused.

4. It also favours women having a family. They have available funds to draw down on, if they have been contributing extra funds.

5. The only cost to the government are from taxpayers on the 42% and 47% tax bracket, as this would be lost revenue. (*It would be likely that top tax bracket taxpayers would salary sacrifice then redraw at a lower tax rate*).

6. Young people are not contributing extra money. So what has the government got to lose? Greater awareness could be achieved if super could be used as a tool to help throughout our full lifecycle.



If undeducted contributions and salary sacrificed amounts above the ABIRT had no limits to draw down, I believe this would further increase its popularity, but it would come at a cost from the abuse of high income earners reducing tax.

Changes to Access of Super in Retirement

- Employer Contributions taken as an income stream only
- Access and flexibility to super balances above Lump Sum RBL
- Reduced tax levels on amounts above the Lump Sum RBL.

I believe the current structure of having to take a 50/50 split at the Lump Sum RBL combined with excessive component being taxed at 38.5% if withdrawn, is a large disincentive to contribute more at a young age. Hardly any young people understand it but from my perspective it looks like a trapdoor. It only takes one dollar over and you're a goner. If the Government want us to save an extra 10%, why should I when my 30years of sacrifice are going to be taxed at 53.5% above the Lump Sum RBL? (15% entry tax + 38.5% exit tax = 53.5% tax). Next financial year in 2006/07 the new tax rates will have the 30% tax bracket up to $70,000. Meaning more people will have a lower tax rate and see it as an extra 23.5% Tax.

I believe that employer contributions should be taken only as an annuity, where as salary sacrifice and undeducted contributions should have full access as they have come out of our own incomes.

So when I'm 10 to 15years out from retirement, my thinking will be that I will put in just enough to be under the Lump Sum RBL and save the rest in the sharemarket. Whereas if I was forced to take my employer contributions as an annuity, and salary sacrifice was limited by the Pension RBL ($1,297,886), I would be going for broke (*if I could access it*) on salary sacrificing, as it would be unlikely I would reach the Pension RBL. But being taxed 38.5% really hurts. That's like being backstabbed even though you made extra sacrifices. Surely the exit tax should only be 15%, and amounts above the Pension RBL taxed at 38.5%.

Suggested Structure

- Amounts up to the Lump Sum RBL ($648,946) should be taken as follows
    - Employer Contributions – Income stream only
    - Salary Sacrificed – Accessible only above (ABIRT) with 15% exit tax.
    - Undeducted Contributions – Fully accessible

- Amounts from the Lump Sum RBL ($648,946) up to the Pension RBL ($1,297,886) should be taken as follows
    - Employer Contributions – Fully Accessible with 15% Exit Tax
    - Salary Sacrificed – Fully accessible with 15% Exit Tax
    - Undeducted Contributions – Fully accessible

By forcing retirees to take an annuity using employer contributions. Retirees will be unable to re-contribute and thus provide the Government significant savings, especially in 30 years time.

Example

Under the current structure

When I retire in 2041 with approximately $450,000 of employer contributions in today's dollars, I would be stupid not to pay the 15% tax of $67,500, lesser if a threshold is included. Then re-contribute $382,500 as an undeducted contribution.

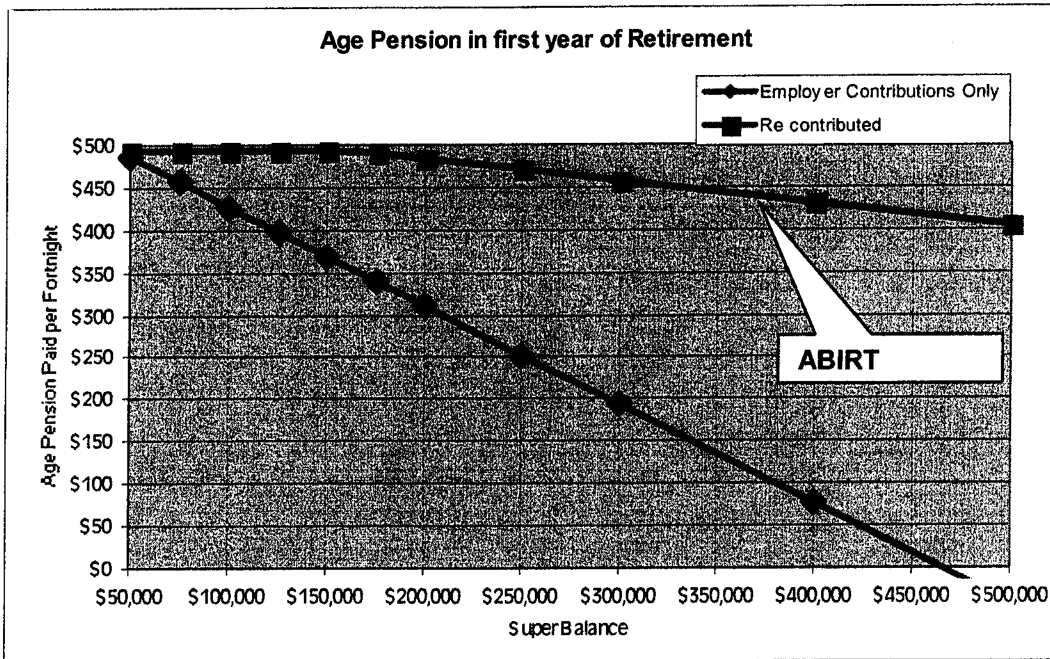
My calculations show that in the first year of retirement I will increase my total yearly income from $34,600 ($468 Pension p.a.) to $40,600 ($11,024 pension p.a.). **Over my life expectancy of a market linked annuity the Government will pay an extra $193,000 in pensions just for me alone. That's what I call rorting the system !!!!!**

Even though a drop from $40,600 to $34,600 is a substantial drop in income, we must remember that for example NSW Department of Housing tenants only live on 75% of the age pension. i.e. $9700 per year. So lets get real when we talk about having dignity in retirement.

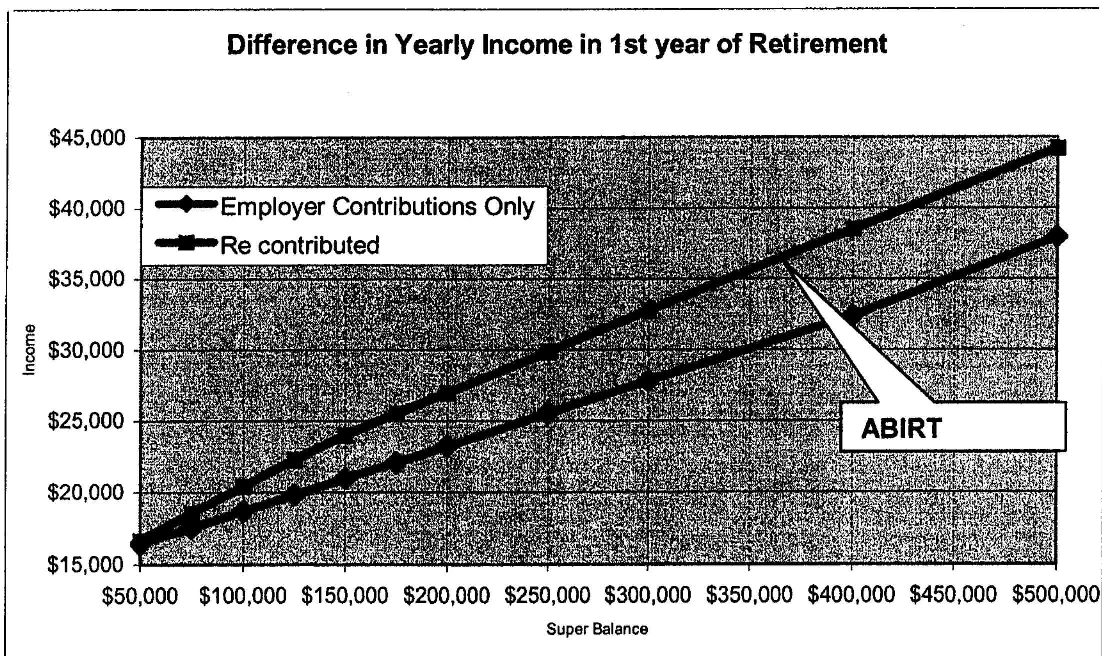
The following data shows how the compulsory annuity would affect super balances.

Example

- Male at age 65 using a market-linked annuity.
- (Employer Contributions taken as an annuity) versus (accessing the super balance and re-contributing as an undeducted contribution and taking annuity).
- Income Test Only



The graph above shows that as the super balance increases the lower the age pension. Meaning that as average balances increase in future year's significant savings can be made by government to fund existing taxpayer super accounts.



Retirees with the (ABIRT) $370,000 would see their yearly income drop from $36,000 to $31,000. Those at the lowest income levels have minimal change.

This example shows that if retirees were forced to take their employer contributions as an annuity up to the RBL Lump Sum, under the income test, the age pension would be reduced. And thus provide government more funding towards younger taxpayers.

The suggested structure provides incentive for retirees to more access above the Lump Sum RBL especially if they are not receiving any pension. This would provide an incentive to place savings into super knowing that they will have access if they save extra and have the flexibility to play with it.

For many young people on average weekly earnings, the employer contribution will provide roughly 50% to 75% of the Lump Sum RBL at age 65. If they add extra funds under the current structure, half their money is locked away if they go over the limit and slogged with a big fat tax of 38.5% if withdrawn. And thus the more they contribute the more they have to take as 50/50. This is a disincentive.

I believe the suggested structure rewards those who wish to invest more. The more money they put in, the more they are rewarded with access above ABIRT and the Lump Sum RBL, and the less of a burden on Government.