30 August, 2002

Committee Secretary
Dr Margot Kerley
Standing Committee on Ageing
Parliament House
Canberra ACT 2600

Inquiry into long-term strategies to address the ageing of the Australian population over the next 40 years.

This submission is made by The Institute of Chartered Accountants in Australia (the "Institute"). The Institute is one of Australia's peak professional bodies and our members represent many of Australia's peak business and finance professionals. These members act as advisors and key decision-makers in all facets of the superannuation and financial planning industries.

The Institute believes that Australia's retirement income policy should be an integrated system that encourages voluntary saving for retirement by middle and high income earners, with a minimum level of compulsory saving for all Australians. Australians should be encouraged to take income streams at retirement. The Australian market place also requires new types of products that enable retirees to place additional lump sums into income streams to supplement pension income.

The Institute welcomes the initiative of the government in undertaking a review with the scope to look at the broad range of issues arising as the population ages. In addition to providing input on the financial aspects of the ageing population we would also like to bring to your attention the "ElderCare" initiative of the accounting and other professions to address the needs of the elderly .

Should you wish to discuss any of the matters raised further, please do not hesitate to contact Susan Orchard on (email) susanorch@optushome.com.au, (ph) 03 9502 4371 or (fax) 03 9502 4372.

Yours sincerely

Allen Blewitt
Head, Strategy & Innovation
The Institute of Chartered Accountants in Australia
Ph: 02 9290 5631
Fax: 02 9262 5469

Adequacy of Retirement Savings

The superannuation system is a maturing system that sees the accumulated savings of those presently retiring with limited resources to assist in reducing the burden on the Government, however, as balances grow there is an increased likelihood of partial self funding occurring within the community.

There is much debate about the level of income to be provided by superannuation. Until the last 20 – 30 years, it was an accepted principle that people would work until a suitably old age and then live for not many years beyond that point. Until now, the Government provided pensions were not heavy burdens for the community to carry because the retired population, relative to the working population, was always quite low in number.

All this changed with three factors, which at first were slow to emerge but have now become obvious. None of these factors are related to any great extent.

The first factor is the issue of a longer life expectancy. This has three main causes - medical advances, generally safer work environments and also technological advances. Many Australians who are aged 55 or older have a very good chance of surviving until 90 years of age and beyond.

The second factor is the changing demographics of the community. After World War Two Australia experienced a population explosion, which lasted from 1946 until the early 1960s. Once this population explosion ceased, the number of children born in the succeeding 30 years was much lower than the 15 or so years after WWII. The level of immigration after this period also reduced considerably and has never recovered. The “baby-boomers” (ie those born in the 15 years after WWII) are now approaching retirement. As a result of lower fertility rates after the baby boom period, there are less workers to pay for the boomers retirement income needs.

The third factor is the retirement pattern of many older Australians. Many people retire below age 65. Some are forced into retirement – frequently they are retrenched and then can’t find new employment. Many retire under age 65 voluntarily for a variety of reasons.

In effect, this means many will be spending many years in retirement as opposed to only a few years as happened in the past. Some will spend longer in retirement, than they will in paid employment.

In recent submissions to the Senate Select Committee on Superannuation, the Institute has highlighted a number of areas that focus on improving the superannuation system through simplification and various measures to encourage contributions. The issues covered during the most recent inquiry are addressed below.

Accumulation Phase

There are a number of deterrents to making superannuation contributions, many of these are linked to taxation e.g. the complexity of three tiers of taxation and age based limits, while others stand alone e.g. the employment nexus. Below we have considered the impact of the current system as a deterrent to contributions and made recommendations that will address these issues.

The Institute believes that the only way to get a fair and equitable tax outcome is to remove up front taxes and tax all benefits at exit. Our comments below recognise that this is a significant deviation from current policy and recommend other alternatives working within the present system to improve equity and retirement income savings.

Employment nexus
The superannuation system is based around the employment nexus. Where the majority of contributors are employed and receive superannuation contributions in respect of that employment. Exceptions include spouses and the measures for child contributions, as announced during the election. The definition of a spouse includes a legal and defacto spouse. This does not cater for those that are single and have been out of the work force for more than 2 years or are in same sex relationships.

We recommend a separation from the employment nexus to encourage all Australians with disposable income to invest for retirement and to preserve the monies in a highly regulated environment increasing the likelihood they will be available for retirement.

Three tiers of taxation
The three levels of taxation leads to complexity and a distrust of the system as contributors are unsure of the true level of tax paid on funds. This complexity has led to situations where some benefits will be taxed at up to 62%, this is significantly higher than the highest marginal personal tax rate. It is noted that the government has given an undertaking to ensure superannuation taxes do not exceed 48.5%, however this is still to be implemented.

In order to address the equity issues we have seen the introduction of a number of rebates and other measures. While these measures are aimed at ensuring that low income earners are not disadvantaged by the imposition of taxes on contributions, these rebates rarely find their way into the system and do little to offset the impact of contribution taxes on long term member benefits.

We recommend a simplification of the taxation system which taxes end benefits and meshes with the social security safety net.

Contributions tax
Superannuation funds are taxed at the contribution, income and benefit stages, with high income earners being subjected to an additional surcharge.

The contribution tax is based on a tax rate of 15% of employer contributions. The Superannuation Guarantee applies where an employee receives income in excess of $450 per month. Based on income tax rates, an employee receiving salary and wages income would not incur an average 15% tax rate on total income until it exceeded $24,135. Therefore persons on an income of less than $24,135 pay a contributions tax in excess of that paid if they had received the income as salary and wages in their hand.

A fairer and more equitable system would be to remove the contribution tax and apply the contributions tax in a similar manner to the surcharge on a sliding scale. This should be at a rate below the effective tax rate applicable to the contributor had the money been taken as income. Contributors could be given the option of paying the taxes personally or from their superannuation fund.

We welcome moves proposed by the government to reduce the surcharge rate improving the equity between superannuation and personal taxes. **It is recommended this is accompanied by a comprehensive education program to self assessing taxpayers.**

Age based limits
The tax deductibility of superannuation contributions is limited by the use of age based limits. These limit the tax deduction available to an employer based on the age of the employee. This measure discriminates against two groups:

- Occupations where income is weighted toward early years in the work force such as sports people and entertainers; and
- Women planning a broken work pattern to have a family.

In both of these cases the individual has a higher disposable income early in their working life and may not have an opportunity to contribute to superannuation later in life. The requirement to contribute monies over the age base limit from post tax income acts as a deterrent from making superannuation contributions. The individual may not be able to make up for this in later life as incomes are significantly lower for many as they return to traditional workplaces or work flexible hours in support of family commitments.

We recommend the removal of age based limits, as these are an arbitrary tool to limit access to concessional superannuation benefits. This objective is met through the imposition of Reasonable Benefit Limits which removes the concessional treatment of excessive benefits.

Reasonable Benefit Limits/ Tax free threshold

The reasonable benefit limit (RBL) and tax free threshold are available to all Australians with superannuation. However, the link between employment and superannuation effectively prevents some individuals from accessing this benefit.

While the Government has announced its intention to enable the splitting of contributions between spouses this does not assist those who are nearing retirement and have already made substantial contributions to superannuation over their lifetime. Some people nearing retirement are able to structure their retirement savings to maximise access to rebates and tax free thresholds, however this involves income splitting strategies which are not available to all due to the employment nexus.

We recommend the expansion of measures enabling the splitting of benefits to all couples of retirement age. This will reduce the cost of maintaining multiple superannuation accounts and will treat all couples the same regardless of changes in marital status.

Deductibility of Contributions for the Self Employed

The self employed are currently able to claim a deduction for contributions up to the age based limit of $3000 + 75% of additional contributions. While this is soon to increase to $5000 + 75% of additional contributions, the self employed are at a disadvantage to other employed persons, as employers are able to claim a deduction for 100% of contributions up to the aged based limit. Employed persons are able to salary sacrifice up to the age based limit and take full advantage of the 15 –30% tax rate applied to contributions, while the self employed are unable to do so due to the discounted deduction rules.

We recommend the removal of the limitation on contribution deductibility for self employed persons to provide equity to those in employment relationships.

Interpretations of superannuation and taxation laws

In practice, the definition of dependent in superannuation and taxation laws are taken to exclude same sex spouses. However, there is a school of thought which suggests that the use of the word 'includes' in the definition, in both SIS and the Income Tax Assessment Act, does not restrict the definition to apply only to a child or heterosexual spouse. It is therefore suggested that the current restrictions on the payment of death benefits, in the case of dependents other than traditional dependent relationships, is caused by a conservative interpretation of the law.

We recommend the clarification of this definition and guidance to ensure that all participants in the market place are treated consistently in respect of benefit payments.

Retirement Phase

The Australian community is fitter and healthier than ever before leading to different expectations in retirement. Many are choosing to work longer and will have a gradual transition into retirement rather than adopting a traditional cutoff type exit strategy. This is likely to increase as Australia's workforce moves from a manufacturing and labour intensive approach towards an educated more technically based work force.

As the population ages and longevity expectations increase we are seeing delays in parenthood. This means that a number of retirees will desire to work longer as they continue to provide varying levels of support for their children.

Other factors such as the growth in housing costs, single parenthood and divorce are leading to delays in children leaving home increasing the likelihood of the family home remaining an asset longer.

Complexity of the interaction between superannuation and retirement income systems

The superannuation system treats people as individuals up to and including the benefit phase. However once retired a couple is treated as a single unit with a means test based on joint income and assets. The joint income provided by the safety net is lower than that of two singles.

The system is complex and those who avail themselves of financial planning advice in the years leading up to retirement can have income and investments restructured to maximise their retirement income. This advice is often sought by those with excess benefits and high levels of savings and the advantage is not taken by those in the middle income brackets. This adds to the perception that the system is unfairly weighted towards the wealthy.

Those in low and middle income brackets do not clearly understand the interaction between the social security system and savings e.g. that income from savings such as superannuation acts as a supplement to the safety net pension to raise income levels and improve living standards in retirement due to favourable replacement rates.

We recommend improvements in the education about the safety net pension and the benefits available to retirees this should also focus on the importance of planning and how the system works.

Sustainability of system

The Government introduced changes which effectively gives retirees $30,000 tax free income. This is a generous measure which may not be sustainable in the long term. These measures have been introduced in the form of rebates such as the Senior Australian Offset.

The years ahead will see retirees becoming a politically strong force. Care needs to be taken that new measures introduced do not favour retirees at the expense of those in work force endeavouring to raise families and purchase homes.

We recommend that measures are costed to enable an assessment of the impact on revenues in the future and measured against the concessions provided to low income earners to ensure equity is maintained.

Restructure of living arrangements
The discussion above highlights a number of changes in work patterns and lifestyles that will see retirees maintain the family home for longer periods and decisions to downsize homes deferred.

We recommend the system cater for top ups to superannuation during retirement and a new range of products which enable a retiree to unlock the equity in their home to enable a better standard of living in retirement and to meet the maintenance needs of the home.

Increase incentives for income streams.
The taxation of income streams has been structured to ensure that the tax treatment of an income stream and a lump sum are comparable. However, the complexity of the tax system as it relates to income streams, makes it difficult to determine the taxation impact of taking an income stream.

We recommend improvements in the taxation of income streams to encourage their use. In addition to this, we recommend the development of a new range of income stream types which have many features of a life time pension but cater for top up payments from the freeing up of capital i.e. from a home sale or deceased estate. These should consider the desire of many retirees that their asset is not lost to subsequent generations in the event that they do not meet their life expectancy i.e. sharing of mortality risk between the product provider and the individual. In addition to these measures the lump sum Reasonable Benefit Limit could be capped while the pension RBL continues to be indexed encouraging individuals to use income streams.

Review Actuarial Standards
The actuarial standards which govern annuities provided by life companies need to be urgently reviewed. The current standards require life companies to be extremely aggressive in the level of reserves that they hold. Under New Business Tax System changes, reserves held by life companies are taxed at 30%. When these two issues are combined, most life companies are providing life time and longer term annuities which provide very poor returns.

As we have noted above longevity is becoming an increasingly important issue. Based on the most recent Life Tables issued by the Australian Government Actuary, a male aged 65 is expected, on average, to live about another 16 years. This same person has a better than 50% chance of living for many years beyond age 81. However many retirement income streams are only effectively designed to last for the life expectancy of the investor at commencement. For those aged 65 now, how is their lifestyle to be maintained? Reform is required in this area

We recommend that the taxation of reserves and the current life tables are reviewed to ensure that adverse tax outcomes and conservative life tables do not limit the benefits of income streams

Product Development Opportunities
Non superannuation allocated pensions - Not everyone has the ability to save within superannuation. To this end there needs to be an ability for fund managers to provide an allocated annuity / pension outside the superannuation arena.

Negative Mortgages – This would allow mortgage institutions to buy equity in elderly peoples homes and hence provide regular payments to them during their retirement.

We recommend resources are allocated to the investigation of new products which will encourage income streams to be made available to all retirees.

Workforce Participation

The Institute recommends that the federal government explore and encourage initiatives which will increase workforce participation in meeting the needs of older Australians over the next 40 years.

It is well known that the proportion of the Australian population aged 65 years and over has grown steadily during recent decades. The Australian Bureau of Statistics predicts that the proportion of Australians aged 65 years and over will rise from 2.3 million (12% of the total population) in 1998 to 6 million (24% of the population) by 2051.

The Institute has recognised that this growing sector of our population is going to be more dependant upon the advice and assistance of its 35,000 members. This is because societal trends[1] mean that it is becoming increasingly difficult for adult children to initiate, monitor and personally attend to the financial, legal and lifestyle needs of their elderly relatives.

> *"Population ageing is a major focus of social and economic planners and policy makers in Australia, as it is throughout the more developed regions of the world. Of particular concern is the anticipated increase in costs associated with the care and income support of a rapidly growing aged population, and how much Australians will be willing and/or able to pay".*
>
> *"Much of recent government policy has focused on cost reduction as well as shifting costs and responsibility from the public sector to individuals, families, community groups and private business".*
> *Source: Australian Bureau of Statistics Australian Social Trends Cat 3222.0*

The Institute recognises and accepts the inevitability of this cost-shifting policy, and believes it can, through its members, make a significant contribution to the ongoing strategies which will be need to achieve these objectives.

The Institute believes that its members are ideally suited to provide (or arrange to provide) the financial advice and related services which will be required by older Australians in the coming decades. Chartered Accountants are already providing some part of these services to their clients and the public generally.

The superannuation system is currently framed around an assumed working life. There is only limited ability for those aged over 70 to make contributions to superannuation where as only a small group of people under 70 are unable to make super contributions.

Treasury are naturally very concerned about superannuation being used as an estate planning vehicle. Nevertheless greater freedom can be provided in this area.

At present there is almost an assumption that retirement is a discrete event when it is becoming anything but this. Those approaching retirement are often finding that they begin with part-time retirement (say, work three or four days each week for about a year, then progress to working for one to two days per week for say the next two years) and then become fully retired.

Policies need to be in place to encourage this development as much as possible.

[1] Societal trends identified by Professor Gary Andrews, Flinders University

Aged Care, Education, Housing and Health

Financial planners, who are also Institute members, often find themselves in the position of having to provide assistance in achieving the best quality care that a family can afford. This includes knowledge of the various Centrelink assessments of benefits.

Sometimes financial planners are asked to act as Powers of Attorney both financially and even from a health perspective.

From a financial planning perspective, it is important to provide clients with not only the funds to enable them to be re-skilled but also to provide with adequate opportunities to do so. “The illiterate of the 21st century will not be those who cannot read and write, but those who cannot learn, unlearn, and relearn.” – Alvin Toffler

Options in this area are:
1. Allow limited access to superannuation funds when a person either wishes to update their knowledge or be re-skilled for every year after they reach age 45
2. Provide a specific savings product that enables those aged over 45 to save, in a tax effective environment, for re-education expenses
3. Provide tax deductions for re-education

New ICAA initiative - ElderCare™

The Institute of Chartered Accountants has joined with its counterparts in Canada and the USA[2] in the development of a new service ElderCare™ able to be offered by members to the Australian public. This new professional service builds upon the traditional services accountants have been providing their clients for many years – e.g. taxation, financial planning advice and estate planning.

The ElderCare initiative contains a unique ingredient which requires the participation of other professionals – for example, lawyers, architects and health care professionals.

To become an ElderCare practitioner, the practice principal or engagement partner/director must complete the Institute’s *ElderCare Training Course* and maintain satisfactory professional development in this area. The practitioners would also be subject to the Institutes’s quality review and disciplinary systems to ensure satisfactory professional standards.

<u>Caring for older Australians - working with other professions</u>

The Legal Profession: The Institute’s ElderCare Task Force is currently working with the University of Western Sydney’s *Centre for Elder Law* in enhancing the knowledge of lawyers to the key legal issues facing older Australians and encouraging their interest in practicing in this growing field. Two training courses have been held this year with the additional support of the Queensland Law Society. Important legal issues identified by the Centre’s co-director include –

- Preparation or reviews of Wills and Powers of Attorney
- Executorships and Guardianships
- Residential, land title and mortgage issues

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[2] Canadian Institute of Chartered Accountants and American Institute of Certified Public Accountants.

- Estate planning, usually in collaboration with financial advisor
- Probate
- Establishment of trusts and estates
- Nursing home issues including questions of patients' rights
- Elder abuse and fraud recovery cases
- Health and Mental health law

Architects: The Director of the Royal Australian Institute of Architects' *Archicentre* has expressed the willingness of architects to inspect the homes of elderly Australians from referrals by accountants. He has said –

> "There's clear evidence now that Australians are living longer than ever and with this comes an increased risk of falls and serious injury in later life. In 1998, more than 1,000 deaths and over 32,000 hospitalisations occurred as a result of falls by people aged 65 and over in Australia. Many homes inspected by Archicentre architects had slip and trip hazards, including slippery steps, poorly lit steps, rugs on slippery floors, moss on outside steps and paths which became like ice when damp."

The Institute understands that a free home safety inspection service for older persons is currently subsidised by the Victorian Government and Archicentre. We would like to see this scheme available throughout Australia and thus available to clients of our 'ElderCare service' and the public generally.

Health care professionals: There are many elements which impact on older peoples lifestyles, such as home ownership, relative wealth, personal interests and preferences. They are in part the result of an accumulation of lifelong habits and practices. These elements shape a person's lifestyle long before they actually reach older age. Changes in society itself affect people's lifestyles, for example, new technologies, transport systems and retail opportunities including tourism. These quite often overlap in terms of effects on lifestyles, and may well become important components of an ElderCare engagement.

In addition to the more traditional services accountants offer to the community – tax advice, financial advice, bookkeeping services – the Institute's Eldercare Task Force has included an additional multidisciplinary service known as the 'ElderCare Plan'. The preparation of an 'ElderCare Plan' includes the review of the lifestyle and health issues which concern elderly Australians. Thus ElderCare practitioners accredited by the ICAA will need to engage an increasing number of health care professionals, such as nurses and occupational therapists, in the preparation of their client's Plans.

At a minimum, the lifestyle component of an ElderCare Plan will include consideration of:

- whether the client's current and future lifestyle is likely to enhance their well-being; and
- whether the client's health is under responsible management of a qualified professional

Recommendations

(1) Funding: The ElderCare initiative is a service which has been sponsored by the ICAA at the instigation of its members. Because it is not funded by the Institute, the initiative does not have the means to resource the professionals involved in the services. Nor can the initiative be readily expanded to provide the service to the elderly citizens who need it.

Funding assistance from the government, on a needs basis, would enable accountants and their professional colleagues to provide ElderCare services to the whole Australian community. This could be achieved in a number of ways, such as:

- **a grant for the development of the ElderCare Service;**
- **a grant to the Institute to prepare and conduct training courses for professional practitioners (principally lawyers and accountants) which focus on awareness- raising of the financial and legal issues facing older Australians and equip them to offer a wider range of professional services to this sector of the community.**
- **A grant to assist the Institute to accelerate establishment of the ElderCare service by supporting initial training and the development and resourcing the enhancement of the Eldercare web site (**www.eldercare.cc**) ; and**
- **A tax deduction or rebate to clients of the Eldercare service.**

(2) Resources: Apart from funding assistance, the provision of information resources to ElderCare practitioners would enable them to disseminate information about aged care services available in their local community. A service of this nature is already available to our members from Centrelink , and the ICAA recommends that accounting practices throughout Australia who provide Eldercare services to the community be provided with information from the relevant Commonwealth departments (eg Centrelink, Health, DVA).

If implemented, this recommendation could potentially provide information about government and private aged care services to 3,700 accounting practices throughout Australia – in local communities which would provide greater access in areas that the elderly are most likely to frequent and thus achieve greater reach to them.