Senate Select Committee on Superannuation

Inquiry into
Planning for Retirement

Submission by the Commonwealth Treasury

May 2003

Introduction

Treasury, in conjunction with the Department of Family and Community Services, is responsible for advising Government on retirement income policy. Treasury has direct portfolio responsibility for providing advice to the Government on superannuation and taxation policy. Agencies within the Treasury portfolio, such as the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission (ASIC) also have a role in providing information to Australians regarding taxation, superannuation and investment.

The Treasury submission comments particularly on four of the committee's terms of reference, namely:

- The continuing relevance of a fixed retirement age;
- The potential to encourage progressive transitions from work to retirement, including through possible new benefits, access and contribution arrangements and part time work;
- Any scope for older workers to access their superannuation to finance retraining to continue work that is more suitable to older people; and
- Ways to assist older workers plan for their retirement.

Treasury does not have any specific data on the impact of age on the productivity of employees and no issues to raise in relation to Federal or State workplace relations systems.

The continuing relevance of a fixed retirement age and potential to encourage progressive transitions from work to retirement, including through possible new benefits, access and contribution arrangements and part time work

Current situation

In general, the Commonwealth, State and Territory legislation has moved away from specifying compulsory retirement ages, with some exceptions, as noted in the submission to this inquiry by the Department of Employment and Workplace Relations.

The superannuation and social security arrangements are broadly designed to allow people to accumulate savings while working or in their pre-retirement years and then drawdown on those savings in retirement, possibly supplemented by a full or part age pension.

Within this broad framework, the superannuation arrangements provide some, but not infinite, flexibility in relation to the ages at which Australians can contribute to superannuation and access their superannuation. While there is a minimum age for receiving the age pension, it is possible for those eligible to defer receiving it under the pension bonus scheme. In addition, the eligibility criteria for benefits that are available to older Australians do not specifically preclude those receiving earned income such as wages and salary.

These features of the superannuation and social security arrangements are important, given the potential benefits of higher workforce participation by older Australians in the context of an ageing population. For example, the Treasury submission to the House of Representatives Committee on Ageing noted that increased workforce participation would improve GDP per capita as well as people's capacity to accumulate savings for retirement and reduce pressure on Government finances.

Contributing to superannuation

Superannuation funds are able to accept contributions from members or on behalf of members in a wide range of circumstances. Contributions for those who are employed, the self employed and spouses are able to be made. The ability of funds to accept contributions was recently extended to include contributions on behalf of children and contributions from those who have received the Baby Bonus.

The current rules allow superannuation funds to accept personal undeducted contributions from members between the ages of 65 and 75, provided they are working at least 10 hours per week. Prior to 1 July 2002, those aged over 70 could not make personal contributions.

Allowing contributions to superannuation in a range of circumstances recognises the variety of individual employment and personal circumstances of Australians who wish to save for their retirement.

Accessing superannuation

The superannuation preservation rules are designed to ensure that superannuation is used to provide income in retirement. As a result, superannuation benefits are generally required to be retained in the superannuation system until the member has reached preservation age. However, there are limited circumstances in which early access to superannuation is possible, such as in compassionate circumstances and in financial hardship.

Preservation age, which is the earliest age that superannuation lump sums can be accessed following retirement, is generally 55 but is increasing to 60 on a phased basis. Fund members can also access their preserved benefits before preservation age on termination of employment where such benefits are taken in the form of a non-commutable lifetime pension or annuity.

In order to draw down their superannuation, those aged between 55 and 59 are required to permanently retire from the workforce. Those aged between 60 and 64 can access their superannuation on the termination of their employment relationship.

The current rules also require those over age 65 to draw down on their superannuation where they are not working at least part time. A member aged between 65 and 75 must work at least 10 hours per week in order to avoid having to draw down, while those over age 75 must work full-time (at least 30 hours per week). These rules provide flexibility by giving people over age 65 the option of continuing to work and not drawing down on their superannuation, or working and receiving some superannuation supplemented by wages and salary.

The Government has also recently introduced into the Parliament legislation to remove impediments to rolling over superannuation from the pension phase back into the accumulation phase in the same superannuation fund. A person may wish to do this where they decide to re-enter the workforce and recommence contributing to superannuation.

Flexibility in allowing access to super, including while working part time later in life, recognises individual employment and personal circumstances.

Other Government benefits

The eligibility rules for a number of Government benefits available to those over age pension age (currently 65 for men and 62 for women) also allow flexibility for those who wish to continue to work. For example, eligibility for the age pension, while subject to a means test, does not distinguish between earned income (such as wages and salary) and income from investments. That is, receipt of earned income will not of itself preclude a person from entitlement to the age pension. The decrease in the pension withdrawal rate to 40 cents per dollar of income under tax reform has also increased the incentive for pensioners to obtain some paid employment.

Moreover, the pension bonus scheme (which is outlined in detail in the Department of Family and Community Services submission to this inquiry) actively encourages people to defer receiving the age pension and instead continue to work and receive a lump sum payment on retirement and access the age pension.

The Commonwealth Seniors Health Card (CSHC) and the Senior Australians Tax Offset also provide specified benefits to those eligible people above age pension age who meet the eligibility criteria. The CSHC, for example, provides holders with prescriptions at a concessional rate, a quarterly telephone allowance and other concessions. The Commonwealth is currently negotiating with the States and Territories to extend some of the concessions currently available to pensioners to holders of the CSHC. The Senior Australians Tax Offset provides a rebate of tax which reduces or eliminates the tax liability of those eligible.

While access to both the Health Card and the Tax Offset is means tested, no distinction is made between earned income and income from other sources in assessing eligibility. Consequently, having earned income, of itself, does not preclude a person from benefiting from these measures.

Allowing more people to transition to retirement

If the existing rules were to be made more flexible, for example, by allowing those below 65 drawdown their super while continuing to work then a number of issues would need to be considered.

Working and drawing down superannuation – particular issues

Any changes to the rules to facilitate more people being able to continue to work while drawing down on their superannuation (for example those below age 65) would need to consider possible behavioural responses and the resultant implications for retirement incomes. For example, such flexibility might encourage some who currently work full time to move to part-time work, reducing their overall retirement income. Others may choose to remain in work instead of leaving the workforce, thereby increasing their overall retirement income.

Longer periods in the workforce result in higher levels of superannuation savings. Consider a single male with career earnings of 75 per cent of AWOTE, receiving superannuation guarantee. In that example, the average expenditure over retirement ranges from $27,543 for a 25-year career to $31,811 for a 40-year career, giving expenditure replacement rates ranging from 72 per cent to 83 per cent.

Working, drawing down and accumulating superannuation – particular issues

In practice, where a person is receiving a superannuation pension while also working and contributing to superannuation, both a pension account and an accumulation account are required. This is because it is not possible to add contributions to a pension once it has commenced (even if the person is eligible to make superannuation contributions). A pension must be commuted and a new pension commenced in order to add new amounts.

In considering whether to allow amounts to be added to pensions, perhaps annually, a number of issues would require consideration. In particular, allowing amounts to be added to a pension would blur the distinction between the accumulation and pension phases of superannuation, which currently have distinct taxation treatments within a fund. Specifically, no earnings tax is payable by a fund in respect of assets backing pensions, however earnings tax is payable with respect to assets in the accumulation phase.

The recalculation of a pension's undeducted purchase price, rebateable proportion, minimum and maximum drawdown amounts and RBL value would also be required each time new contributions were added to the pension. In addition, the ability to contribute to a pension, for example annually, would result in higher drawdowns in the early years of the pension, relative to if the new contributions were in an accumulation fund until the person completely retired. The impact of fees and charges and the potential for additional complexity would also need to be considered.

Any scope for older workers to access their superannuation to finance retraining to continue work that is more suitable to older people

Current situation

Current Government policy is that superannuation savings that have received concessional tax treatment should be used to provide income in retirement and should not be withdrawn from the superannuation system for other purposes before retirement.

The Government recognises, however, that the preservation restrictions may cause undue hardship for some people because of their personal circumstances. The legislation therefore provides for the early release of superannuation benefits in certain limited circumstances, such as severe financial hardship, retirement due to incapacity and on specific compassionate grounds. Superannuation is not available under these provisions to pay for training.

Superannuation accessed through early release is subject to tax. In the case of a lump sum taken before age 55, the post-June 1983 component (below the individual's reasonable benefit limit) is taxed at a maximum rate of 20 per cent (plus Medicare levy) if paid from a taxed fund. If it is paid from an untaxed fund the rate is 30 per cent (plus Medicare levy). That part of a lump sum benefit which represents the return of an individual's undeducted contributions is not subject to further tax.

Severe Financial Hardship

There are two criteria that an applicant must satisfy in order to be eligible for early release of superannuation benefits on severe financial hardship grounds. The applicant must be able to show that they have been in receipt of a qualifying Commonwealth income support payment for a continuous 26-week period, and must also satisfy the trustee that they are unable to meet reasonable and immediate family living expenses.

If members satisfy both of the above tests, the fund trustee may, in any twelve-month period, release to them one lump sum payment. The lump sum payment is to be no more than a gross amount of $10,000 and no less than $1000, or the balance of the member's benefit if that is less than $1000.

Compassionate Grounds

Benefits may be released on compassionate grounds only in very limited circumstances. These circumstances are defined in regulations and cover expenses in respect of medical treatment, medical transport, modifications necessary for the family home due to disablement, palliative care, and funeral expenses. Funds may also be released on compassionate grounds to prevent foreclosure of a mortgage or exercise of a power of sale over the member's principal place of residence.

Separate rules (administered by APRA) apply to the maximum amounts which can be released on compassionate grounds.

Existing Government programmes

The Department of Employment and Workforce Relations currently has a range of initiatives and programmes to provide assistance to older workers should they become unemployed, and to encourage mature age people to enter or re-enter the workforce. A number of these programmes include identification of and assistance with training opportunities. More detail on these initiatives is contained in the submission by the Department of Employment and Workplace Relations.

Extending the existing criteria

Any changes to the early release criteria to permit release of benefits to fund training would need to consider the overall impact on retirement incomes. That is, would such training be likely to lead to employment and therefore superannuation contributions in the future? If the proposal leads to a decrease in retirement income then this is also likely to lead to an increase in age pension outlays.

The terms and conditions under which training could be funded through superannuation would also need to be considered. These may include:

- a minimum length of time a person needs to be unemployed to access this option;
- the types of courses that would qualify;
- the administration arrangements that would be required to ensure integrity; and
- the age of applicants.

Ways to assist older workers plan for their retirement.

A flexible superannuation system can assist Australians to plan for retirement by recognising a variety of individual circumstances and saving capabilities. The licensing of financial advisers and rules around disclosure are also important in helping workers make informed decisions about their retirement savings. Together with other Government agencies, the Australian Securities Investment Commission (ASIC) produces information to assist people to learn more about saving and investment.

The superannuation system

The superannuation system recognises and accounts for different personal circumstances. In doing so it provides flexibility for people in different circumstances to plan for their retirement.

As noted earlier, the superannuation system allows undeducted contributions to be made up to age 75, provided particular criteria are met. This provides a significant degree of flexibility for those wishing to contribute to superannuation throughout their working life or even when they may not be working (for example through spouse contributions).

This flexibility, combined with the fact that deductibility limits on contributions increase with age, recognises that some Australians have a greater capacity and/or desire to contribute more to superannuation closer to their retirement. For example, people may contribute more once they have paid off their mortgage and their children are supporting themselves. They may also contribute more to account for earlier periods out of the workforce. Of course, the superannuation guarantee provides for a minimum level of contributions to be made throughout a person's working life.

Many Australians also save for their retirement through their small business. This has been recognised by the Government's capital gains tax small business initiatives, such as the 'small business retirement exemption' and the 'small business 15-year exemption'.

A small business can disregard a capital gain when an active asset that has been held continuously for 15 years is sold. Furthermore, a small business can disregard a capital gain where the proceeds of the sale of an asset are used for retirement (up to a lifetime limit of $500,000).

Access to these concessions is available to those small businesses that meet the relevant eligibility criteria. These concessions provide flexibility for people in small business to plan for their retirement.

Seeking financial advice

In planning for retirement, many Australians will seek financial advice. This is often regardless of whether they are beginning their career or approaching retirement. The licensing of financial advisers and rules around disclosure are important to ensure that Australians make informed decisions.

The *Financial Services Reform Act 2001* (FSRA) is a comprehensive licensing regime for those carrying on a financial services business. While the FSRA commenced on 11 March 2002, there is a two-year transitional period until 11 March 2004.

The Act outlines the requirements that must be met for a financial service provider to obtain a license. It also requires that a financial services guide be provided to clients which presents information, for example on fees, commissions and charges, so that the client can make an informed decision.

When advice is provided an adviser must also provide a statement of advice to the client. This outlines the basis of the advice, any charges in taking up the product and any benefits the client might lose, among other things.

ASIC enforces the licensing requirements of the FSRA.

Information available from Government agencies

Together with other Government agencies, ASIC produces information to assist people to learn more about saving and investment. The ASIC website has general information for those interested in investment. There is information on shareholding, such as how to obtain information on a company, buying and selling shares, tax and social security information and being an involved shareholder. The information on superannuation covers issues such as choosing a fund, judging performance, changing superannuation funds, keeping track of your superannuation and investment choices. The site also contains information about choosing a financial adviser and obtaining a financial plan, budgeting, financial counselling and boosting savings.

The submission from the Department of Family and Community Services, details the information that both it and the National Information Centre on Retirement Investment (NICRI) provide as well as the Financial Information Service provided through Centrelink.

Some of the industry representative bodies such as the Investment and Financial Services Association (IFSA) and the Association of Superannuation Funds Australia (ASFA) also have information about superannuation on their websites.