Better Pensions, Better Super, Better Australia

Submission to Re:think – Better tax system, better Australia

By Lorraine April 2015

Executive Summary

The current retirement income system in Australia, comprising the government age pension and the superannuation system is completely dysfunctional.

We have a government pension system for the poor and a superannuation system giving huge tax benefits to the wealthy. The retirees in between get little or no pension and many get no tax benefit at all.

They face disincentives to save, incentives to spend their super as soon as they have access to it, high marginal tax rates, and disincentives to remain in the workforce. The income they do receive from their super simply reduces their pension and in this way the main benefit of their super flows not to them but to the government in lower pension costs.

We need a rethink of the system so pensions and super complement each other as two parts of a unified retirement income system, so all Australians are encouraged to save and are properly rewarded for their efforts.

Hundreds of thousands of wealthy retirees are receiving a tax benefit on their super earnings far in excess of the pension they would have been paid if they had no assets or income. This is counter productive.

As the system matures and more Australians choose to take a tax free pension mode income stream from their super, we could end up with a situation where nobody over sixty years of age pays any tax at all unless they have employment income. This is unsustainable.

But there are other problems.

Retirees with the same income face huge tax differences depending whether their income is within or outside of super.

The government age pension system discourages saving, discourages work after retirement age, is far too complex, and rewards those who spend all their income while still working. Some pensioners have marginal tax rates exceeding 70%. Many pensioners lose pension income faster than they earn income from their savings. These people face the equivalent of a marginal tax rate of 120%.

The current pension system encourages social inefficiency, particularly in housing, and lowers productivity.

In this submission I am putting forward a simple and more holistic system for retirement benefits that involves some quite small changes to the rules for the government age pension and the tax treatment of super but which vastly reduces the complexity and inequality of the system and eliminates all of these problems.

This new approach gives every Australian over retirement age the same basic retirement benefit. The benefit could be taken as their choice of a refundable tax offset or a pension payment. All income earned on the assets supporting pension mode super income streams would now have some tax payable, but for most retirees the new tax offset would more than compensate for this extra tax. Only higher income retirees would pay more tax than their benefit would offset.

This benefit would be set at the amount currently paid to each member of a pensioner couple. For all current age pensioners and for those self funded retirees who choose to take their benefit as a pension this amount would no longer be means tested and would no longer be taxable. An extra means tested amount would be paid to single pensioners to make their benefit up to the value of the current single age pension.

The changeover would be easy and completely seamless. For most people the only change would be a reduction in their reporting obligations.

The new system would be simple to understand, simple to implement and simple to administer. It would leave all but the highest income Australian retirees better off. My system cuts through all of the current complexity and solves every single one of the problems I have identified with the current system. Everyone would be treated equally and everyone would have incentives to work and to save. We would no longer be giving high income earners tax benefits that cost more than paying them an age pension. Their tax benefit would be capped.

Young people and those not yet retired would be more likely to save extra in their super and engage more with the system as they would know they would receive some real benefit from it when they retire.

The new system will not cost the government any more than it is paying out now – in fact it would likely be cashflow positive from year one. The extra cost of removing the means test on the basic pension amount would be more than made up by the increase in tax paid on the earnings within pension mode super.

Australia could have the fairest and best retirement income system in the world.

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Introduction – Why the system is broken

The current retirement income system in Australia, comprising the Government Age Pension and the Superannuation System is completely dysfunctional.

There is a government pension system for the poor and a superannuation system giving huge tax benefits to the wealthy. The retirees sandwiched in between need a degree in financial planning to have any idea how to make the best use of what access they have to the two often conflicting systems. They face disincentives to save, incentives to spend their super as soon as they have access to it, high marginal tax rates, and disincentives to remain in the workforce.

We have a three tier system with the wealthy getting huge tax benefits, those with no savings getting a government age pension and many of those in the middle getting little or no pension and no tax benefit at all. These people are the part pensioners and the lowest income self-funded retirees.

The income they do receive from their savings or super simply reduces their pension and they receive little or no net benefit. Often they actually lose more pension than they earn in income. The benefit of their savings flows not to them but to the government in lower pension costs. This is why a lot of Australians see super as a con and have no real interest in it.

Changes currently being proposed to tighten up pension assets testing and the prospect of further interest rate cuts reducing the interest they earn on their savings will only make the situation worse for these people.

We need a rethink of the system so pensions and super complement each other as two parts of a unified retirement income system, so that all Australians are encouraged to save and are properly rewarded for their efforts.

The original and still the most important reason for having a super system as well as a government pension system is so that those who want to save money to enjoy a better standard of living in retirement than the government age pension would give them are able to do so in a structured, tax efficient and equitable way. Here in Australia we seem to have totally lost sight of this.

The focus now seems to have shifted to having a super system that aspires to eliminate the need to pay the aged pension to any but the poorest of seniors, thus saving revenue now and into the future. But to accomplish this we are offering huge tax incentives to the wealthy and losing tax revenue far in excess of what it would cost to pay the pension to all seniors. This is counter productive, hugely inequitable and totally absurd. And as time goes by this will only get worse.

Giving tax breaks on super contributions that mostly benefit high income earners in the hope that this will encourage workers on average incomes to stow away enough money in super so they won't require any pension at all when they retire is totally futile. If you work for forty five years on an average wage you are unlikely to be able to save enough to live on for a further thirty years, no matter how much tax incentive you are offered.

Wealthy retirees have huge tax breaks

Under the current system hundreds of thousands of retirees are given a tax break on the income derived from their super pension assets which is far in excess of the age pension that they would otherwise have been paid. Some retirees enjoy a tax break worth hundreds of thousands of dollars. Super in Australia is probably the best legal tax minimisation scheme ever invented by any government anywhere in the world.

As the system matures and more Australians choose to take a tax free pension mode income stream from their super, we could end up with a situation where nobody over sixty years of age pays any tax at all unless they have employment income. This is unsustainable.

Not only do we allow those whose super is in pension mode to have a complete tax holiday on the earnings in their super, we also give high income earners a huge tax break on their contributions to super before they retire. This benefit can be up 50% of what they would receive if we were paying them a government age pension at the single rate. And they can claim a concession every year of their working life.

Those between 60 and 65 can receive a double benefit – the earnings on the assets supporting their pension income stream are tax free and they also receive a concession on their contributions.

But there are plenty of other problems

Giving people a tax break far in excess of what they would receive as a pension is not the only problem with the current retirement income system. There are many others. I have listed some of them here and I will cover them all, with examples, in the next section of the submission.

Retirees with similar assets and income are taxed differently depending on whether their income is within or outside of superannuation. Retirees with their assets in super pay no tax at all on the earnings. Those with their assets outside of super pay tax at their normal marginal rate.

The government age pension system has an income leveling effect that is a disincentive to save and a huge incentive to draw down much of your super and either spend it or hide it in some way. For part pensioners having more money in the bank actually results in a lower overall income from pension and bank interest than if they had spent it. This encourages profligate spending in the lead up to and first years of retirement. A flow on effect from this is that these pensioners are less able to contribute to the cost if they need home or residential aged care later in their lives. In

the next section I will give some examples of this income leveling effect and show how it discourages saving.

Retirees who spend up big during their working years are rewarded with a government age pension, while those who saved often get no benefit at all. Is this really fair?

Part pensioners face a high marginal tax rate with 50c taken from their pension for every dollar they earn above the income test threshold and the remaining 50c taxed at over 40% if they earn enough to pay tax. This 40% includes the phase in of the Medicare levy and the phase out of the senior tax offset. This is a marginal rate of over 70c in the dollar.

The system is so complex that most pensioners would have no idea how earning extra money would affect their net income. This is a disincentive for retirees to do part time work.

The pension means test encourages socially inefficient housing patterns, with pensioners reluctant to move from large houses to smaller more suitable accommodation.

The current system lowers productivity. A lot of time and energy is wasted by retirees and financial planners concentrating on schemes to maximise benefits for seniors. Centrelink staff are employed in explaining the system, recording asset and income details and policing delinquents who have not declared their income or assets correctly. The people involved in all this could be doing something more useful.

There is a way forward

In this submission to the Tax Review I am putting forward a holistic system for retirement benefits that would be simple to implement and would leave all but the highest income retirees better off. The government age pension and the superannuation system would complement each other as two parts of a unified retirement system, rather than fighting with each other as they do at present.

For simplicity I will refer to all Australians who have reached the current age pension age as seniors, as not all retirees are seniors and not all seniors are retirees.

This new retirement income system gives every senior the same benefit, called a Basic Retirement Benefit or BRB, either as a refundable tax offset or a tax free non means tested pension. This would be set at the current couple pension rate, around $17,000. In addition to this there would be an extra means tested payment for single pensioners.

All income earned on the assets supporting super income streams would now have some tax payable, but for most seniors the BRB would more than compensate for this. The only seniors who would see some reduction in income are those who currently earn over $108,000 tax free on the earnings of their pension mode super. Their current tax benefit would

now be capped at the amount of the BRB. This way we are not giving high income earners tax benefits that cost more than paying them an age pension.

Income stream payments would continue to be tax free. Only the earnings on the assets supporting the pension mode income stream would be taxed. As I will refer to this income a lot in the course of this submission I will call this pension mode earnings. It is important to keep in mind that this is not the same as the income stream amount paid by the super fund to the member. This is always tax free.

The senior tax offset would be abolished as it would no longer be necessary, and there would be some changes to the current transition to retirement rules and also to the tax concessions on contributions.

The changes needed are actually quite small and together they make the system vastly simpler for seniors and for super funds. Most current full pensioners would see no change at all and all part pensioners would be better off. Because the system would be so simple all seniors would be better able to manage their affairs. The changes to super that are required would simplify the super system for most people, and managing a superannuation fund would also be easier.

The new system eliminates all of the current complexity and solves every single one of the problems we currently have. Everyone has the same benefit, everyone pays more or less the same tax on the same income, there is an incentive to save money and no incentive to spend it before retirement or to hide it under the mattress. Pensioners would not have to consider their pension amount when they wish to move house or downsize their home. Overall productivity would increase as fewer Centrelink staff would be needed to manage the system and accountants and financial planners could spend their time working on investment strategies rather than pension maximisation schemes.

My solution will not cost the government any more than now. In fact it would likely be cashflow positive from year one and this will increase over time as new retirees with super come into the system. The extra cost of removing the means test on pensions would be more than compensated for by the increase in tax on pension mode super and a reduction in tax concessions on contributions.

The Problems – What we need to change

In the introduction I outlined some of the problems with the current retirement income system in Australia. In this section I will cover them in more detail, with examples.

Huge tax benefits for the wealthy

The first problem we need to address is the huge tax benefit available to wealthy Australians through their super.

For a system designed to reduce the number of retirees requiring the pension, giving those not receiving a pension a tax benefit worth far more than the pension just doesn't make any sense. It defies logic. We have allowed our super system to become a tax haven for the wealthy.

Although there is some restriction on the amount you can stow away into super, there is still scope for some retirees to build up huge balances and receive large amounts of tax free income when they retire. We know from recent media reports (Cuffelinks, 5 March 2015) that there are five self-managed super funds in Australia that have managed to amass over $100m in assets and somewhere around 1500 have more than $10m.

We know from the 2011-12 tax tables available from the ATO website that there were 10 self-managed super funds with a taxable income above $5m, 130 more with a taxable income above $1m and a further 550 earning more than $500,000. These funds may have up to four members, but the majority of self-managed super funds have two.

From the recent report by ASFA, *Superannuation and high account balances* that was released in April 2015 we also have the following statistics about super funds in Australia.

More than 210,000 people in Australia have superannuation balances greater than $1m. Of these 140,000 have more than $1.5m and 70,000 have balances greater than $2.5m. There are 475 Australians with superannuation balances above $10m who are already in pension mode and their average income stream payment is $1.5m per year.

Anyone over 60 with their super in pension mode and with $1.5m in assets could expect to earn about $105,000 each year tax free if their super was returning 7% including franking credit. You can easily get this by investing in bank shares and some other blue chip shares. If these people earned this outside of super and if they had no other income, they would pay income tax of almost $29,000. If they had $20,000 in other income as well as their superannuation earnings, they would pay tax of $36,600. If they were in the top tax bracket from their other income, they would pay an extra $51,450 in tax on the earnings. These are the amounts they could be saving under the current superannuation tax rules. Even if they had no income apart from their pension mode earnings, the $29,000 tax benefit is still more than the pension they would receive if

they had no income at all. We are giving this benefit to tens of thousands of people.

For those with $10m in assets, their expected income earned at 7% would be over $700,000 and the tax they are saving by earning this inside super is at least $310,000. We are giving this benefit to hundreds of people.

Have we totally lost the plot here or am I just missing something? Superannuation is supposed to allow you to retire with enough to enjoy a comfortable lifestyle, not to live it up on well over half a million dollars a year totally tax free. The government gives you a tax break of $310,000 so they can save the $22,500 they would pay you as pension if you are single or $17,000 if you are partnered. Unbelievable!

Not only do we allow those whose super is in pension mode to have a complete tax holiday on the earnings in their super, we also give high income earners who have not yet retired a tax break of up to $11,900 a year on their contributions to super. This in itself is over 50% of a single age pension and 70% of a partnered age pension. And some of these people are receiving a concession every year for tens of years before they reach pension age.

Those between 60 and 65 and those over 65 who are still in employment can receive a double benefit – their pension mode earnings are tax free and they are also able to enjoy the $11,900 concession on their contributions.

High income individuals do not need incentives like this to save for their retirement. No-one who is currently on even a moderately high income is going to squander their savings just so they have the privilege of living on a government pension of $34,000 per year for a couple or $22,500 for a single. These people do not need huge tax incentives to save money. The prospect of having to live out their retirement on a low income would be incentive enough to save.

Seniors with the same income can be taxed differently

One of the aims of a well structured tax system is that taxpayers with a similar income should pay a similar amount of tax. This is not the case for seniors who hold their assets within super compared to those holding the same assets outside of super.

This is quite straightforward and very easy to illustrate.

A senior earning $100,000 within their pension mode super pays no tax at all. A senior with an income of $100,000 earned on assets held outside of super pays around $27,000 in tax. If both retirees are earning $200,000 then the tax difference is around $68,000.

There are people out there who took their super as a lump sum before the latest super changes in 2007 and invested it themselves. They are now unable to put it back into super unless they are still working. There are

widows who have some savings but who have no super at all as they have never worked. There are seniors who have some funds left over from downsizing their home. These people all pay tax on their earnings because their assets are outside of super.

But they now have no way of getting the funds into super so they can receive a tax benefit on the earnings. If you are over 65 and not employed you are unable to contribute.

This is a glaring example of a failure in our tax system. Individuals with the same income and situation should pay similar amounts of tax. These people pay vastly different amounts of tax.

The current government age pension system discourages saving

In some cases the more assets you own the lower your total income. This discourages saving and encourages people to squander money to lower their assets in the lead up to retirement, or to retire early and spend their super before they reach age pension age.

This reduction in total income comes about because of the way the assets test works, combined with the current very low interest rate environment.

Under the assets test for age pensioners for every thousand dollars you have in assets above a threshold, you lose $39 per year of pension income, but only gain $32.50 in interest if your money is in a bank account. This gives you the equivalent of an effective marginal tax rate of 120% and an investment return of minus 0.65% on your savings.

I am talking here about current part pension seniors in their seventies, eighties or nineties who grew up in the Depression and through the Second World War and have managed to accumulate a few hundred thousand dollars in savings. These people have always known the value of trying to put a bit aside and would not be comfortable with their savings invested anywhere but a bank account.

This also affects those who have contributed to super all their working lives and retired with a balance between $300,000 and $800,000 for a single pensioner, or up to $1.15m for a couple. They get very little benefit from having this money in super unless they take out lump sum amounts. The extra income earned on their super may not even compensate for the pension income they are losing. The main benefit of their super flows not to them, but to the government in lower pension costs.

For a single pensioner their pension starts to reduce under the income test if they have $150,000 in savings. For a couple this reduction threshold is around $250,000. The assets test starts at an amount of around $200,000 for a single and a bit under $300,000 for a couple. For every $100,000 that they have above this they will be losing $3,900 of pension (combined pension for a couple) and gaining $3,250 in bank interest. These pensioners are losing $650 per year of their total income, pension plus

bank interest, for every $100,000 they have above the limit. But surely if they have saved more money their total income should be going up!

We should be encouraging these people to retain their savings and get some real benefit from them. Eventually we may need to subsidise their aged care, and this is means tested too, so if we give them an incentive to spend but none to save, then their aged care subsidy will cost the government more.

The system is currently a great leveler of retirement income, making it a bit pointless going to great lengths to save more than a basic amount of money for your retirement either within super or outside of super, unless you have the capacity to save $1m or more. This loss of income effect actively encourages retirees to take money out of super and spend it as there is so little benefit in leaving it there. Retiring at 60 and using up some of your super is actually the financially sensible thing for many people to do. You get five more quality years of retirement and you lose no income.

More on income leveling

Anyone who doesn’t like tables and charts is welcome to skip down a couple of pages to the next heading, example of income leveling and the benefits of spending. There are no graphs or tables beyond that point and you will not lose any continuity.

Here is a table of income and assets for a single pensioner receiving a government age pension and with their money held in a bank account which pays interest at the current deeming rate. The pension amount and deeming rate are current as at April 2015.

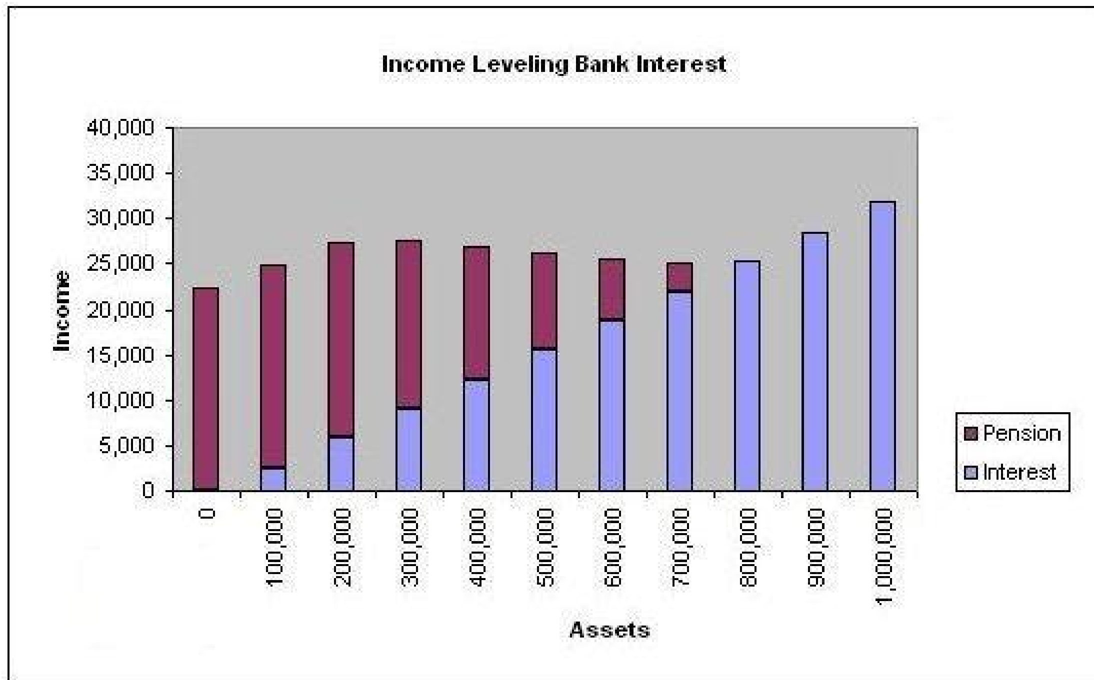
Total Assets	Interest income	Govt Pension	Total income
0	0	22,365	22,365
100,000	2,530	22,365	24,895
200,000	5,780	21,555	27,335
300,000	9,030	18,543	27,573
400,000	12,280	14,643	26,923
500,000	15,530	10,743	26,273
600,000	18,780	6,843	25,623
700,000	22,030	2,943	24,973
800,000	25,280	0	25,280
900,000	28,530	0	28,530
1,000,000	31,780	0	31,780

What we see in the table is a small but steady drop in income for the pensioner over the asset range of $300,000 to $700,000, due to the assets test reduction in government pension income.

The pensioner with a bank balance of $300,000 receives a total annual income of $27,573, while the pensioner with a balance of $700,000

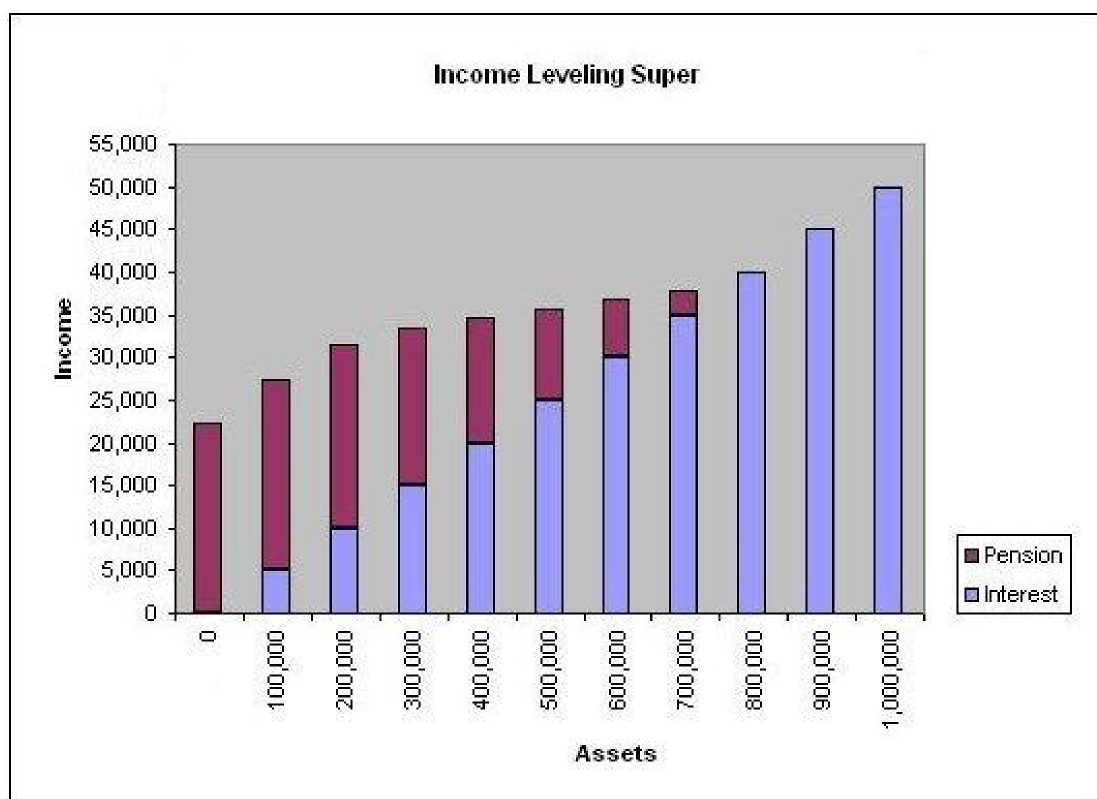
receives $24,973. The extra $400,000 dollars saved by the second pensioner results in a decrease in annual income of $2,600. Yes a decrease. They get less income. This is a negative return on your $400,000 of 0.65%.

Here is a chart for those who find pictures easier to follow.



The senior may be a little better off if the money is invested in super and the fund returns a rate higher than the bank deeming rate after fees. Here is the same table and the chart for a 5% return. The pension amount stays the same because any return above the deeming rate is disregarded and because for most of the range it is the assets test not the income test that determines the pension amount.

Total Assets	Income at 5%	Govt Pension	Total income
0	0	22,365	22,365
100,000	5,000	22,365	27,365
200,000	10,000	21,555	31,555
300,000	15,000	18,543	33,543
400,000	20,000	14,643	34,643
500,000	25,000	10,743	35,743
600,000	30,000	6,843	36,843
700,000	35,000	2,943	37,943
800,000	40,000	0	40,000
900,000	45,000	0	45,000
1,000,000	50,000	0	50,000



Now the pensioner with $700,000 receives $$4,400 dollars more than the pensioner with $300,000 but this is a return of only 1.1% on the extra.

For those who do have a little extra money when they reach pension age it just could make sense to reduce it down to around $300,000. You could take some or all of it as a lump sum, pay down any remaining debt, renovate the house, have a holiday, buy a new car, update all your furniture and carpets, store cash or gold under the bed. The effective return you are getting on the money is below the inflation rate, so if you spend the money now you are actually better off. And you would still have some savings left.

The most obvious way to alleviate this problem is to assess assets of a pensioner using only the deemed income test, not the assets test, as this gives a much fairer outcome. Only 50c of your interest is lost to pension decrease. However the solution I am proposing in this submission will result in much better outcomes for these seniors, while costing the same or less overall to the government.

Example of income leveling and the benefits of spending

And finally, for those who skipped the tables and graphs, here is a slightly frivolous example of the difference in income for two couples where one has no savings and the other enough in savings to lose the pension altogether.

Our first couple, Allan and Alice Allgone are spendthrifts. They have a good income but they constantly live beyond their means. They own a boat, drive expensive cars that they replace every two years, dine out most nights and spend their holidays skiing in Switzerland or shopping in New York. When they retire they have $200,000 in super between them, their home, an old but now unseaworthy boat and lots of holiday photos.

They retire with a full couple age pension of around $34,000 and $4,000 a year from their super. This gives them a total annual income of $38,000. As well as this they get all the really useful discounts and benefits that come with a pension card.

Our next couple, Barry and Betty Bobsaver have similar jobs and income to the Allgones but they live very frugally and save a lot of what they earn. When they retire they have their home, the same $200,000 in super and an additional $950,000 saved in the bank. They do not qualify for a government pension as their assets exceed $1.15m. Their money is kept in a savings account with their bank which pays interest at the deeming rate, as currently this actually gives them a better return than they would get in a term deposit. They do not trust stocks and shares.

Their income is $4,000 from super and around $30,250 interest on their deeming account. This is a total of $34,250. This is $3,750 less than the Allgones who spent all their earnings and qualified for a government pension. The Bobsavers also lose out on a lot of other pensioner savings that are available to the Allgones.

Neither of these couples pays any tax on their income as each person's half of the total income is below the tax free threshold, so they actually get no net benefit at all from the tax free status of the earnings on their super.

But the Bobsavers are millionaires. Why should we be subsidising them you say. They should spend all their money before we give them a pension. The point here is that they have this money simply because they did not spend it before they retired as the Allgones did. We are rewarding the spendthrift habits of the Allgones and penalising the savings habits of the Bobsavers.

No-one complains about the Allgones getting a pension, they are the needy, but some of us may object to subsidising the Bobsavers, they are the greedy. Well the Allgones could have been millionaires too if they had saved their money. By giving a pension to the Allgones but not the Bobsavers we are now subsidising their past extravagant lifestyle. The needy and the greedy is not always a clear cut distinction.

With this example I am trying to illustrate two interlinked problems with our current pension system. It is a great income leveler and it rewards spenders and discourages savers.

It can put seniors in a position where having more assets can result in a lower total income. There is no real incentive for people to save for their

retirement (unless they can put away more than $1m) and every incentive for them to retire at 60 and use up some of their super or savings or spend their money or give away assets before they reach pension age.

The current system can result in very high marginal tax rates

Current retirees and age pensioners can earn up to around $32,000 if they are single before they pay any tax. This amount includes their government pension, any employment income, any superannuation pension they may have from an untaxed source (eg a Commonwealth or State Government retirement pension) and any bank interest or other investment income they receive from assets held outside of super.

For every dollar they earn over this amount from their savings they are losing 50c in pension and are paying an effective tax rate of up to 41.5% on the remaining 50c.

This high rate is a combination of tax at 19%, the phase in of the Medicare Levy at 10%, and loss of the senior tax offset which reduces at 12.5% for each dollar over the threshold. This is a total of 41.5%.

The net effect of this is that some pensioners lose 70.75c for each dollar they earn up until the Medicare Levy has completely phased in and 66.75c per dollar thereafter.

There is little incentive to take on part time work if you are unlikely to earn any meaningful amount of extra income. If you took a job paying $20 per hour and worked an eight hour day your net take home pay could be as low as $48. If you worked in a city centre shop or office that would scarcely pay for your parking.

The current system is complex, inefficient and high stress

The current age pension means testing is dysfunctional. It causes stress to pensioners, housing inefficiency and lowers productivity by discouraging seniors to stay in the workforce. It ties up Centrelink staff in the administration of the scheme and financial planners in the avoidance of the pitfalls it creates.

If you save money in a bank account your total income is likely to go backwards. Under the current assets test your pension will be reduced by more than the amount of interest you are earning on the extra in the account.

Some pensioners actually do hide money around the house to avoid it being assessed and reducing their pension. Can anyone blame them when they are getting a negative return on it? But this lays them open to burglary and exploitation. This cash could be invested, earning interest for the pensioner, profit for the bank and income for a business the bank lends it to, thus benefiting the whole economy.

Part pensioners worry about extra income or assets reducing their payment down to zero, with the consequent loss of a range of other

benefits only available to pensioners, such as reductions in rates and utility costs, concessions on public transport and health care benefits.

Discouraging seniors from saving has the flow on effect that they will be less able to contribute to the cost of their care further down the track if they need home care or residential aged care.

Financial planners are tied up with devising complex schemes to maximise pensions for retirees and Centrelink staff are employed to calculate entitlements and oversee the rules. There is scope here for a vast increase in productivity of these people if the system is changed in the way I will set out in the next section and they are freed up to work on something more useful.

But the worst problem is pensioners retaining homes which are inappropriate for their needs as the family home is exempt from the government pension assets test. Pensioners are reluctant to move from large family homes with gardens that may have become beyond their ability to enjoy or maintain. They fear that if they move to a smaller less expensive home the extra money they have may affect their entitlement to the pension and the associated benefits.

This ties up larger suburban houses and old houses on larger inner city blocks of land. If we could eliminate this problem, our housing could be allocated much more efficiently, with pensioners choosing to live in smaller units which are more appropriate for them and the larger houses being occupied by families with children who could keep the house properly maintained and would benefit from having a garden. Inner city blocks with old houses on them could be subdivided or redeveloped to increase housing density in areas already well serviced by public transport and infrastructure. This would help to alleviate housing shortages.

Fixing this problem would eliminate a major cause of stress for pensioners, who cling to houses they know are unsuitable for fear of losing income. It would result in a lower rate of accidents as many of our seniors live in poorly maintained older houses with steps, outdoor toilets, insufficient heating and cooling, and outdated kitchens and bathrooms.

These seniors would be better off with smaller homes and gardens to look after, better access to shopping and medical centres and more time to engage in social activities and community groups.

The Solution – How we work the magic

Under my new system every Australian who reaches age pension age will get a Basic Retirement Benefit (BRB) which they can take either as a refundable tax offset or as a pension, but obviously not both.

The BRB will be set at the rate currently paid to a pensioner who is part of a couple, around $17,000 per year. The BRB amount will not be taxable and will be indexed to average weekly earnings as the age pension is now.

In addition to this, seniors who are single, or who are in residential aged care, will receive a means tested Single Pensioner Supplement (SPS) of up to $5,500 which will bring their total payment up to the amount of the current single pension, around $22,500 per year. This SPS will also be indexed.

To offset this increase in payments, all other income of those who reach pension age will be taxed, including their pension mode earnings. The BRB will act as a cap on the tax benefit currently available to high income earners on their pension mode super.

The income stream paid by the super fund to the member will not be taxed as it is equivalent to those whose earnings are outside of super spending their own money as and when they like. Only the earnings on pension mode super will be taxed and this will occur inside the fund.

There would also be some changes to transition to retirement pensions and to contributions tax, which I will deal with in more detail shortly.

Changes to pension payments

The BRB will simply replace the current age pension for couple pensioners. Most single pensioners will receive the BRB and the SPS.

New seniors who reach pension age can choose to take their benefit as a pension or a tax offset. If they take a pension they will be paid the BRB in fortnightly payments. The BRB amount will not be taxable and will not need to be included on a tax return. It will not be means tested.

The Single Pension Supplement (SPS)

An amount equal to the difference between the BRB and the current single pension rate will be paid as a means tested SPS to single pensioners.

The amount of the SPS would be reduced by 40c for every dollar earned above $4,160 per year, so it would phase out completely just before the senior's income reaches the tax free threshold. By the time their non BRB income reaches the tax free threshold of $18,200, seniors will no longer qualify for the SPS. No senior would therefore pay tax on the same income that had reduced their SPS entitlement.

Means testing for the SPS would only be done on income, including deemed income on financial assets, not on the value of assets.

All current age pensioners who receive the single full rate of pension will receive the SPS. Those receiving a single rate part pension will not have their total payment reduced below what they currently receive.

Changes to tax for pensioners

Seniors will be able to earn up to the usual tax free threshold, currently $18,200, before they pay any tax. With their tax free BRB this will give them a total income of $35,200 before they need to pay tax. This is slightly higher than the current senior's tax free threshold which is just above $32,000 for singles including their age pension income.

In exchange for this extra tax free threshold, pensioners will no longer receive a senior tax offset or the low income offset.

Changes to taxation of super

To pay for the extra cost of giving everyone a BRB, we would tax the earnings of super funds in pension mode. Once the BRB is taken into account, only very high income earners would be worse off.

We would not grandfather existing pension mode retirees as some of these are receiving tax benefits far in excess of what anyone needs for a comfortable lifestyle. There would not be a lot of public sympathy for a retiree with a tax free income of $700,000 who was complaining because they now have to pay at least some tax on this.

Amounts drawn down from the super fund will still be treated in exactly the same way as for people accessing their capital outside of super – no tax whatsoever will apply. The tax only applies to the earnings on the assets held in the fund in the same way that someone with assets outside of super pays tax on their investment income but not if they access their capital.

As we are now giving all seniors either a pension or an equivalent tax offset, then any tax benefit we give in addition to this is simply icing on the cake and would not need to be large. However we do want to continue to encourage everyone to save some super so they can have a better retirement lifestyle than they would have from the BRB alone.

Ideally we would like a system where super continued to be managed within the fund and the tax on pension mode earnings was looked after by the fund manager. This would keep to a minimum the number of seniors who needed to lodge an income tax return. This would keep their lives as simple and stress free as possible.

We also want to keep the administration of super funds as simple as possible. This keeps fees low.

There are two fairly obvious ways we could tax pension mode earnings and we will look at both of them. We can tax the earnings at marginal rates or we can tax them at the same rate as accumulation super,

currently 15% (but this could be increased) and possibly have some sort of surcharge for high incomes.

So let's look at how these two methods would work in practice.

Tax at marginal rates

The first way of taxing pension mode earnings, is to add the earnings of the pension mode super to the taxable income of the senior, and give a tax credit for the tax already paid in the fund.

Information would need to be exchanged between the fund, the member and the ATO and there are three alternatives to do this.

The member could lodge a return as normal then pass on the details of their taxable income to the super fund so the fund can work out the extra tax owing at the members marginal rate on the additional earnings that the member has within the fund and send this tax to the ATO. Those with non-super income less than the tax free threshold would now need to work out their taxable income to give to the fund.

Oh dear, no. This would be hopeless. We don't want seniors bothered with all this if they would not normally need to lodge a tax return and we don't want fund managers bothered with it all either as it would increase workload and therefore fees. And what about members who held their super in more than one fund. Nightmare territory. So let's look at the next alternative.

The fund could give details of the pension mode income and any tax already paid to the member so they can include it with their tax return. The fund would have to send out this information before the deadline for individual tax returns at the end of October. But the fund may not have all this information until the end of September if some investments are in real estate investment trusts or managed funds. So the fund manager has only a one month window to send this information out to all the members.

This is not much better. What about the third alternative.

The super fund reports to the ATO the earnings of the member and any tax paid within the fund. This bit is easy, the funds do this anyway. The member sends in their tax return including only their non super income. The ATO collates the information and sends a tax bill to the member for the additional tax on the pension mode earnings. The member can pay this themselves or ask their super fund to pay it.

This is better and it might work, but now all seniors, including those whose income is below the tax free threshold would need to lodge tax returns. We don't want that.

I think perhaps we have now eliminated tax at marginal rates. All agreed? I will assume for the remainder of my submission that we use the next method to tax pension mode earnings for seniors.

Tax at 15%

The second way is to tax all super earnings at the current rate of 15% regardless of whether the senior is in accumulation or pension mode. We could also have some sort of surcharge on higher incomes to bring the tax more in line with normal marginal rates. Or we could increase this 15% rate slightly if we wanted.

I would see this as by far the better method as there would actually be very little change required to implement it and the changes to the system for most people would be negligible. The change would be totally transparent to most super fund members.

In addition to the 15% tax a surcharge could be applied for those with high incomes. For example an extra 10% of the amount over $100,000. This would still give a generous tax concession on super fund earnings compared to marginal tax rates. The surcharge would apply to the earnings in accumulation mode as well.

Each year all super funds would report to the ATO the total for each member and their tax file number as they do already when the normal 15% tax is paid. The ATO would collate the information from all super funds held by the senior and assess whether any surcharge was owing. If there was any amount owing the ATO would send a notice to the senior who could then either pay the extra tax themselves or ask their super fund to pay it.

This tax at 15% method would be easy for the super fund administrator, as there would no longer be any separation of pension assets and accumulation assets. The earnings within the fund and any concessional contributions would all be taxed at the same 15% rate. Actuarial certificates would no longer be necessary. The ATO would look after levying any surcharge owing, the fund would not need to do this.

All income stream payments would remain tax free as now and all reporting to members would remain the same.

This would provide the government with a good deal of tax revenue that could be used to fund the BRB payments to all the retirees who are currently totally self funded. It may not be enough to fund it completely. However if we also make some reductions to the tax benefits of concessional contributions to super it should be cashflow positive for the government.

The only one of our listed problems that this does not completely address is the difference in tax treatment of retirees depending whether their assets are held inside or outside of super. It does go a long way to reduce the tax difference, but it doesn’t eliminate it.

Under this tax method those seniors whose assets are in super would pay $15,000 in tax on earnings of $100,000 (this tax would be paid within the fund) and those with assets outside of super would pay around $27,000 in tax on this amount. Both would get the same BRB of $17,000. The retiree with their assets in super would still be better off by around $12,000. This is not perfect, but it is a big improvement on the current system.

There are two ways round this if we think this issue is important enough. We could tax all investment income of seniors at 15% regardless of whether it was held in or out of super or we could offer a one time option for these seniors to contribute an extra amount to super so they could get back into parity with those who retired under the current super regime.

This would still give some tax benefit to those with very high super fund balances. Our retiree with $10m in super who is earning $700,000 on their pension mode earnings would now pay $165,000 in tax (including the surcharge amount) rather than the $310,000 they would pay if it was taxed at their marginal rate and they had no other income. However if we also make changes to the contribution rules to prevent people from accumulating these huge balances in the first place, then the existing funds with high asset balances and high tax benefits will eventually work their way out of the system.

Retaining some tax benefit on pension mode earnings would also encourage these high net worth fund members to leave their super where it is as 15% is still a good tax rate and super would still be a tax effective investment for them. Even those paying the extra 10% surcharge still receive some tax benefit as the maximum tax rate they would face is 25%, less than the company tax rate and significantly below the income tax rate for this level of income.

There are also effects on those with smaller balances and all their assets held in super as they will pay tax at 15% on all the earnings and will miss out on the tax free threshold of $18,200 on earnings outside of super. These seniors could arrange their affairs better by withdrawing some or all of their super to mitigate this effect, and they may also save administration fees and costs in the process. Most people are capable of making changes that give them the maximum tax benefit and in practice most seniors would already hold some of their money outside of super.

This 15% tax method would be a really beautiful solution as the senior would simply be taxed in the normal way on all non-super earnings as at present with the tax on the super looked after by the fund administrator and any surcharge looked after independently by the ATO.

Taxing pension mode earnings in this way should easily raise enough revenue to cover the cost of paying all seniors the BRB if we also reduce concessional contribution benefits. I will cover these shortly. But if this still did not raise enough tax revenue then we could gradually increase the tax on super funds to 20% across the board, for both contributions and

earnings. The increase would be phased in at 1% per year for five years so any anomalies this created could be dealt with.

Effect on existing pension mode funds

Regardless of which tax method was chosen, all existing pension mode super funds would be brought back into the tax system. This may pose some problems, but they would not be insurmountable.

For super income streams where the assets are held separately from any accumulation super there may be some issues with capital gains tax. Brought forward losses may have been extinguished at the commencement of the pension. If there was a problem resurrecting the amount of these losses and applying any gains that had occurred since, then we could simply use the value of the fund assets at the current market price at the start date for the new system and use this value for calculating any capital gain or loss in the future.

This revaluation concession could be extended to all current pension mode super funds with no accumulation phase component if this made the changeover easier or the retirees happier.

Changes to income tax for seniors

If we chose to tax all pension mode earnings at 15% plus surcharge within the fund, then most seniors would see little or no change to their tax affairs.

Seniors who wish to receive their BRB as a refundable tax offset would lodge their tax return including all other income and their BRB would be paid as part or all of their tax refund.

The BRB amount would not be taxable even if paid as a pension. All other non-super income of seniors would be taxed at normal rates. The low income offset would not be available to taxpayers who receive a BRB and the senior tax offset would be abolished.

The 10% tax offset currently paid on taxable super pensions (eg for those receiving their super from a Commonwealth or state superannuation scheme) would no longer be available to those receiving a BRB. This offset was introduced in 2007 to compensate these retirees for the tax free status of pension mode earnings for those with normal super.

Any retiree with less than $170,000 from a taxable pension would be better off. The BRB would more than cover the loss of tax offset. The tax free amounts for untaxed super pensions would remain tax free.

Part year benefits

In the first year that a senior reaches pension age, their benefit would obviously be paid only for the part of the year they qualify. If they prefer to take their benefit as a tax offset, for the first year this would be

reduced to cover the proportion of the year that they were over pension age.

If for any reason a senior wanted to change from one system to the other this could easily be catered for in a similar way. Any BRB amount not paid as a pension during the year could simply be claimed in the tax return.

Transition to retirement pensions

At present those over 60 years of age can choose to transfer their super into pension mode so they pay no tax on the earnings. They are also able to make concessional contributions up to $35,000 and they receive a tax benefit on this that can be worth up to $11,900.

Under the new arrangements these people would no longer receive the zero tax rate on the earnings of their super, but would pay 15% tax the same as for the accumulation phase. The result of this would be no difference in treatment of accumulation and pension phase super for these people, so no separate pension would need to be set up. As they are below pension age they would not of course be eligible to receive a BRB even if they are retired.

On reaching transition to retirement age at 60, everyone would be allowed to take out up to 10% of their super each year regardless of their employment status and this income stream or lump sum would be tax free as currently.

The transition to retirement age would be kept at five years below the pension age, so it would rise to 62 at the same time that the pension age rises to 67.

Access to super for those below 60 would be discouraged or preferably no longer allowed. Access to super from age 55 is still currently available although it is gradually phasing out and in actual fact most people receive very little benefit from it. This is because it results in some income being taxed (but with a 15% offset) that would otherwise be tax free if taken when they reach 60. We would need to allow those who are currently doing this to continue to do so, but no new transition arrangements would be allowed for those under 60.

Accumulation mode super

Accumulation mode super is currently taxed at 15% on all earnings. We could levy the surcharge on this as well. The amount over $100,000 would be taxed at an additional 10%.

The obvious way around this for fund members would be to have several smaller super accounts, each earning less than this. We would need to put in place some process to overcome this loophole.

As all super funds have to report their members’ earnings in accumulation mode (to pay the 15% tax) and all have their members’ tax file numbers, the information from all super accounts held by the member could easily

be collated by the ATO and any surcharge owing would be calculated. The member would receive a surcharge statement from the ATO and would either pay the tax themselves or ask their super fund to pay it for them.

Super would still be a tax effective investment for these members as the maximum tax rate of 25% is around half of what they would pay in income tax on this extra income.

Contributions tax and contributions limits

The tax benefit on concessional contributions is currently far too generous. However any scheme to align it more closely with a person's marginal tax rate would be necessarily complex.

It is easy for super funds to receive contributions and pay the 15% tax without needing to adjust this for the taxable income of the contributor. We would hesitate to make significant changes to this arrangement as it would add to the cost and complexity of managing super funds.

At the moment those earning over $300,000 have a surcharge levied of a further 15% and I see no reason why this threshold could not be reduced to $180,000 so all taxpayers on the top marginal tax rate pay it. The easiest way to collect the extra tax would be in the individual tax return, so the fund managers do not need to keep track of the taxable income of the contributors.

Since under my suggested system the government is not saving a lot in future pension costs by giving people overly generous incentives to contribute to their super (everyone gets the same BRP so the government potentially saves only the SPS amount) then the amount that can be concessionally contributed could be wound back considerably.

People would still be encouraged to contribute after tax income as their savings would be earning income and compounding in a low tax environment. We do want to encourage people to save enough to retire with sufficient extra to live a comfortable and low stress lifestyle. We especially want to help those who are low to middle income earners. Under the new system anything saved in super would give additional income for them on retirement. They would have this amount as well as their BRB, not instead of it.

One of the main benefits of super is the low tax rate on the earnings within the fund. Many people are happy to contribute after tax income, with no tax concession at all, into their super to gain the benefit of the lower tax rate on the earnings. Minor changes to the tax concessions and caps will not drive people away from contributing to super.

Reducing the maximum concessional contribution back to $20,000 as well as lowering the threshold where the surcharge applies as suggested above would reduce the maximum benefit obtained to $4,800 for those earning from $80,000 to $180,000 and would reduce the benefit for higher

incomes than this to $3,800. These amounts seem more reasonable and just for once they benefit most those in middle income tax brackets.

Those earning less than $37,000 get little or no tax benefit on their super contributions. For these employees with low incomes, the Low income super contribution would be retained. All other co-contribution payments would be eliminated.

For these lower income earners a government contribution of up to $527 would be added to their super to compensate for the tax paid. The $527 is the tax that would be paid by the super fund on the superannuation guarantee amount, currently 9.5% of the $37,000 earnings. It would be nice if this could have a phase out above $37,000, so those earning $37,001 did not miss out completely. A reduction of 4c for every dollar earned above $37,000, so it phased out at a little over $50,000 would be about right.

The maximum non-concessional contribution could also be reduced, or a lifetime cap could be put in place to restrict the total that people can accumulate, as the earnings on the assets are in a low tax environment.

All Australians have the option of saving as much as they like outside of the super system as well as what they are allowed to contribute to their superannuation fund. We are not restricting the total amount that people are able to save by restricting the total they can contribute to super.

The Benefits – The problems simply disappear

I have covered in the preceding sections the problems with the current system and how the new system would work. All of the problems covered previously are improved or eliminated in the new system.

Those with large balances in their super would no longer have tax haven status, although they would still have some tax advantage. They would receive the same BRB as all other Australians who are above pension age.

Seniors would be taxed at approximately the same rate for the same income. Some seniors would need to adjust the balance between their super and their non-super assets.

The new system would be equitable and fair. All retirees, regardless of income and assets would receive exactly the same benefit (with the exception of the Single Pensioner Supplement). Most retirees would get additional income from their super as well as receiving their BRB and this would be proportional to the amount they had saved.

Seniors who saved money during their working years, whether in or out of super, would gain a better income and a better living standard for their efforts. There would be every incentive to save and there would no longer be any incentive to spend money before retirement, to hide money away, or to put more capital into the family home.

Seniors who wish to do full or part time work could do so in the confidence that they will not be facing punitive marginal tax rates on their extra income even if they are receiving the SPS. This will increase workforce participation by these people. Their maximum effective tax rate would be 40% on the phase out of their SPS and 29% when their income exceeds the tax free threshold (19c plus phase in of Medicare levy at 10%). Once the Medicare levy has phased in their tax rate would be 21%.

Seniors and their financial planners will no longer need to plan their finances to optimise receipt of the government aged pension. They can concentrate on the investment side of financial planning.

Centrelink staff currently involved in checking and recording income and assets of age pensioners and advising them on the rules for their particular circumstances would be freed up to do more productive work.

Seniors would no longer lose income by moving to a smaller home. In fact they would be encouraged to do this as any extra money released could be banked and would give them an increase in income rather than a decrease in income. This would free up larger houses with gardens that could be occupied by families with children. It would also make larger inner city blocks available for development into higher density housing.

If a senior had a significant amount over when downsizing their home we could allow them to make a one off addition to their super so they can take advantage of the lower tax rate on super fund earnings.

Young people and those not yet retired would be more likely to save extra in their super and engage more with the system as they would know they would receive some real benefit from it when they retire.

The Transition – Changing is really easy

Changing to the new system would be easy, although there may be some situations that I have not covered here that would need to be thought through. As far as I can assess, the only retirees who would be worse off are those who currently receive very high tax free incomes.

Full pensioners

Current full pensioners will notice little or no change. All current single pensioners will retain the SPS.

They would no longer need to contact Centrelink to report any changes to their income or assets and they could gain extra income from employment without any worry about losing pension entitlement.

As pensioners can currently earn only $4,160 per year before their pension starts to decrease, very few full pensioners would currently pay tax. So changes to taxation would be unlikely to affect them at all. In any case none of them would pay more tax than at present.

All new seniors on reaching age pension age would apply for their BRB but would not need to supply any details of income or assets unless they were applying for the additional SPS.

Part pensioners

Current part pensioners would have their payment increased to the BRB if it is currently below this. Any amount above the BRB that they currently receive as part of a single pension would be retained.

If they are single and the SPS amount they qualify for is greater than what they now receive, they would of course get the increase.

If they earn enough to lodge a tax return they may see a few changes in the offsets they are allowed, however any increase in tax paid should be more than compensated by their increase in pension entitlement.

Part pensioners with some pension mode super but little other income may be better off taking some of their assets out of super to take advantage of the tax free threshold on non-super earnings.

Self funded Retirees with no income from super

Self funded retirees with no income from super would all be better off. They currently pay tax at normal rates with possibly some benefit from the senior tax offset. As the BRB that they would now receive would be much higher than any lost offset, this group would all gain.

These retirees could apply to have their BRB paid as a fortnightly pension or they could simply claim it as a refundable tax offset at the end of the year when they submit their tax return.

They would also be given a one off opportunity to move some of their assets into super to take advantage of the lower tax rate.

Self Funded Retirees with income from untaxed super pensions

Self funded retirees with a superannuation pension paid from an untaxed source normally have some tax free income and a tax offset of 10% of the remainder. These retirees are mainly ex employees of the Commonwealth Government or State Governments.

If they are below pension age then there would be no change to their tax arrangements. They would still receive an offset until they reach pension age. However the offset would be phased out for new pensions.

The year they reach pension age they would get a part benefit from the offset and a part BRB.

If they are above pension age the 10% tax offset would be replaced by the BRB. The cost of their BRB would be partly or wholly funded by the elimination or the tax offset. The tax free portion of their income would remain tax free.

These people would gain unless their untaxed super pension income was above $170,000.

Self Funded Retirees with some income from pension mode super

Self funded retirees with superannuation in pension mode would have tax taken out of their fund earnings at 15%. To compensate for this they would now receive a BRB if they are above pension age.

These seniors would lodge their tax return as usual with their non-super income and their super fund would look after the tax on their pension mode earnings.

For most of these seniors their BRB will be at least partly funded by the tax they are now paying on their pension mode super. To be self-funded a retiree they would normally need to have $775,000 or more in assets if they are single and much of this would likely be in super. If they have $700,000 in super and are earning around $50,000 on this then they would now pay tax of $7,500. This will offset part of the cost of paying them the BRB.

Anyone earning less than $108,000 on their pension mode assets will be better off with the new system.

For those whose pension mode earnings are more than $108,000 the tax they would pay would be higher than the benefit they would receive. Any extra tax they pay will be helping to fund the BRB for one or more other seniors. In the case of the 475 retirees earning over $700,000 the tax they would now pay would totally fund the BRB for at least 4600 other seniors.

Seniors who are still in the workforce

This group would generally gain from the new system as they would receive their BRB in addition to their employment income. This would be an incentive for these people to stay in the workforce as they would not be forgoing an age pension by doing so.

In exchange for the much higher BRB tax offset they will lose the low income tax offset and the senior tax offset. They would pay tax on the earnings of any pension mode super that they have.

Those above 60 but below pension age

Those who choose to access their super up to five years before age pension age would still be free to do so, however tax would be paid on the earnings in the fund at the usual 15% rate. The pension mode earnings would no longer be tax free.

These people would not need to do anything to transition to the new system. Their super fund would look after the changes. They would no longer need to withdraw 4% of their super but could still withdraw up to 100% of it if they wish. They would still be allowed to make concessional contributions.

For new transitional people reaching 60 the rules would change slightly. Those between transition age and pension age would be allowed to access up to 10% of their super each year. There would be no requirement for them to take a 4% minimum and they could still make concessional contributions.

Super fund management would be easier for these members as separating the assets supporting the pension to work out the tax free amount would no longer be needed.

The Costs – The new system funds itself

I do not have enough information to accurately cost the new retirement income system that I am proposing but we can make some general estimates and we can define the areas where we would have gains and losses.

In a previous section we noted that most self-funded retirees with pension mode super would be funding their own BRB to at least some extent with the tax they would now be paying on their pension mode earnings. Those with a taxable super pension would lose their current tax offset and this would contribute to funding their BRB.

We know from the ASFA research papers that the Government saves around $7bn per year through not needing to pay the pension to all current retirees. We also know that the cost of the pension mode superannuation concessions is $6.9bn.

If we also reduce concessions on contributions the benefit would be considerable. If we halved the benefit to those earning over $180,000 we would gain around $1bn. Reducing concessions for those earning above $80,000 could easily raise another $1bn.

These are 2011/2012 figures and we know that these tax concessions are rising considerably year on year. At that stage the new superannuation system had been operating for only four years, now it has been operating for over seven years.

If we taxed all pension mode earnings at marginal tax rates then we would spend $7bn (probably actually less as explained below) and gain $6.9m. This only leaves $100m to find from reducing concessions.

However the preferred system would be to tax all pension mode earnings at 15%, possibly with a surcharge for high incomes, and rising to 20% if this is necessary to fully fund the system.

From the available information we cannot immediately quantify how much extra revenue this would raise, although reducing concessions should still be more than enough to cover any gap.

What we can do is define the areas where will make gains and losses as a starting point for costing the system.

Paying the Basic Retirement Benefit (BRB) to seniors who are currently self-funded or on part pensions would be a cost. The cost would actually be lower than this $7bn amount as the BRB payments and offsets to those not currently receiving pensions would all be at the lower couple rate rather than the much higher single pension rate.

Tax at 15% would be paid on all pension mode earnings, including those of retirees who have converted to pension mode but who have not yet reached pension age. There may also be a surcharge on high incomes. This will be a considerable revenue increase.

Seniors with low balances and little other income may be better off taking their funds out of super to take advantage of the tax free threshold. This would be a reduction of some the revenue from the tax on pension mode earnings. This revenue would not be replaced by income tax paid by these seniors as they would owe none. This is unlikely to be a significant amount.

Some tax revenue will be lost as the effective low income threshold before seniors start to pay tax will be slightly higher than now. This will be a cost, but probably only a very small one.

Seniors would no longer receive the senior tax offset, the low income tax offset or the offset on taxable super pension income. This would be a gain.

Revenue gains will be made by reducing the benefit of the concessional tax contributions and introducing a lifetime cap on contributions. This amount would be significant.

Retaining and slightly expanding the low income super contribution would be a cost, but this would be reduced slightly by eliminating the current co-contribution.

Some existing super may be moved to other tax advantaged forms of savings. This could result in a loss of revenue, however as the 15% tax rate is still quite low, super would remain a tax advantaged investment and the leakage may not be a lot. Even with a surcharge of a further 10% on higher incomes, the 25% tax rate is still well below the top marginal tax rate.

The cost of administration of the pension system would be much lower as most Centrelink staff who currently record and calculate the income and assets of age pensioners would no longer be employed in this role. Some staff would still be needed in this area to assist seniors who were claiming the SPS. Most seniors would no longer need to have any contact with Centrelink at all, particularly those who chose to take their BRB as a refundable tax offset.

The cost of administration for APRA super funds and self-managed super funds would be lower as all fund income would be taxed at 15%. Actuarial certificates would no longer be required. This would not be a benefit to government revenue, but would be a benefit to the funds.

Seniors would benefit if they remained in the workforce. Any tax they pay would contribute to revenue.

Many part pensioners and self-funded retirees would have more income. They would spend more and this would have a flow on effect of increasing employment.

Encouraging seniors to save money would make them more able to afford private health insurance and to contribute more if they eventually need home or residential aged care.

Less easily quantified would be the benefits from improvements in housing efficiency. By moving to more appropriate accommodation seniors would rely less on social services and stay safer, healthier and happier.

There would also be a small economic benefit from pensioners with hoarded cash or gold returning this to a bank. The pensioner would benefit, the bank would benefit, a home loan or business customer of the bank would benefit, the whole economy would benefit.

By keeping high income seniors in the tax system instead of allowing everyone over 60 to live totally tax free, the pension payments and tax offsets for seniors would be at least partly funded by their own demographic. We would no longer be totally relying on the income tax of younger people to fund all the benefits for seniors.

Younger people would be encouraged to value their super and make extra contributions to it as they would now get a real benefit from it. This would flow on to higher balances when they become seniors and they would then be more likely to be contributing to the tax base and funding their own aged care.

Conclusion – Better pensions, better super

I am putting forward a suggestion for a new holistic approach to retirement incomes which is fair and equitable and which gives all Australians an incentive to save for their retirement years.

The current government age pension system and the current superannuation system would be combined into a unified system that gives an increased retirement income to those who are able and willing to save extra. Currently the interaction of these two systems results in problems of equity and fairness, high marginal tax rates, and disincentives to save. Part pensioners and the lowest income self-funded retirees are particularly disadvantaged.

I have covered some of the problems with the current retirement income system; the very high benefit of the tax free status of pension mode super to high income earners; the discouraging income leveling effects of the interaction between super incomes and the age pension for middle income earners; and the dysfunctional effect of the current pension means testing on social efficiency and productivity in Australia. These are real problems with the current system that need to be addressed.

I have put forward a suggestion for simple amendments to the current system which would overcome all of these problems in a way which is cost effective for the government, more fair and equitable for retirees and which leaves only the wealthiest retirees worse off than they are now.

Here is a summary of the changes I am proposing.

Every Australian on reaching age pension age would receive a Basic Retirement Benefit (BRB) which is set at the current rate of each person's share of the couple pension rate, approximately $17,000. This would be indexed in the same way the age pension is now and would not be means tested.

This benefit could be taken either as a refundable tax offset or as a fortnightly pension amount and would be tax free. The senior tax offset would be abolished, and possibly also the low income offset for this group.

Single pensioners would receive a means tested Single Pensioner Supplement (SPS) which would bring their benefit up to the amount of the current single age pension.

All earnings on the assets supporting a pension income stream would now be taxed. This would be at the same 15% tax rate as accumulation mode super, with possibly a surcharge for higher incomes. The only seniors who would be worse off overall under the new system would be those with very high earnings on their pension mode super.

The new system I have put forward would be simple to implement and most current retirees and pensioners would be happy to change over to it. Most would transfer seamlessly and see no difference at all. Younger Australians would welcome the certainty of having a basic pension amount paid to them when they retire and having a real benefit from their super.

This system could give Australia the fairest and best retirement income system in the world.

And the changes are all really quite small.

Please note that I am not an accountant, a tax agent or a financial planner. There may be some situations I have not covered, some problems I have missed and some cases where the facts, figures or terminology I have used are not correct.

I offer this submission in the genuine belief that what I am proposing is a better system than the dog's breakfast that we have now.

Thank you for taking the time to read my submission, particularly if you got this far.

Lorraine

April 2015

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