Submission to Objective of Superannuation Discussion Paper

By Lorraine 26th March 2016

Suggestions for Further Subsidiary Objectives

Another two Subsidiary Objectives could be included in the table, along the following lines

1. A no disadvantage provision - to ensure that those who have contributed to their super are not left worse off than if they had not contributed.

The system should ensure that those who have saved super over their working life and who are making rational choices in their investments actually derive some benefit from their super and are not left with a lower income in retirement than those who have little or no super.

I have included two examples below of cases where super gives little or no benefit to an individual or actually leaves them worse off.

At the end of this submission, as an Appendix, I have also included some notes and graphs showing how the current system discourages saving beyond a certain amount and encourages people to spend to improve their lifestyle while they are still working, rather than saving more for retirement. The interaction of pension and super that this illustrates should be considered when planning any changes to the current retirement income system.

2. The tax benefits of superannuation should not significantly exceed the cost to the government of paying a pension to the retiree

Super has become the ultimate tax minimisation strategy for the wealthy, with thousands of retirees receiving a tax benefit on their pension mode super that is far in excess of what they would have received had they qualified for a government pension.

Working Australians are subsidising tax benefits for very wealthy retirees.

My third example below illustrates this.

Examples

Example one – a couple who are worse off with super than if they had none.

A couple saves $850,000 in super over their working lives with a combination of employer contributions and their own after tax contributions.

On retiring at age 65 they decide to invest this money in a lifetime annuity indexed to inflation. Their income is $28,000 per year. This amount was calculated from figures available on the website of an Australian company offering this type of product.

This couple does not receive a government pension as the asset value of their annuity is higher than the maximum (using the new values which will apply from January 2017).

If this couple had no super at all, they would receive a government pension of around $34,000 per year, which is $6,000 more than they receive from their annuity.

Eventually the asset value of their annuity will reduce as some of the money paid to them is considered returned capital, however it will be many years before the value of their assets has reduced enough for the government pension they receive to make their income up to the total they would have had with no super.

This couple gets no benefit at all from the super they saved over their lifetime. They are, in fact, worse off than if they had never saved at all.

As their own contributions were after tax, they did not receive a tax benefit for their contributions and would have been better off using the money to improve their lifestyle while they were still working.

Example two – pension reduces faster than income from assets increases

A retired couple has $850,000 that they have invested in a term deposit at the current rate of 2.5%. They consider shares are a risky investment at their age and they feel happier with their money in a bank. They receive $21,250 in interest each year, well below the $34,000 they would receive in government pension if they had no savings.

They can spend some of their capital to assist their living expenses. However their most rational option is to spend some of their savings on

home improvements and international holidays. For every $100,000 that they spend, their income increases by $5,300 (the pension increase of $7,800, less the $2,500 bank interest foregone by spending the money).

Example three – tax benefit greater than pension amount

A retired couple has $2m in super between them in pension mode, all invested in the sharemarket. The return on their shares is 7.5% including the benefit of franking credit. This gives them a tax free combined income of $150,000 a year.

If all of their assets were outside of super and split evenly between them they would pay tax of around $35,000. Thus their tax saving is greater than the $34,000 pension they would have been paid if they had no assets.

For very high net wealth individuals with high super balances the tax benefit is stratospheric. A couple with $10m in super between them in pension mode, invested at 7.5%, would save over $307,000 in tax per year. This is nine times the pension amount they would receive if they had no assets.

These are not simply a few isolated retirees. From the report by ASFA, *Superannuation and High Account Balances* that was released in April 2015 we 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.

Disclaimer

I am not a financial planner and nothing in this submission is intended to be financial advice. While every effort is made to ensure accuracy, the figures and calculations in this submission should not be relied on when making investment decisions.

Appendix

The two graphs below show the income of a retired pension age couple with varying total asset amounts using the new scale for the pension assets test that will apply from January 2017.

The green section is the pension income, the blue section the interest and dividend income and the yellow section the tax that would be owing if the assets were held outside of pension mode super and the retiree had no other income.

The first graph assumes the assets consist of cash in the bank in a typical pensioner savings account paying 1.5% on the amount below $48,600 and 2.75% on the balance above that amount. These people would pay no tax at these income levels.

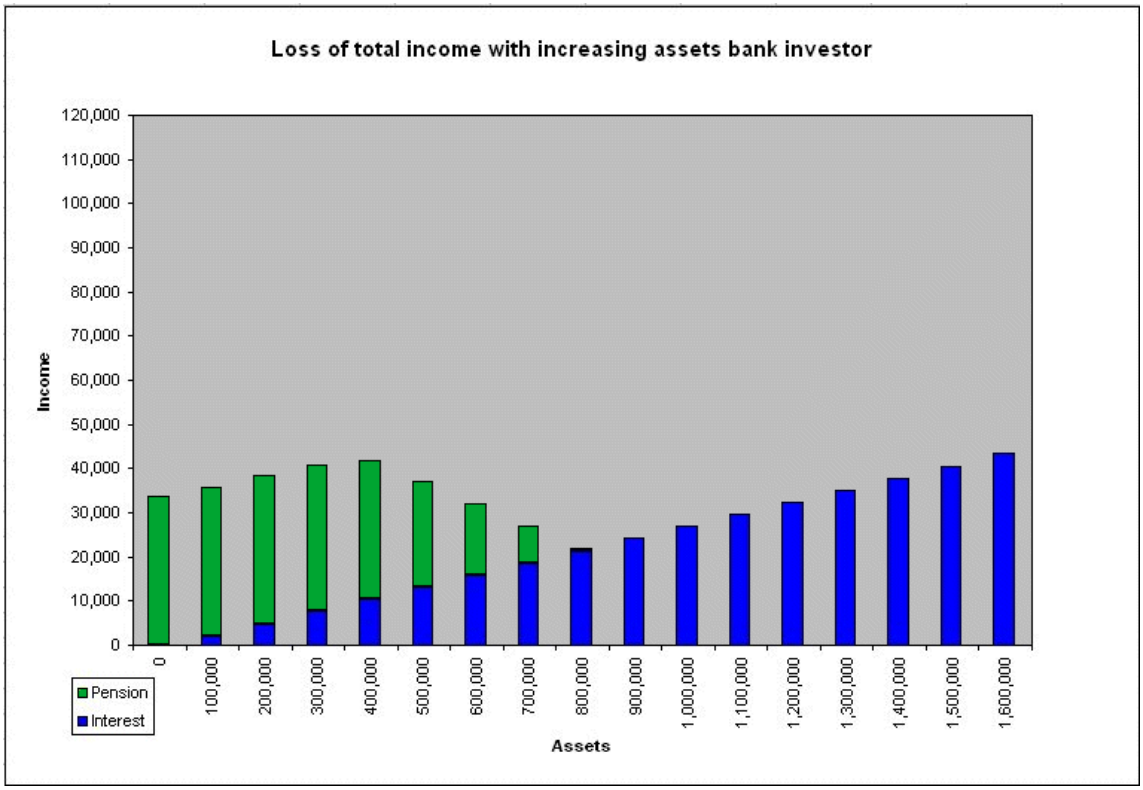
The second graph assumes the first $100,000 of assets is held in the bank account with the remainder in blue chip shares with a return of 7.5% including franking credit.

The most striking feature of both these graphs is that the best outcome for most couples is to retire with around $400,000 in assets. Above this amount, unless they can save really large sums, most couples are better off spending their money to improve their standard of living before they reach retirement age.

Couples who are able to save well over $1m and who are prepared to take on more risk will get some benefit from the tax saved by holding their assets in share market investments in pension mode super. But for the middle band of retirees, with between $400,000 and $1m, there is little or no tax benefit to help offset the pension they lose for the extra assets they own.

With $400,000 in assets, a pensioner couple will still receive around 95% of a full pension. Above this amount the pension reduces by more than the income the retiree is likely to earn on their savings.

Most people can be relied on to arrange their financial affairs in their own best interest. If we wish to design a retirement income system that encourages people to save enough over their working life to fund their own retirement without the need for any government pension, then this disincentive to save needs to be addressed.


Loss of total income with increasing assets bank investor
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Assets
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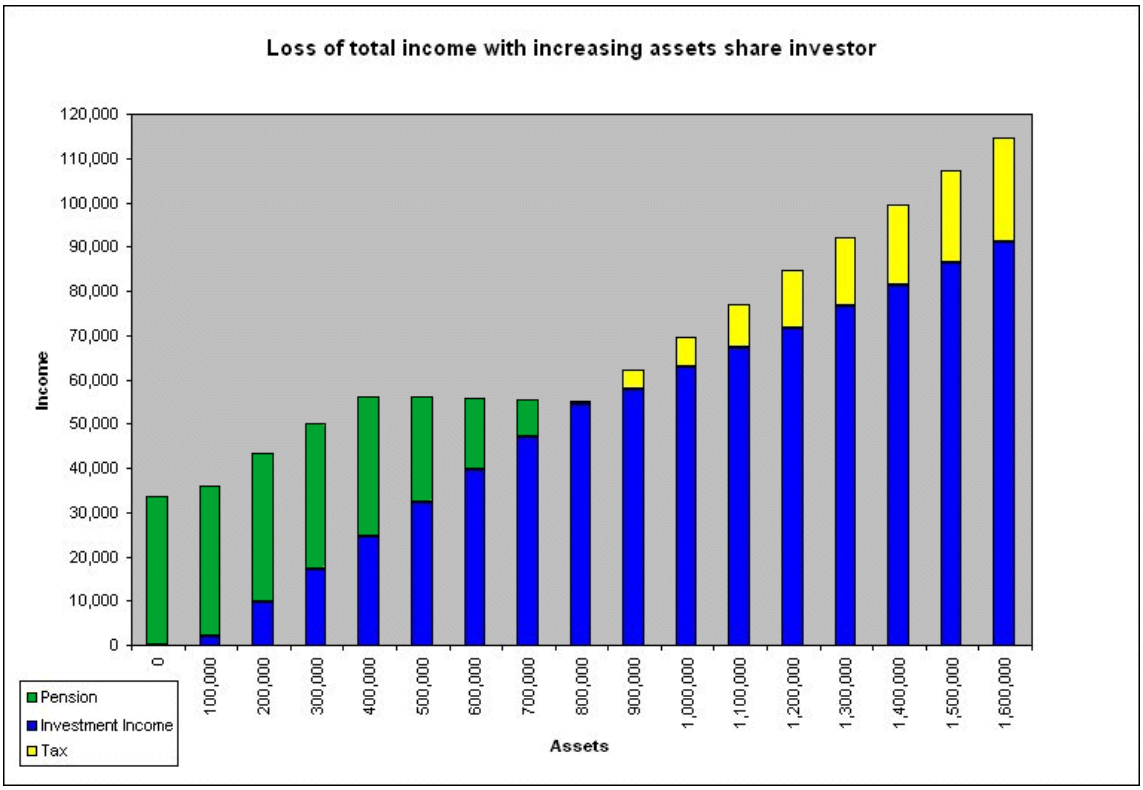
Loss of total income with increasing assets share investor
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Investment Income
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