The equity and sustainability of government assistance for retirement income in Australia

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About ASFA
ASFA is a non-profit, non-politically aligned national organisation that is the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate for policy in the best long-term interest of fund members. Our members – which include corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider members – represent more than 90 per cent of the 12 million Australians with superannuation.

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This report provides a detailed analysis of the performance of the superannuation system with respect to retirement incomes and the equity of government assistance provided to support those incomes. It paints a clear picture of the magnitude and distribution of government assistance, which includes tax concessions applied to superannuation, as well as the Age Pension. It's important to ensure that the conversations in relation to tax concessions and the development of public pensions and retirement policy are based on sound assumptions.

The report draws the following conclusions:

1. **There is clear evidence that super is boosting people's retirement incomes and decreasing reliance on the Age Pension.**
   Our projections indicate that the proportion of people in 2023 reaching the qualifying age for the Age Pension who are self-funded retirees will be around 40 per cent. This means significantly lower Age Pension expenditure after 2025 as a result of superannuation savings.

2. **Reducing the concessional caps placed on superannuation has significantly reduced the tax concessions applied to high-income earners.**
   Individuals in the top tax bracket received around 13 per cent of the tax concessions applied to superannuation contributions in 2011/12, down from 15 per cent in 2009/10 and substantially less compared to 2005/06 levels.

3. **The bulk of employer contributions go to middle and low-income earners, with most of the tax concessions for contributions flowing to middle-income earners.**
   Around 90 per cent of employer contributions go to individuals paying less than the top marginal tax rate, with 57 per cent going to those paying a marginal tax rate of 30 per cent or less. This means 75 per cent of the tax concessions applied to contributions go to those paying either the 30 per cent or 38 per cent marginal tax rate. This is a large part of the Australian workforce.

4. **The majority of tax concessions applied to investment earnings flow to middle and high-income earners who generally have higher superannuation balances.**
   65 per cent of the tax concessions applied to superannuation investment earnings flow to individuals with a taxable income of more than $80,000. Some individuals in this income range have account balances in the millions.

5. **The majority of tax concessions on earnings during the pension stage go to low and middle-income earners**
   Almost 70 per cent of the tax concessions applied to superannuation earnings in the pension phase flow to people earning less than $80,000.

Based on these findings and other ASFA policy research, we make the following recommendations:

1. **The capping of the concessional tax treatment of superannuation, consistent with what might be reasonably needed for retirement income purposes, should be continued.**
   This includes ensuring the assistance provided is sufficient to accommodate future investment return uncertainty and the financial consequences of longevity. The current concessional caps are working, so the thresholds should not be lowered, but indexing them is important.

2. **Lifetime caps for non-concessional contributions should be introduced.**
   The current rules allow people to contribute a maximum of $540,000 every three years in non-concessional contributions. In theory, this would allow some individuals to accumulate very large account balances if they made such a contribution every three years. It is important to enable people to 'catch up' if they have not been in the system over a long term period, in order to provide a comfortable income in retirement for them. However, superannuation should not be used as a wealth accumulation or estate planning vehicle. One solution lies in the application of lifetime caps, which would allow people to accumulate adequate funds for a dignified retirement, while not providing tax concessions on earnings for very large balances. Lifetime caps are now able to be administered more efficiently due to the new reporting requirements required by the Australian Taxation Office (ATO).

3. **Superannuation tax concessions should not extend to very high account balances.**
   Once a superannuation account reaches a certain level, it is appropriate to question whether or not tax concessions still need to be provided in order for the individual to generate the income required for a dignified retirement. Using the ASFA Retirement Standard, it may be argued that account balances in excess of $2.5 million per person (indexed to average weekly ordinary time earnings [AWOTE] to reflect future increases in community and retirement living standards) no longer require the same concessional tax treatment as balances under this threshold. The implementation of such thresholds is not simple and has the potential to deliver unintended consequences, so ASFA will explore the options available in a later paper.

1. Introduction

The equity and sustainability of the tax concessions applied to super will continue to be the subject of debate. This paper seeks to provide an evidence-based contribution to this debate by providing an analysis of the impact of superannuation on government expenditure, now and into the future, and the distribution of superannuation concessions by taxable income bracket.

The notion that governments should provide assistance for people to save money for their retirement is based on sound policy. Such assistance encourages people to save money to partially or fully self-fund their retirement and, in effect, compensates people for sacrificing income they could use today, in order to help ensure they have adequate income when they cease working.

Tax concessions are therefore a necessary part of our superannuation system, as they provide the incentives and assistance people need to save money for their retirement. While the Age Pension provides just enough income to avoid poverty in retirement, it does not in itself support dignity or adequacy in retirement.

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2. Impact of superannuation on age pension expenditure and retirement incomes

The principal objective of establishing the compulsory superannuation system was to deliver better retirement incomes for Australians, particularly the 60 per cent or so of employees who, in the 1980s, did not receive the benefit of any employer superannuation contributions. The Age Pension was deemed by the then government, unions and other interest groups alike as an inadequate means of funding a dignified retirement. Compulsory savings, in the form of superannuation, would deliver the additional income required to provide dignity in retirement.

The second objective was to deliver a wage increase in an economically sustainable way. At the time, there were concerns about the rate of inflation, and superannuation contributions were seen as a form of deferred wages that would not have immediate inflationary effects. The subsequent increase in national savings resulting from greater superannuation contributions was a flow on effect, and related objective.

The final objective was to reduce government expenditure on the Age Pension. Faced with an ageing population, and the prospect of ballooning Age Pension and other age-related costs, it made policy sense for the government to provide incentives and assistance for people to fully or partially self-fund their retirement, thus reducing future expenditures. However, there never was any expectation or intention that superannuation would entirely replace the Age Pension for many or most employees, or that Age Pension expenditures in aggregate, would decline in real or nominal terms. The proposal was about boosting retirement incomes, not fundamentally changing who was paying the cost of retirement incomes.

When evaluated against these original objectives, there is little doubt the superannuation system is successfully delivering. Retirement incomes are up, national savings are up, and Age Pension expenditures are lower than they would otherwise be.

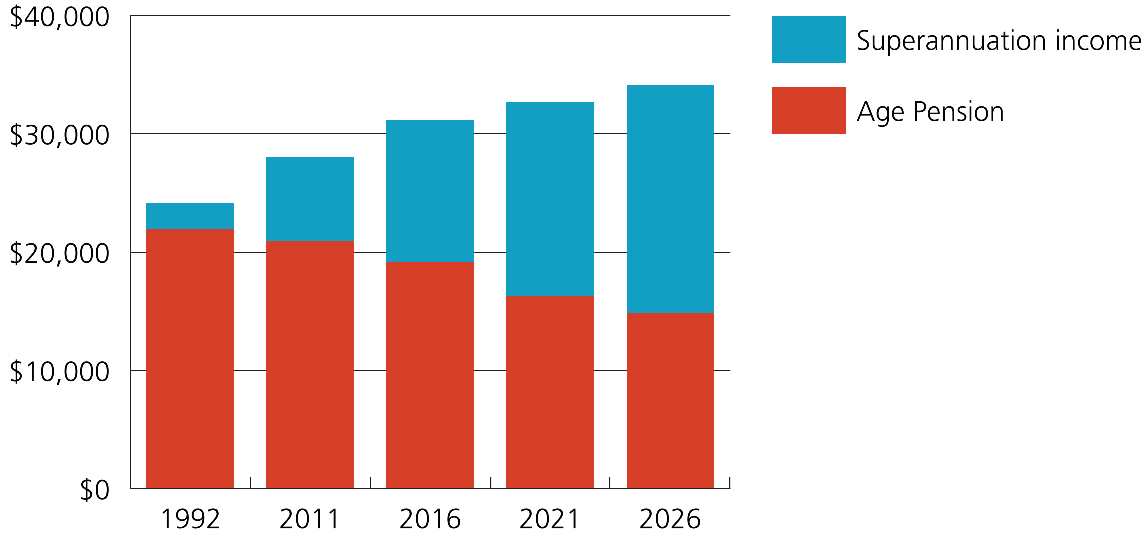
2.1. Delivering better retirement incomes

Today, superannuation is boosting incomes and providing a lifestyle in retirement that is better than that which can be sustained on the Age Pension alone.

These benefits are likely to be even greater in the future as the system matures and more people have the benefit of savings sustained over a number of years. As indicated in Chart 1 below, we project this will increase average retirement incomes substantially over the years ahead.

In addition, while an individual with the current average amount of superannuation will receive a substantial part Age Pension, for a person retiring in the year 2026 with the average amount of super, the majority of their retirement income will come from superannuation. In today's dollars, the projected amounts are $14,770 a year from the Age Pension and $19,340 from superannuation.

Chart 1: Average retirement income at Age Pension qualifying age (in today's dollars)



Source: ASFA Research Centre based on Rice Warner forecasts.

2.2. Increasing national savings

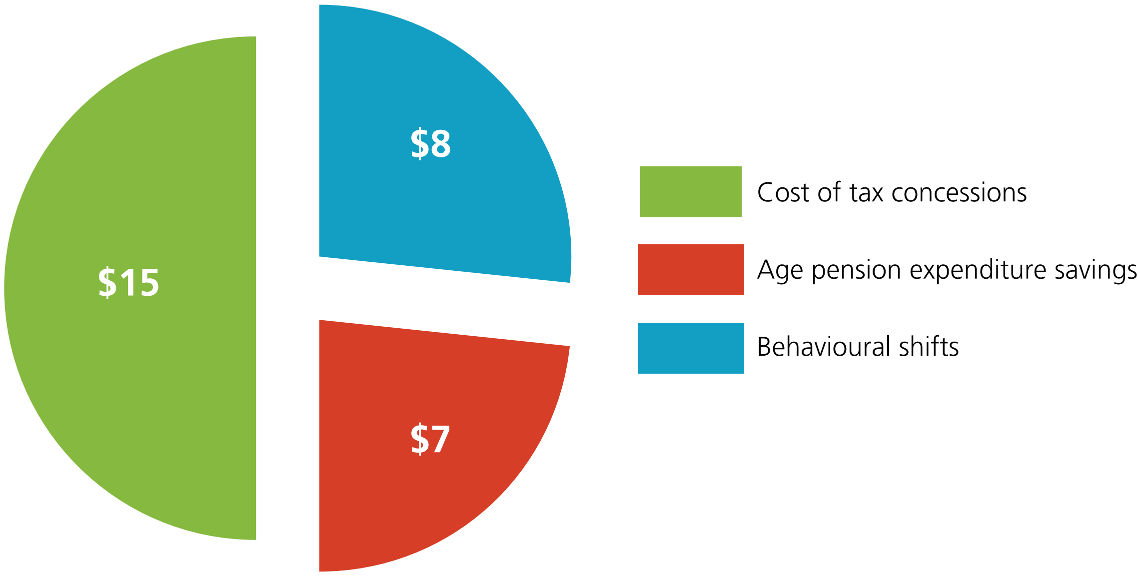
Superannuation has substantially increased national savings, and will continue to do so over the years ahead. Recent Treasury figures indicate that compulsory superannuation increased national savings by about 2 per cent in 2010/11, with this forecast to rise to around 3.5 per cent over the next few decades.

2.3. Decreasing expenditure on the age pension

Estimates previously prepared by the ASFA Research Centre indicate that more than $7 billion a year is already cut from the Age Pension bill due to individuals having superannuation savings. This includes:

- Around $3 billion savings annually from around 160,000 people with super balances sufficient to take them completely outside the Age Pension system.
- Around $3 billion savings from around 500,000 people receiving around $5,000 a year from the Age Pension due to the income test on superannuation income streams.
- Over $1 billion savings from around 150,000 people no longer receiving a part Age Pension because of the income test.

Chart 2: The real cost of tax concessions $billion



Source: ASFA Research Centre.

Commentators frequently use the figure of $30 billion (or more) when quoting the cost of superannuation tax concessions. The $30 billion figure refers to 2011/2012. Chart 2 highlights the real cost of superannuation tax concessions when you take into account the savings in expenditure on the Age Pension as a result of super and also the fact that people would shift funds out of their super into other favourably taxed vehicles, if the super tax concessions are removed. Using an alternative conceptual base for calculating tax expenditures, such as the expenditure tax base explored by the Treasury in the 2013 Tax Expenditure Statement, also decreases the estimated tax expenditure by a substantial amount.

Going forward, the amounts related to Age Pension savings and behavioural shifts will increase as both the aggregate amount in superannuation increases and as balances at the time of retirement increase. Given that contributions only reached 9 per cent in 2002 and are still some years away from reaching 12 per cent of wages, it will be some decades before the system fully matures with most retiring people having the benefit of contributions over an extended period of at least 9 per cent.

Many current retirees have never had the benefit of compulsory superannuation contributions, so it would be unrealistic to expect that people who retired 20 to 30 years ago will be less reliant on the Age Pension due to compulsory superannuation. However, the impact on younger retirees is already significant. Figures on the take-up of the Age Pension by specific age groups indicate that a substantial proportion of those currently aged 65 to 67 are fully self-funded. Around 32 per cent of those aged 65 in 2013 were fully self-funded in retirement, up from 22 per cent in 2000. However, at age 75, only 16 per cent of people were self-funded, not much different to the level in 2000.

Projecting forward, the proportion of persons newly turning 66.5 in 2023 who are self-funded is projected by the ASFA Research Centre to be around 40 per cent. This reflects projected increases in average retirement savings balances. Of course, the overall proportion of retirees who are self-funded will be much lower than this given the lower percentages of self-funded retirees in older age groups.

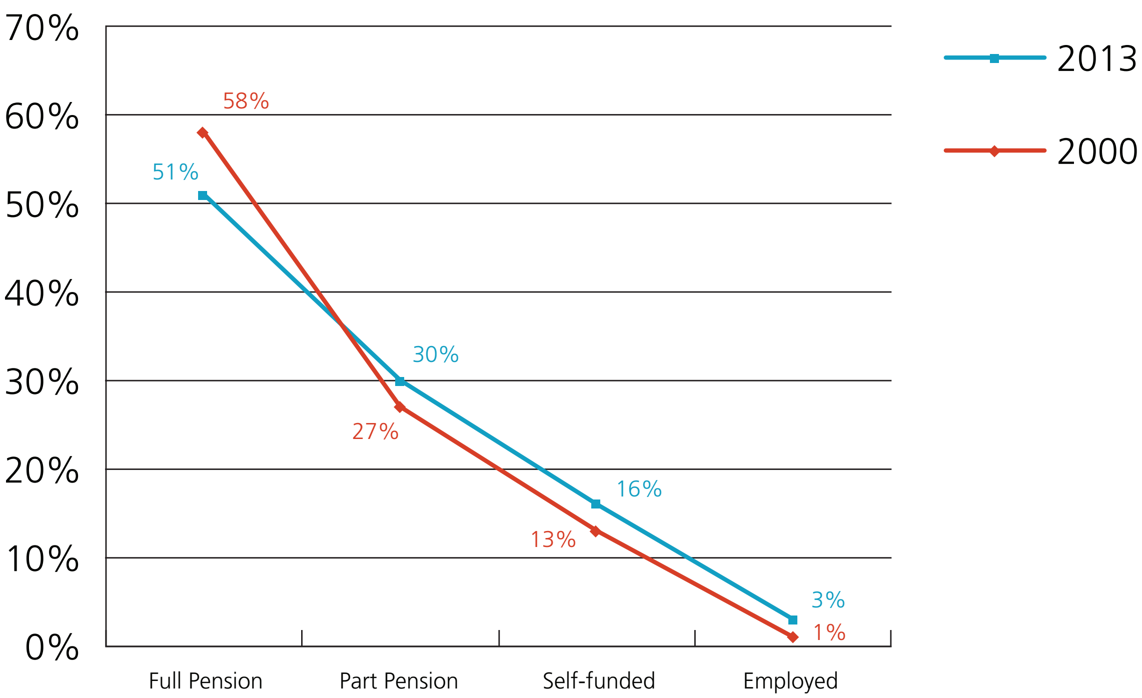
These various numbers are somewhat different from some of the projections in the last Intergenerational Report (IGR) prepared by the Australian Treasury. There are a number of reasons for that. The last IGR was prepared in 2010, prior to the announced increase in the rate of compulsory contributions and just after the global financial crisis (GFC), which led to lower account balances for many individuals. It also was prepared before there were increases recorded in both the percentage of fully self-funded 65-year-old retires and higher rates of employment for those aged around 65. Finally, most of its projections related to the circumstances of all persons aged 65 and over. What is more relevant is the impact on those who have received the benefit of compulsory contributions over an extended period of time.

Charts 3 and 4 provide further details.

Chart 3: Retirees at age 65

Source: Department of Social Services and ASFA Research Centre.

Chart 4: Retirees at age 75



Source: Department of Social Services and ASFA Research Centre.

Equity is a key issue in the debate about superannuation and retirement income reform. There is strong government and community concern that the assistance provided to retirement income should be spread fairly and according to need. There also is a strong tradition in Australia of support for a 'fair go'. In the context of superannuation, this means that no groups should face barriers to participation in the retirement income system.

3.1. Contribution caps are working – they have reduced the concessional contributions made by upper-income earners

Changes in the tax provisions relating to superannuation are beginning to have a significant impact in terms of limiting the tax concessions available to those on high incomes and/or making large contributions.

Individuals in the top tax bracket received around 13 per cent of the tax concessions applied to superannuation contributions in 2011/12, down from 15 per cent in 2009/10.

Concessional contributions include:

- employer contributions (including contributions made under a salary sacrifice arrangement)
- personal contributions claimed as a tax deduction by a self-employed person.

Concessional contributions subject to the 15 per cent tax rate are limited by the concessional contribution cap.

Contribution caps have changed several times over the past decade. In 2005/06, a maximum employer- based deductible contribution limit of $100,587 applied for each employee aged 50 and over and for the self-employed aged 50 and over. For those aged 35 to 49, the figure was $40,560 a year.

In 2006 new rules were introduced. The general cap was $25,000 per annum (indexed and rounded down to the nearest $5,000) for a number of years. From 1 July 2013, a transitional higher cap of $35,000 applied to individuals aged 60 and over. This cap was extended to individuals aged 50 and over from 1 July 2014. The transitional arrangements in which persons aged 50 and over were subject to a $50,000 per annum cap ended on 1 July 2012. Prior to 1 July 2009, individuals could receive concessional taxation treatment on up to $50,000 ($100,000 for persons 50 and over) of concessional contributions.

The general concessional contributions cap has risen as a result of indexation to $30,000 in 2014/15. The transitional caps for older Australians will converge with the general cap when it reaches $35,000 at some point in the future.

From 1 July 2012, individuals with income greater than $300,000 have the tax concession on their contributions, including notional employer contributions, reduced from 30 per cent to 15 per cent (excluding the Medicare levy).

These various changes that have been made to the superannuation tax rules also appear to have impacted on people's confidence in contributing to superannuation, thereby leading to lower discretionary contributions.

3.2. Superannuation contributions are not spread evenly across all taxpayers or income ranges

Table 1 sets out estimates of the proportion of concessional superannuation contributions made on behalf of wage earners in the various marginal income tax bands applying in 2011/12.

Table 1: Concessional contributions by income range: 2011/12[1]

Taxable income range ($)	Marginal income tax rate	Percentage of contributors	Contributions $m	Percentage of contributions
0 - 6,000	0%	5.4	405	0.7
6,001 - 37,000	15%	31.5	8,280	13.9
37,001 - 80,000	30%	42.7	25,254	42.5
80,001 - 180,000	38%	18.0	19,615	33.0
180,001+	47%	2.4	5,864	9.9

Source: ATO and ASFA Research Centre.

Those taxpayers on very low incomes are not receiving superannuation contributions or are receiving the benefit of only relatively small contribution amounts.

However, individuals on a low income in any given year will not necessarily be on a low taxable income for all of their life. Many individuals who have low taxable incomes from employment are undertaking part-time employment while they are studying or while they also have family responsibilities that prevent them from undertaking full-time work. Over their lifetime, they will have many years, usually decades, of full-time work. As well, wages often increase in real terms over the course of a career. As a result, the distribution of taxable incomes and tax concessions for superannuation contributions in any given year is not a good indicator of assistance delivered over a lifetime.

3.3. The bulk of employer contributions go to middle and low-income earners

In regard to a single year, as indicated by Table 1, around 90 per cent of employer contributions relate to individuals paying less than the top marginal tax rate, with around 57 per cent of contributions relating to individuals paying a marginal income tax rate of 30 per cent or less.

3.4. Seventy five per cent of tax concessions for contributions flow to middle-income earners

Table 2 indicates that the bulk (nearly 75 per cent) of government assistance for superannuation contributions flows to those paying either the 30 per cent or 38 per cent tax rates. Such taxpayers make up a very large part of the full-time work force in Australia.

Around 13 per cent of the government assistance for superannuation contributions flows to those on the top marginal rate. This same group of taxpayers account for around 30 per cent of aggregate personal income tax collections. While upper income earners do receive assistance for their superannuation contributions, the overall personal tax system imposes a substantially higher tax burden on upper-income earners compared to those on lower incomes.

For those paying the top marginal tax rate, the achievement of significant savings in the form of superannuation has the potential to make them totally self-funded in retirement with no reliance on the Age Pension. Section 3 provides further details.

1 These estimates are based on Australian Taxation Office (ATO) data on concessional contributions (both employer and those made by the self-employed) by taxable income range. This is the latest available data given that information for the 2012/13 financial year is only available after a lag as individuals lodge their tax returns over an extended period of time and then the ATO has to analyse and publish the data.

The estimates in this paper are meaningful for comparing the share of superannuation tax concessions received by those in various income bands. They do not indicate the tax revenue that would be obtained if superannuation contributions or investment earnings were taxed at normal marginal personal tax rates.

The additional revenue from such a change would be much lower because a proportion of contributions would shift to other tax-preferred forms of savings and the amount in superannuation assets would be lower, leading to lower investment earnings.

Table 2: Tax concessions on contributions by income range: 2011/12[2]

Taxable income range ($)	Marginal income tax rate	Value of tax concession(a) $million	% of total tax concession for contributions	% of total tax concession for contributions if no LISC or Co-contribution
0 - 6,000	0%	261	2.0	-0.5
6,001 - 37,000	15%	1,575	11.8	1.2
37,001 - 80,000	30%	5,024	37.6	42.3
80,001 - 180,000	38%	4,736	35.4	41.5
180,001+	47%	1,767	13.2	15.5
All		13,362	100.0	100.0

(a) Takes into account the Medicare levy, the phasing out of the Low Income Tax Offset, and the phasing in of the Medicare liability. Also takes into account the payment of the Low Incomes Superannuation Contribution and the Superannuation Co-Contribution

Source: ATO and ASFA Research Centre.

3.5. Maintaining the LISC is important to maintain equity for low-income earners

Table 2 indicates the significance of the Low Income Superannuation Contribution (LISC) and the Super Co-contribution in providing assistance to lower-income earners. Without these measures, those on incomes below $37,000 a year would receive little or no tax concession in regard to their superannuation contributions.

At the other end of the spectrum, if the higher tax applying to contributions made on behalf of those on incomes of more than $300,000 per year had applied in 2011/12, it would have reduced the tax concession flowing to those on the top marginal tax rate to around $1,400 million and reduced the share of tax concessions flowing to such contributions from 13 per cent of the total to 11 per cent.

3.6. Tax concessions on the investment earnings of account balances flow predominantly to middle and higher-income earners as a result of their higher balances

Tax concessions on investment earnings associated with account balances are spread over a larger group than just wage and salary earners, and self-employed people, as they also relate to those not currently in the paid labour force, including the retired, the unemployed, and those taking a break from employment.

Around 30 per cent of superannuation assets relate to individuals who are taking an income stream from superannuation. While a zero tax rate applies to the investment earnings supporting a complying income stream, most recipients of such income streams are on a low average personal tax rate in any event due to the existence of the general personal tax threshold in conjunction with the Senior Australians Tax Offset. A significant number of recipients are also aged under 60 and pay tax on their superannuation income stream at personal marginal tax rates, less a 15 per cent tax rebate.

However, there are some individuals receiving a superannuation income stream who are on a higher personal tax rate, or would be if income from superannuation received at age 60 and over from a taxed fund formed part of personal taxable income. This includes individuals who are still working and making use of a Transition to Retirement (TTR) pension.

2 The table provides estimates of the amount of tax concession by personal income tax rate and factors in the receipt of the co-contribution, which is only available to low-income earners making personal contributions, and the LISC, which is payable in regard to those receiving the benefit of concessional contributions and who are on incomes of less than $37,000 a year.

Some individuals have very large superannuation balances. Between May 2006 and 30 June 2007, it was possible to contribute up to $1 million in un-deducted contributions into superannuation as part of transitional arrangements put in place by the Howard Government, which resulted in significant contributions being made during that period. Clearly, the current contribution caps are much tighter and this will significantly limit an individual's ability to accumulate such large superannuation balances.

Self-managed super funds (SMSFs) were a major destination for large contributions in the 2006 to 2007 period, with over $56 billion in such member contributions made during 2006/07. This was much higher than the trend level of member contributions of around $10 billion or $11 billion a year. For funds regulated by the Australian Prudential Regulation Authority (APRA), the increase was from $33.3 billion to $95.2 billion.

There also are examples of individuals with very high superannuation balances (in excess of $30 million), which are the result of the transfer of assets (including business assets) into mostly SMSFs prior to the introduction of non-concessional contribution caps.

In addition, there also are individuals earning higher incomes and with relatively high account balances who are making use of TTR pensions. The investment earnings related to the assets backing such pensions are subject to a zero rate of tax.

Table 3: Tax concessions on investment earnings by income range: 2011/12[3]

Taxable income range ($)	Marginal income tax rate	Value of tax concession accumulation (a) $billion	Value of tax concession for pension phase $billion	Value of total tax concession on investment earnings $billion
0 - 6,000	0%	0.0	0.0	0.0
6,001 - 37,000	15%	0.1	2.0	2.1
37,001 - 80,000	30%	4.3	1.4	5.7
80,001 - 180,000	38%	5.2	1.1	6.3
180,001+	47%	2.9	0.4	3.3
All		12.6	4.8	17.4

Source: ABS and ASFA Research Centre.

3.7. Tax concessions for investment earnings during the accumulation stage are less evenly distributed by income level than is the case for contributions

Table 4 takes into account each of the contribution, accumulation and pension stages of superannuation to provide the distribution of tax concessions at each stage.

3 This table takes into account the Medicare levy, the phasing out of the Low Income Tax Offset, and the phasing in of the Medicare liability. Based on investment earnings of 7 per cent and distribution of balances by income level as indicated by the ABS Survey of Income and Housing.

Table 4: Share of tax concessions at contribution, accumulation and pension stages: 2011/12

Taxable income range ($)	Marginal income tax rate	Percentage share of tax concession for contributions	Percentage share of tax concession for investment earnings during accumulation	Percentage share of tax concession for investment earnings during pension phase
0 - 6,000	0%	2.0	-0.4	0
6,001 - 37,000	15%	11.8	0.8	41.4
37,001 - 80,000	30%	37.6	34.6	28.5
80,001 - 180,000	38%	35.4	41.7	22.4
180,001+	47%	13.2	23.3	7.7
All		100.0	100.0	100

Source: ABS and ASFA Research Centre.

Even though much policy attention has been given to the tax concessions relating to contributions, the table indicates that tax concessions for investment earnings during the accumulation stage are less evenly distributed by income level than is the case for contributions.

During the pension phase, a much larger share of the tax concession goes to lower-income earners, reflecting the fact that most retirees have much lower incomes than people in paid employment.

However, there are some outliers, with tax concessions being provided to those with relatively high taxable incomes, or at least what would be relatively high taxable incomes if all superannuation income was included in taxable income.

4. Conclusion

When evaluated against the objectives under which it was established, it's clear that the superannuation system is successfully raising retirement incomes, increasing national savings and decreasing government expenditure on the Age Pension. Over the coming years, the system will need to be adjusted to accommodate the demands posed by an ageing population and reducing tax base, however it's important that these decisions be made based on accurate information.

This report shows that the tax concessions applied to concessional superannuation contributions are not significantly skewed towards high-income earners, and, in fact, support the bulk of the working community to save for their retirement.

The current annual and three-year bring-forward caps applied to non-concessional contributions allow individuals to accumulate very high balances. A better policy outcome in relation to such contributions could be the introduction of a lifetime cap. This would ensure that superannuation is used to provide income in retirement and is not used for wealth accumulation or estate planning purposes.

When it comes to the tax concessions applied to superannuation investment earnings, a disproportionate amount flows to higher-income earners. One way to manage this is to remove the concessional tax treatment for very high superannuation balances, for example those in excess of $2.5 million. This is an area where government policy could be adjusted in order to ensure the distribution of tax concessions is more equitable.

These estimates are based on ATO data related to concessional contributions (both employer and those made by the self-employed) by taxable income range. This is the latest available data, given that information for the 2012/13 financial year is only available after a lag as individuals lodge their tax returns over an extended period of time and then the ATO has to analyse and publish the various data. Estimates of the tax concession on investment earnings by income level are derived from ABS data on average superannuation balance by income level.

The estimates in this paper are meaningful for comparing the share of superannuation tax concessions received by people in various income bands. They do not indicate the tax revenue that would be obtained if superannuation contributions or investment earnings were taxed at normal marginal personal tax rates.

The additional revenue from such a change would be much lower because a proportion of contributions would shift to other tax preferred forms of savings and the amount in superannuation assets would be lower, leading to lower investment earnings.