Mythbusting superannuation tax concessions

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Given the ongoing public debate and discussions between the government and key stakeholders on a broad range of possible tax reforms, including in regards to superannuation tax concessions, it is crucial that conversation and decision-making take place in the context of accurate information.

Australia faces an ageing population with escalating pension, health and aged-care expenditure. Governments will face challenges in setting a tax framework policy that will help accommodate the costs of supporting older generations throughout their retirement years. An informed debate will allow the government and community stakeholders to reach a consensus on ways to adjust the current superannuation system, to ensure it remains sustainable and equitable.

While this debate is both welcome and necessary, it is important that discussions are based on, and decisions are made in, the context of accurate information, and not based on some of the myths that are perpetuated by inaccurate data, dubious analysis or assertions not backed by evidence.

In this context, this paper busts some of the key myths regarding superannuation tax concessions.

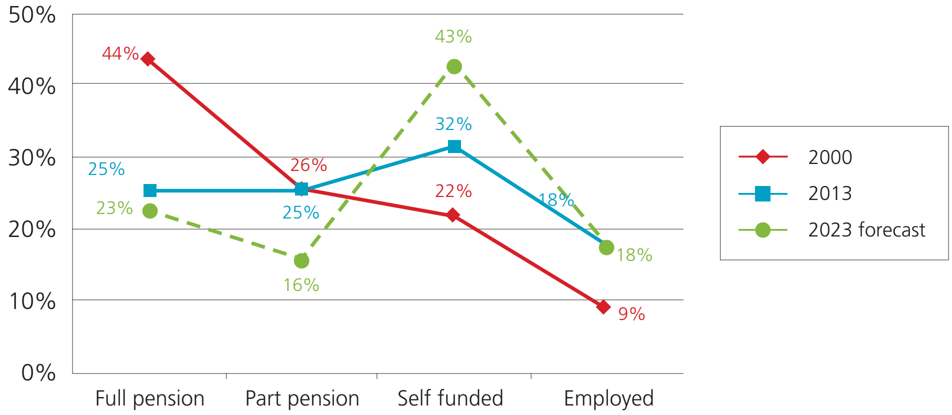
MYTH: Superannuation is not helping reduce the government's spending on the Age Pension

FACT: Super saves the government $7 billion in Age Pension expenditure annually, and these savings will only increase as the system matures

Superannuation is boosting incomes and providing a lifestyle in retirement that is better than that which can be sustained on the Age Pension alone. Around 32 per cent of those aged 65 in 2013 were fully self-funded in retirement, up from 22 per cent in 2000. We project this number will rise to 43 per cent by 2023. The Intergenerational Report (IGR) released earlier this year acknowledges that reliance of younger retirees on the full Age Pension is dropping. However, the figures published do not show the reliance on the Age Pension falling as much as the numbers in chart below. This is because the IGR looks at all retirees (not just those turning 65). The tightening of the asset test that will apply from 1 January 2017 will also reduce the percentage of retirees receiving the Age Pension.

One of the challenges still facing the system is ensuring retirees have adequate superannuation in retirement, particularly in the later years of their retirement. Reforms such as increasing the Superannuation Guarantee (SG) from 9.5 to 12 per cent and the development of longevity products (reflecting that we are living longer) will further reduce pressure on the Age Pension.

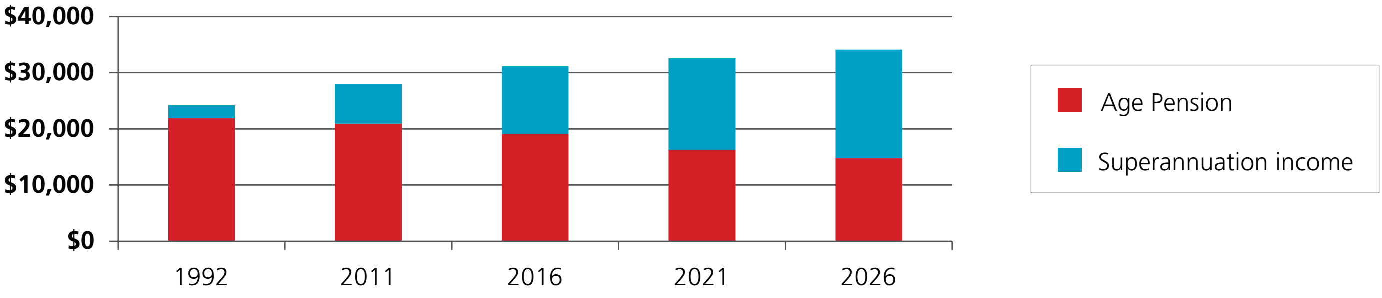
Retirees at Age Pension eligibility age



Source: ASFA Research Centre, 2015.

As shown by the following chart, over time the average retiree at the time of retirement will receive a lower Age Pension due to the projected increase in superannuation account balances.

Average retirement income at Age Pension eligibility age (in today's dollars)



More than $7 billion a year is already cut from the Age Pension bill due to individuals having superannuation savings. This includes:

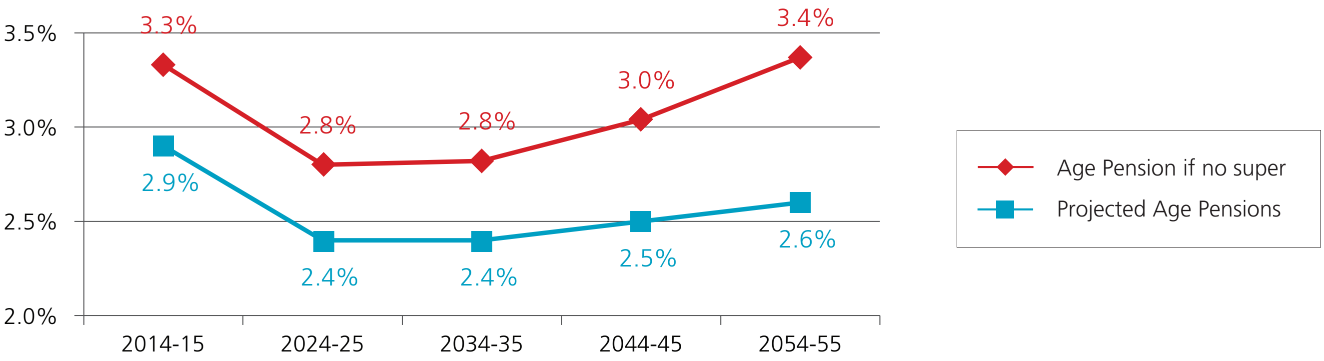
- around $3 billion in savings annually from around 160,000 people with super balances sufficient to be fully self-funded
- around $3 billion in savings from around 500,000 people receiving around $5,000 on average a year less from the Age Pension due to the income test on superannuation income streams
- over $1 billion in savings from around 150,000 people, including many in defined benefit schemes, no longer receiving a part Age Pension because of the income test.

These amounts will increase in the years ahead as more Australians retire with substantial superannuation balances.

Based on the 2015 *Intergenerational Report* ASFA projects that expenditure on the Age Pension will fall from 2.9 per cent to 2.6 per cent of GDP over the period to 2054/2055. Australia's ageing population will increase the cost of the Age Pension. However, superannuation is not yet a mature system, as many people retiring have not had the advantage of a full working life of compulsory superannuation payments. As the system matures, more retirees will have larger balances and private incomes. Through the operation of the means test, this reduces Age Pension costs.

As well, the Age Pension eligibility age is increasing to 67 and the means test has been progressively tightened, with a further substantial tightening scheduled to come into effect in 2017.

Age Pension expenditure as a percentage of GDP



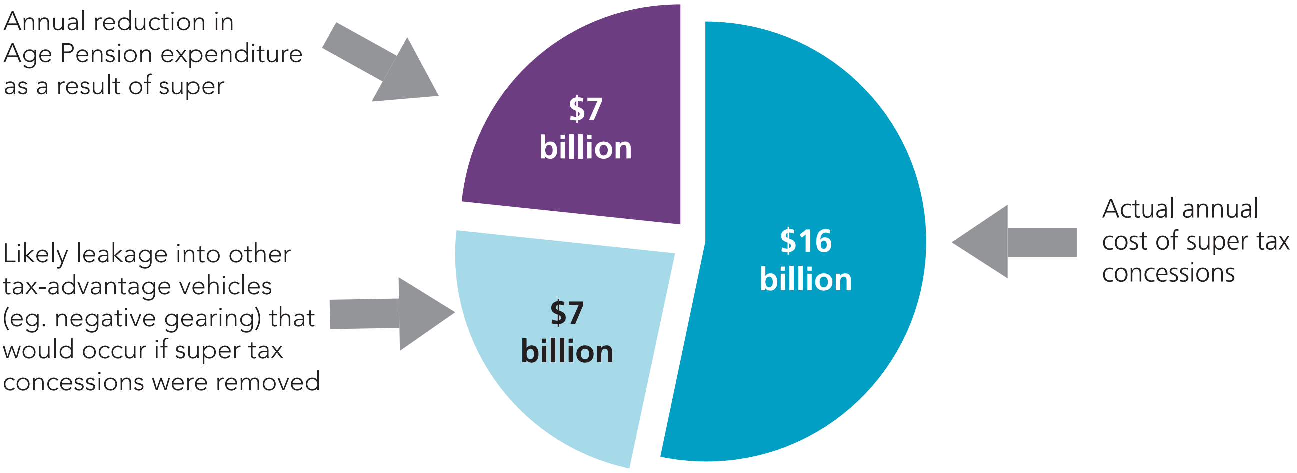
Without superannuation Age Pension expenditures are estimated to be 30 per cent higher.

As a result, Australia both currently and in prospect, has some of the lowest expenditures (in terms of percentage of GDP) for government income payments to the aged in the world. This includes countries across both the developed and developing world. Some European countries already have four times the level of Australian expenditure with this projected to rise further.

MYTH: Superannuation tax concessions cost the budget $30 billion annually—more than the total spending on the Age Pension

FACT: The actual cost of tax concessions is around $16 billion a year

When you take into account the savings the government makes on the Age Pension as a result of super, and the impact of behavioural change (people shifting money from one tax-effective vehicle to another) that would occur if super tax concessions were removed, a more accurate estimate would be around $16 billion a year. This is shown in the diagram below.



MYTH: The cost of superannuation tax concessions will not be sustainable in the decades ahead as the population ages

FACT: Both the cost of the Age Pension and of the tax expenditures are affordable and sustainable

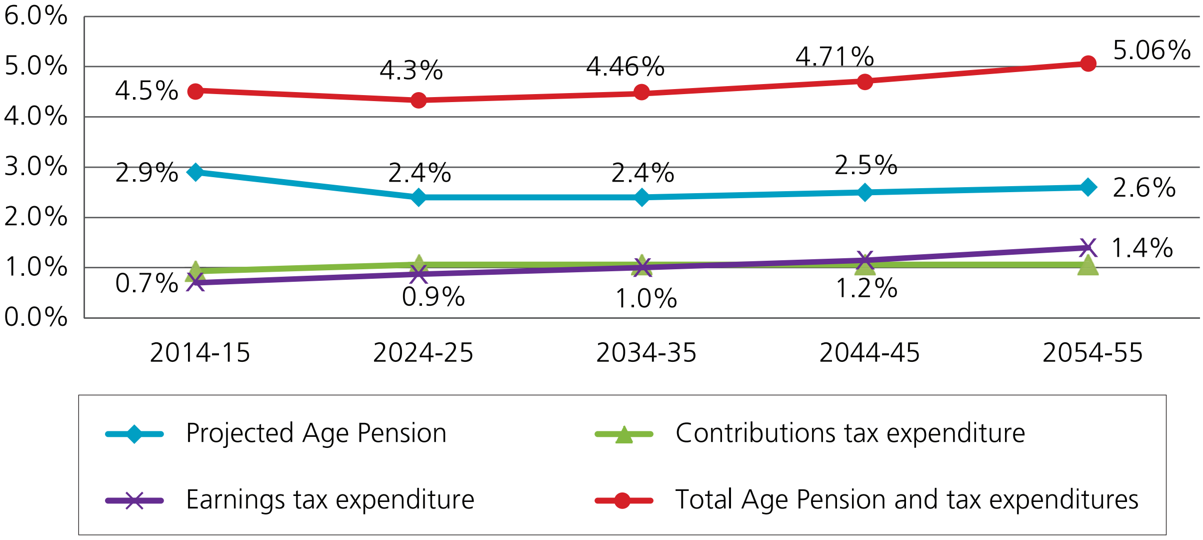
ASFA analysis also indicates that the cost of tax expenditures for superannuation will be sustainable going forward, peaking at about 2.5 per cent of GDP in 2054/2055.

Contribution caps are working, as is the additional tax charged on contributions made by individuals with income of $300,000 or more a year. This leads to the cost of tax concessions for superannuation contributions remaining stable at around 1 per cent of GDP once the SG rate reaches 12 per cent. Compulsory (SG) contributions make up the great bulk of concessionally taxed contributions.

As the superannuation asset pool increases the aggregate value of the tax concessions on investment earnings will increase. More assets will be totally tax free as they will back complying retirement incomes, but there will be a smaller proportion of assets in very high account balances due to long term impact of contribution caps.

The total cost of expenditure on the Age Pension and on tax concessions for superannuation are projected to rise, but only from 4.5 per cent of GDP to around 5.1 per cent of GDP. Assistance for retirement incomes is affordable now and in the future.

Projected Age Pension and tax expenditures on superannuation as a percentage of GDP



The real challenges for government are in controlling future health and aged care expenses. Health care expenses paid for by the Australian government are projected to rise from 4.2 per cent of GDP to 5.7 per cent. Much of this growth is driven by supply side factors, such as the cost of new drugs and the charges made by health care professionals and facilities.

Aged care expenditure by the government is projected to rise from 0.9 per cent of GDP to 1.7 per cent of GDP. As with health care expenses, what is needed is the ability of retirees to make greater contributions to their cost. Reducing the income of retirees is not a policy formula that would address the real future challenges for government in terms of budget expenditure.

MYTH: The majority of government support for retirement goes to high-income earners

FACT: Financial assistance for retirement provided by the government is broadly comparable across the personal income tax brackets

All Australians receive financial support for their retirement from the government through either the Age Pension, tax concessions to fund their own retirement through superannuation, or a combination of both. When both of these forms of assistance are summed across a lifetime, all Australians receive around $300,000 across all tax brackets as a contribution by the government to their retirement. The main difference for individuals is in the timing and vehicle through which it is delivered. For example, the full Age Pension for a single person is currently $22,542 a year, while tax concessions for superannuation are generally for smaller annual amounts spread over a number of years. That is, everyone receives the same amount of assistance from the government – the only difference is the timing and vehicle through which it is delivered.

A lower-income person will receive this mostly in the form of the Age Pension, concessionally-taxed contributions and the low income superannuation contribution (while it still remains in place), while a person in the top income tax bracket will receive it as tax concessions for super. Many will receive a combination of all of these.

What's more, the amount of government assistance provided to individuals on very high income levels has been substantially reduced though lower caps for tax concessional contributions to super.

MYTH: The bulk of tax concessions for superannuation contributions go to high-income earners

FACT: The bulk of tax concessions for superannuation concessional contributions go to middle-income earners

Tax concessions applied to superannuation concessional contributions are not significantly skewed towards high-income earners, and, in fact, support the bulk of the working community to save for their retirement. ASFA analysis of data from 2011/12 found that around 75 per cent of the tax concessions applied to contributions went to those paying either of the (then) middle income marginal tax rates of 30 per cent or 38 per cent: those earning between $37,000 and $180,000 a year.

		Share of tax concessions (%)		
Taxable income range ($)	Share of total contributions (%)	Contributions	Investment earnings – accumulation phase	Investment earnings – pension phase
0 – 6,000	1	2	-0.4	0
6,001 – 37,000	14	12	1	41
37,001 – 80,000	43	38	35	29
80,001 – 180,000	33	35	42	22
180,000+	10	13	23	8

This shows that the contribution caps, which have been lowered substantially over the past few years, are working to reduce the concessional contributions made by upper-income earners, while continuing to provide support to the majority of Australians to help them save for their retirement.

However, some individuals have accumulated relatively high superannuation balances through contributions and transfers made before the contribution caps came into effect. ASFA has recommended that the tax treatment of very high superannuation account balances, in particular those in excess of $2.5 million that are in the pension phase, should be the starting point for discussions around ensuring the future equity and sustainability of the system.

MYTH: The most important tax concessions received by high-income earners relate to superannuation

FACT: High-income earners get the most benefit from concessional capital gains tax treatment, negative gearing and exemptions for the family home

The bulk of the wealth of high-net-worth individuals is in the form of shareholdings or property, both residential investment properties and commercial real estate. Around $360 billion in total is held in superannuation by those with more than $1 million in super. This is just over 20 per cent of the $1.6 trillion investable assets held by high-net-worth individuals.

For most high-net-worth individuals, tax arrangements relating to capital gains, negative gearing and the family home are likely to have more impact on the achievement and maintenance of wealth than superannuation tax concessions.

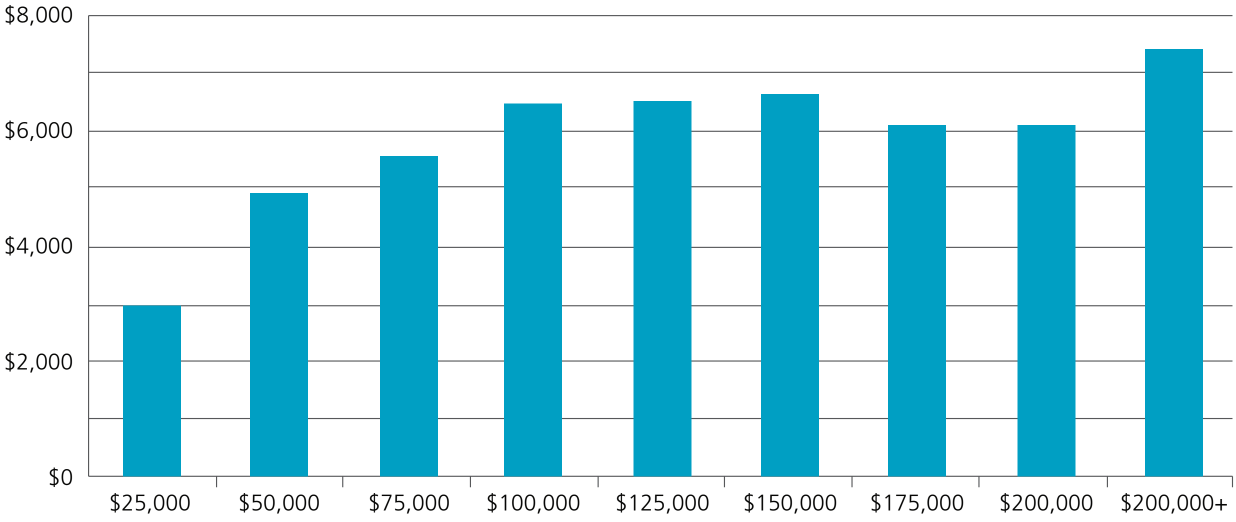
MYTH: Only high-income earners make salary sacrifice contributions

FACT: Many middle-income individuals make salary sacrifice contributions

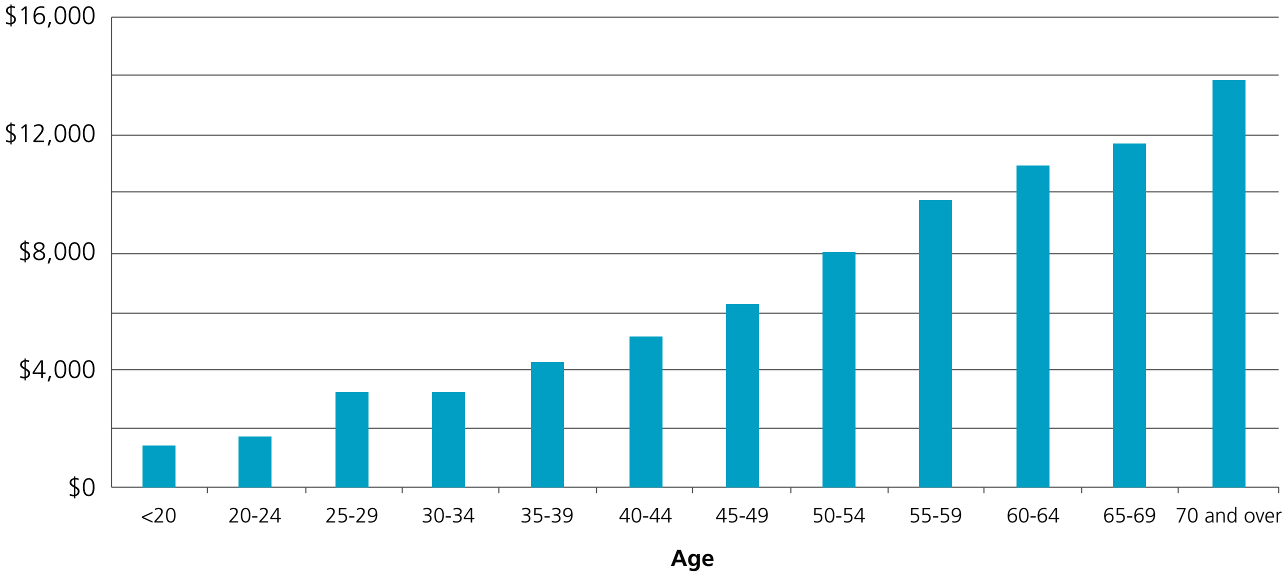
Only around 35 per cent of employees with incomes above $150,000 a year make salary sacrifice contributions. Around 85 per cent of salary sacrifice contributions relate to employees with incomes below $150,000 a year. Over half a million Australians earning between $40,000 and $80,000 a year make salary sacrifice contributions.

The amount of salary sacrifice contributions people make are much more related to their age than their taxable income, as shown by the following two charts. The average figures relate to those who make additional contributions.

Average additional contributions, by total income



Average additional contributions, by age



MYTH: Most people take a lump sum from their super when they retire, spend it all on a big holiday or to pay off debt, then end up on the Age Pension

FACT: The majority of superannuation assets end up in income-stream products when people retire

There is no evidence that the majority of retirees are using their super to pay off debt or using a lump sum to fund the purchase of boats, cars and overseas trips before going on the full Age Pension.

In fact, only a minority of households have debt around the time of retirement (only 18 per cent of 65-69 year olds, falling to 6 per cent for those 70 plus), and even then, they generally have assets outside super which they can use to pay it off.

The vast majority of Australians are very sensible with what they do with their retirement savings. The great bulk of larger balances are retained in the superannuation system in order to generate ongoing income in retirement. In 2013/14, around $46 billion in superannuation assets were invested in phased drawdown income-stream products, compared to just $9 billion taken as lump sums. many individuals taking a lump sum also establish an income stream with only around $5 billion taken as a full lump sum payment of superannuation savings.

MYTH: Compulsory superannuation has not increased household or national savings

FACT: National and household savings have been substantially lifted by compulsory super

The household savings rate has increased by around five percentage points from five per cent in 1992, when compulsory superannuation was first introduced, to around ten per cent in 2013/14. Some analysts have concluded that the household savings rate would only be two per cent in the absence of compulsory superannuation, as other developments have been driving the household savings rate down.

While there has been some offsetting reduction in voluntary savings because of compulsory superannuation, especially by higher-income earners, compulsory super currently is injecting an additional amount in excess of $35 billion a year into household savings, or 50 per cent of the total SG contributions flowing into superannuation.

MYTH: Government funds spent on superannuation tax concessions would be better directed at helping other areas of the economy

FACT: Superannuation provides broad economic benefits that are the foundation for growth and prosperity

Superannuation plays, and will continue to play, an important role in providing the foundations for economic activity and prosperity. It currently lifts household savings by around two percentage points of GDP or nearly $40 billion a year and, with the increase in the compulsory SG from 9.5 per cent to 12 per cent, this is expected to rise to 2.5 percentage points of GDP. This helps Australian businesses and governments to finance investment and infrastructure without having to rely unduly on foreign savings and investment. Higher levels of domestic savings reduce the cost of capital in Australia, increasing investment by Australian businesses which drives stronger economic growth.

Superannuation benefit payments, including lump sums, pension payments and insurance payouts, also boost domestic demand by over $50 billion a year, a figure which could quadruple by 2040 as more people move into retirement. The ageing population is expected to slow GDP growth, and, without superannuation, this reduction would be much greater. This is because superannuation provides business with the consumers of the future, delivering a boost to the economy which benefits all Australians.

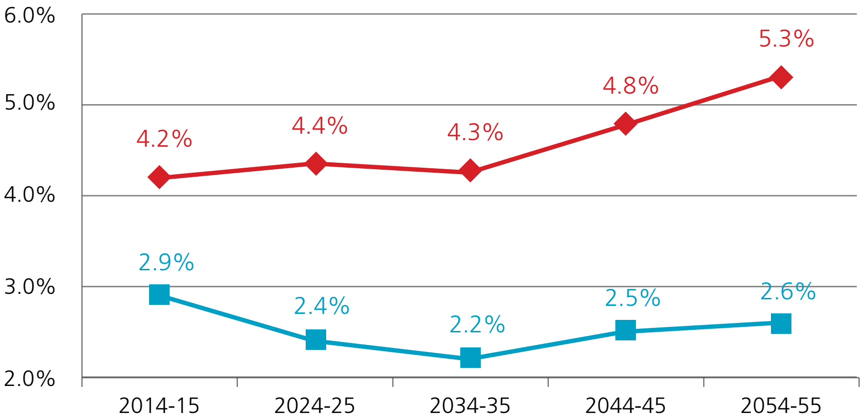
Through their superannuation, all Australians have a stake in the Australian economy through the shares they own indirectly in the superannuation fund.

MYTH: It would be cheaper for the government to pay a universal Age Pension after qualifying age rather than having the current means test for the Age Pension and tax concessions for superannuation

FACT: A universal pension with no means test would substantially increase the cost to government of the Aged Pension

In the absence of the means test, expenditure on the Age Pension would be 4.2 per cent of GDP today rather than the actual 2.9 per cent. By 2054/55 expenditure on the Age Pension under such arrangements would reach 5.3 per cent of GDP, a massive increase.

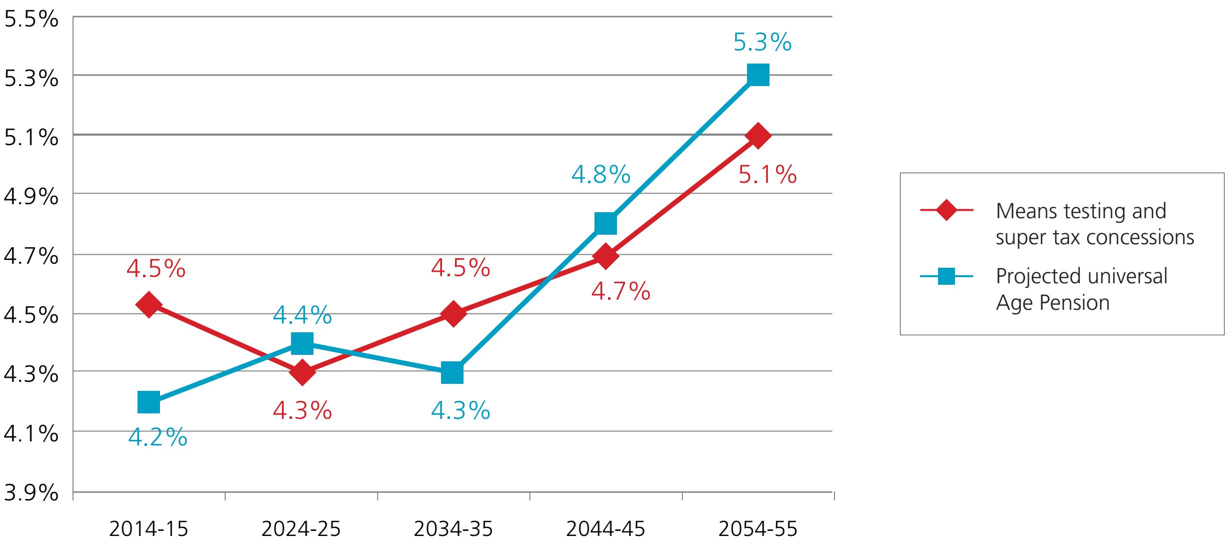
Age Pension expenditure as a percentage of GDP



Both the adequacy of retirement incomes and the equity of government assistance would be adversely affected. Low to middle income earners would not receive any additional Age Pension but would retire with a much lower superannuation balance and a lower private retirement income. On the other hand, relatively wealthy retirees would receive an unexpected and unneeded bonus of the full Age Pension for the rest of their life.

It also would be more expensive in the long run than the projected total government expenditure on a means tested Age Pension and tax concessions for superannuation, as shown in the following chart.

Universal Age Pension versus means tested Age Pension and super tax concessions as a percentage of GDP



Finally, it would not be possible to immediately move to taxing superannuation contributions and investment earnings at personal marginal rates. Among other things, this would create considerable inequities between those who previously benefited from superannuation tax concessions and have now retired and those still in the accumulation phase. Awarding a non means tested Age Pension to all existing retirees would involve considerable inter-generational inequities.