Revenue implications of removing the contributions tax and recent developments in the tax attractiveness of superannuation

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Executive Summary

- ASFA is proposing that the government require employees to contribute an extra 1% of salary to superannuation in return for the government matching this by abolishing the current contributions taxes on employer contributions.

- **the impact of removing contributions taxes would be of the order of $2.1 billion if implemented in 2001-02, rising to $2.9 billion in 2002-03**. The cost to tax revenue could be expected to fall in subsequent years given that the increased tax collections from fund earnings would grow faster than what would have been collected if the contributions taxes remained in place.

- tax revenue from the earnings of superannuation funds and the superannuation business of life companies is substantial and growing. Taxes on fund earnings are likely to exceed $3 billion in 2002-03, and if taxation of fund earnings continues could exceed $9 billion by 2015, doubling as a percentage of GDP.

- using the Access Economics methodology for estimating tax expenditures, the overtaxation of superannuation and other retirement benefits has risen from $1,304 million overtaxation in 1996-97 to a projected massive $4,599 million in 2000-01**.**

- on average the personal income tax rate faced by individuals contributing to superannuation will fall from around 40 per cent to 35 per cent which would substantially reduce the tax attractiveness of superannuation contributions. Many superannuation contributions attract contributions and benefits taxes of the order of 29 per cent, and those contributions subject to the surcharge attract tax at even higher rates.

- while contributions to superannuation generally are only marginally advantaged in taxation terms compared to other investment options, investment earnings within a fund can receive substantial tax advantages. For individuals on a marginal income tax rate greater than 29% (the combined earnings and benefits tax rate) it is advantageous for earnings to accumulate within a superannuation environment. It is particularly advantageous for those on the 43.5% and 48.5% rates given that no surcharge tax rate applies to earnings within the fund.

- For individuals on the 18.5% marginal tax rate accumulating earnings with a superannuation fund is marginally attractive in taxation terms provided that the tax free threshold of $100,696 (in 2000-01, indexed to AWOTE) for benefits is not breached.

1. Introduction

Sound policy development requires both appropriate methodology and accurate and relevant data and information. This is particularly so in the case of taxation analysis and reform given the importance of both equity and efficiency considerations in the design of a taxation system.

In addition, the revenue implications of any proposal need to be taken into account. A proposal has to be justified on its own merits and as well be consistent with the overall taxation and spending decisions of government. There is an overall funding target to be met, and less tax in one area implies that more has to be collected elsewhere and/or government spending needs to be curtailed.

That said, there is also a temporal dimension to be considered. Some policy measures provide benefits in the long run in the terms of an enhanced taxation revenue stream, but at the cost of revenue in the short term. Other policy measures bring forward receipt of revenue at the cost of revenue in the longer term. Unfortunately, a number of changes to the taxation of superannuation over the last decade have focussed on the bringing forward of revenue at the cost of the overall efficiency and equity of the system. Such changes have included the introduction of taxation of contributions and fund earnings in 1988 by the then Labor Government, and the introduction of the contributions surcharge in 1996 and the bringing forward of fund tax instalments in 2000-01 by the current government.

ASFA is arguing for a reversal of those practices. Its current proposal to abolish the levying of taxation on contributions received by superannuation funds is a step towards that objective.

This paper presents new ASFA Research Centre research which:

- Quantifies the likely impact on taxation revenue of the removal of taxation on contributions received by superannuation funds.
- Projects the likely long term tax revenue stream from taxation of fund earnings.
- Compares the cost to revenue of such a change with the cost of other initiatives proposed or adopted in recent years.
- Updates previously released Access Economics estimates of the cost of superannuation tax concessions.
- Illustrates the impact on the value of tax concessions for super that has flowed from the reduction in personal income tax rates.
- Examines the equity and efficiency implications of removing taxes on contributions.

2. The short term and long implications for tax revenue of the ASFA proposals

2.1 What ASFA is proposing

In recent research into public opinions conducted for ASFA by Wirthlin Worldwide Australia, very strong support was given to the proposal that "government would require employees or workers (like you) to contribute an EXTRA 1% of your salary to super if in turn the government matched this by abolishing the current 15% taxes on your contributions when they enter the funds".

This proposal was put forward by ASFA given findings in earlier Wirthlin research which underlined the support of the community for compulsory savings, the importance of greater incentives and simplicity, and a concern that government needed to encourage (and provide a partnership) for greater self-reliance in retirement.

In more concrete terms, adoption of the ASFA proposal would:

- Help to simplify the tax arrangements for super by reducing the number of steps involved. This would simplify both the taxation compliance of funds and the accounting arrangements for individual member accounts.
- Improve adequacy by increasing member contributions by one percentage point of salary.
- Lift individual retirement savings on average by around a further two percentage points of salary as a result of the removal of the contributions tax (Superannuation Guarantee contributions currently account for around 75% of total employer contributions, so removal of a 15% tax on contributions would be equivalent to a 20% or so increase in the SG from 9% to 11%).
- Lift compulsory saving through superannuation to the equivalent of 12% of an employee's salary by way of the combined effect of removal of contributions taxes and introduction of compulsory member contributions.
- Benefit all employees receiving the benefit of employer contributions, not just employees covered by the SG.
- Add to national savings without adding to the wages bill or to inflationary pressures.

For someone on $40,000 per annum (which is just over current AWE), a 3% increase in savings would result in an additional lump sum in today's dollars of $55,500 or $2,700 per annum extra in real terms in a pension or annuity over 20 years.

For an individual on AWE a 2% government contribution would boost that individual's savings by around $800 per year. This is equivalent to receiving a $20 a week pay rise, but it would involve no costs to employers and would have no inflationary consequences.

ASFA has not yet specified its proposed date of effect for the removal of the contributions taxes. However, it has used terms such as "down payment on broader review" and "early action to move towards improved adequacy". ASFA has noted that it would be possible to stage the removal of the contributions tax, but on grounds of simplicity doing away with altogether quickly and in one stage has much in its favour. **Accordingly for the purposes of the revenue estimates in this paper it is assumed that the taxes on contributions will be removed in its entirety as from 1 July 2001.** This includes the contributions surcharge for upper income earners.

In any event, most of the estimates of revenue foregone are proportional to the extent that the contributions taxes are removed. However, some costs for funds, such as the costs of additional administration requirements due to the operation of the contributions tax surcharge for upper income earners, are dependent on whether there are contributions taxes or not.

Removal of the standard tax on employer contributions and tax deductible employee contributions would impact on tax collections from the quarter following such removal given the operation of the PAYG instalment system for the income tax obligations of superannuation funds. Given that surcharge collections generally relate to contributions made a year or more earlier, abolition of the surcharge would have a more delayed impact on revenue collections.

2.2 Current taxation revenue from contributions and fund earnings

Taxation revenue derived from the taxation of superannuation fund contributions and earnings is substantial. This was one of the major reasons, rather than any principles of equity or efficiency, that led to the introduction of superannuation fund taxation in 1988.

Table 1 sets out actual tax collections from superannuation funds compared to the forecasts in successive Budget Papers. Collections have tended to run ahead of forecast revenues, in part due to very strong capital gains tax collections from funds. Australian Taxation Office analysis indicates that in 1997-98 around $1.3 billion was paid by superannuation funds in capital gains tax on total capital gains of $8.5 billion. In recent years forecasts have been closer to the mark given that no major downturn in the prices of shares listed on the stock exchange has been assumed.

Table 1 – Taxation revenue derived from superannuation funds

Year	Actual Revenue	Estimated Revenue
	$m	$m
1995-96	1 634	2 150
1996-97	2 595	1 800
1997-98	3 093	2 490
1998-99	3 916(a)	2 950
1999-00	3 893	3 900
2000-01	na	5 175(b)

(a) From 1998-99 revenues include the contributions surcharge

(b) Up to $1 billion of the revenue in 2000-01 is a one-off bringing forward of collections due to the introduction of the new PAYG tax instalment arrangements.

Source: Budget Papers, various years

The bulk of taxes on superannuation contributions and investment earnings are collected from superannuation funds, but just under 20% of superannuation business is conducted within life companies. This revenue is not included in the estimates provided in Table 1 other than in regard to surcharge collections relating to contributions received by life companies.

Taxes on superannuation contributions collected by life companies or transferred to life companies and the associated investment earnings form part of company tax collections. For instance, in 1997-98 life companies had $3.7 billion in taxable contributions and total gross taxable income of $7.1 billion. This compares to $18.5 billion in taxable contributions and gross taxable income of $41.7 billion for superannuation funds established outside life companies.

Table 2 provides ASFA Research Centre estimates of total taxation revenue derived from superannuation funds and life companies.

Table 2 – Total taxation revenue derived from superannuation contributions and investment earnings

Year	From funds	From life cos	Total
	$m	$m	$m
1995-96	1 634	410	2 044
1996-97	2 595	650	3 245
1997-98	3 093	775	3 868
1998-99	3 916	980	4 964
1999-00	3 893	975	4 868
2000-01	5 175	1 290	6 465

Source: 2000-2001 Budget Papers and ASFA Research Centre estimates

Clearly, removal of all taxes on superannuation contributions and earnings would have a significant impact on Commonwealth tax collections if implemented in a single year. However, removal of taxes on contributions would be far more affordable.

Table 3 sets out what would be the impact on tax revenues if contributions no longer formed part of the taxable income of superannuation funds and life companies and the surcharge did not apply to contributions made on behalf of higher income earners.

The loss of revenue estimate is calculated by deducting surcharge collections from total collections derived from funds and the superannuation business of life companies. The resulting figure is then split between contributions and earnings on the basis of the historical split between the taxable contributions and earnings components of fund taxable income as set out in the ATO Taxation Statistics 1997-98. The estimated surcharge collections are then added back on to give an estimate of the aggregate impact of removing contributions taxes.

The estimate for 2002-03 is based on projected growth in employment and earnings and takes into account the increase in the SG from 8% to 9% in that year. Estimates for each year assume a full flow through in the year for the elimination of taxation of employer contributions received by funds. This assumption leads to an overestimate of the cost to revenue in the first year of implementation given that some funds are not assessed and do not pay tax until after the end of an income year. Some income tax payments made by such funds in 2002-03 would relate to contributions made in the previous year.

However, the bulk of superannuation contributions are received by funds which from 1 July 2000 will make PAYG instalments on a quarterly basis related to the fund income in that quarter. In contrast, given that surcharge collections relate to the contributions and employee taxable income in the previous year, it is assumed that abolition of the surcharge on 1 July 2001 would not impact on surcharge collections until 1 July 2002.

Table 3 also provides estimates of the impact of removing contributions taxes on tax collections from superannuation and life company investment earnings and on benefit taxes received by those retiring. Less taken in the form of contributions taxes means that there would be a larger sum generating investment earnings, and lump sums take on retirement would also be larger. Over time this would have a significant effect on both benefits paid to members and the taxes collected by the government on the payment of benefits and fund earnings.

The estimates for 2001-2002 onwards also assume that members will be contributing an additional one percentage point of wages in the form of member contributions. This would lead to more assets under management than would otherwise be the case and hence larger collections from taxation of fund earnings. Both of these effects will have a compounding effect on fund balances, and over time a significant and increasing offset could be expected, reducing substantially the "cash flow" revenue implications of removing contributions taxes.

Table 3 –Impact on revenue of removing contributions taxes

Year	**Loss of revenue from contributions taxes**	**Increase in revenue from higher earnings and benefits tax collections**	**Total**
	$m	**$m**	**$m**
1998-99	2 480	15	2 465
1999-00	2 500	30	2 470
2000-01(a)	3 040	35	3 005
2001-02	**2 245**	**70**	**2 175**
2002-03(b)	**3 060**	**150**	**2 910**

(a) Estimates for years prior to 2001-02 are point estimates that do not take into account any lags in impact on revenue, or the compounding effect on fund earnings of increased fund balances. Revenue in 2000-01 will be boosted by the one-off bringing forward of revenue associated with the new PAYG tax instalment provisions.

(b) First year in which the abolition of the surcharge would impact on revenue. Surcharge collections are assumed to be around $600 million a year by 2002-03 reflecting the impact of both the inclusion of fringe benefits in the earnings base of surcharge purposes (increasing the number affected from around 350,000 to over 600,000) and some diminution in voluntary contributions by high income earners.

Source: ASFA estimates based on ATO data and Budget revenue forecasts.

As indicated in Table 3, **the impact of removing contributions taxes would be of the order of $2.1 billion if implemented in 2001-02, rising to $2.9 billion in 2002-03**. The cost to tax revenue could be expected to fall in subsequent years given that the tax collections from fund earnings would grow faster than what would have been collected if the contributions taxes remained in place, and taxes collected from the payment of benefits would be higher. While the exact magnitude of these impacts on earnings and benefits tax collections is difficult to forecast, after a period of ten years the impact could be $1.5 billion or more.

As well, in the longer term there may also be a need to adjust the taxation of benefits, which could potentially and over the longer term lead to higher taxation collections. For instance, there may be a need to adjust the 15% rebate on the income tax payable by the recipient of a pension funded from a taxed source given that the ASFA proposal, if adopted, would remove taxes from future contributions and earnings. Other taxation provisions relating to the taxation of lump sums as well as pensions and annuities also might require some adjustment.

Any future requirement for a substantial part of a retirement benefit, over a threshold amount, to be taken as an income stream would also have implications for the time pattern, level and categorisation of tax levied on benefits received by individuals. For instance, a significant shift to the receipt of benefits in the form of income streams rather than lump sums would increase collections of personal income tax and decrease collections from lump sums taxed at concessional rates.

2.3 The revenue costs of removing contributions taxes relative to other recent policy changes

$2.1 billion is a very large amount of money even if you say it quickly, but the costs of removing taxes on contributions need to be considered in context. First, the cost diminishes over time in absolute terms as the result of the increase in tax collections from fund earnings and lump sum benefits received by individuals. This fall is even greater when expressed as a percentage of GDP.

Second, other recent policy changes have had an impact on tax collections of a similar scale, but were not found to be unacceptable on the basis of cost. For instance, the savings rebate was forecast to have a full year cost to revenue when fully in operation of $2.04 billion in 2000-2001. Removing taxes on contributions would involve an initial cost to revenue of a similar order. It also is significantly less expensive than the original proposal for a government co-contribution to match 3 per cent contributions from employees, which, if implemented, would have cost $3.98 billion in 2000-01.

The contributions and earnings taxes introduced in 1988 are in effect an advance revenue stream and amount to borrowing by governments from future incomes in order to fund current government expenditures.

2.4 The tax revenue stream associated with future fund earnings and payment of fund benefits

Tax revenue from the earnings of superannuation funds and the superannuation business of life companies is substantial and growing (Table 4). Taxes on fund earnings are likely to exceed $3 billion in 2002-03, and if taxation of fund earnings continues could exceed $9 billion by 2015, doubling as a percentage of GDP.

Taxation revenue associated with the payment of funded lump sum benefits is also substantial and rising. It current exceeds $0.5 billion per year, and can be expected to grow rapidly as a larger proportion of benefits paid are sourced from post-1983 contributions. Removal of the contributions taxes would also lead to stronger growth in taxes levied on lump sum benefits given that it would lead to higher post-1983 benefits for members. While this additional tax take from benefits would be less than $20 million in the first year, it could be expected to increase rapidly in subsequent years as the proportion of benefits sourced from the higher net contributions increased.

Table 4 – Taxation revenue derived from superannuation investment earnings and from tax on funded post-1983 lump sum benefits ($m)

Year	From earnings	From lump sums	Total
1997-98	1 910	360	2 270
1998-99	2 480	400	3 280
1999-00	2 320	450	2 770
2000-01	3 425	510	3 935
2001-02	2 700	570(a)	3 270
2002-03	3 100	650(a)	3 750
2015-16	9 300		

(a) Estimate does not include any adjustment for the increase in end benefits flowing from the ASFA proposed removal of contributions taxes.
Source: Budget Papers and ASFA Research Centre estimates.

3.1 ASFA update of cost of superannuation tax concessions

The Commonwealth Treasury in the annual Budget papers publishes estimates of what it claims to be the tax expenditures on retirement and other employment termination tax concession and a number of other tax concessions. More detailed estimates are also provided in an annual Tax Expenditures publication published several months after each Budget.

The Treasury estimates suffer from a number of conceptual problems, as detailed in Access Economics (1998) and ASFA (1999) amongst other articles. In essence, Treasury argues that the benchmark for the taxation of superannuation should be a comprehensive income tax system in which savings are made from after-tax income and earnings from savings are taxed at full marginal tax rates. The preferred tax benchmark of Access Economics, and a number of major OECD countries such as Belgium, France, Germany, Netherlands, and Portugal (see OECD 1996), is an expenditure tax benchmark in which the appropriate point for taxation is the receipt of benefits.

Accordingly, ASFA commissioned Access Economics to prepare authoritative estimates of tax expenditures on superannuation on an expenditure tax basis (Access Economics 1998). When released those estimates received considerable public attention.

The Access Economics estimates of tax expenditures were prepared for the three years up to and including 1995-96. ASFA updated those estimates to cover 1998-99 (ASFA 1999). With the release of further Budget revenue estimates, the 1999 Treasury Tax Expenditures Statement, and Australian Taxation Office taxation statistics it is now possible to prepare estimates and forecasts out to 2001-02.

As shown by Table 5, the principal factor impacting on the estimates based on the Access Economics methodology is the overtaxation of superannuation contributions and fund earnings. **The overtaxation of these items has grown from $2,391 million in 1994-95 to a forecast $5,445 million in 2001-02.**

The fall in the level of taxes collected (and hence in the level of overtaxation) projected between 2000-01 and 2001-02 is due to the one off boost to tax collections in 2000-01 due to new instalment arrangements which bring forward the payment of fund taxation. However, over the longer term taxes collected from funds have shown strong growth due to steady growth in compulsory employer contributions and substantial fund earnings due to growth in equity and property prices.

The main category for which superannuation payments were undertaxed on an expenditure tax basis is the treatment of unfunded lump sums. Such lump sums typically are paid to retiring or retrenched members of public sector superannuation schemes. The cost of these arrangements peaked in the early to mid 1990s but has fallen away a little with the closure of a number of unfunded schemes to new members and the substantial completion of retrenchment programs.

A significant proportion of unfunded lump sums are made from the Commonwealth employee superannuation schemes, with the nature of the taxation of payments something that was presumably taken into account by the then Commonwealth government when the schemes were implemented and later modified. However, the figures also include termination and redundancy payments made by a variety of employers. Such payments and any favourable taxation treatment received are more attributable to concessional treatment of redundancy payments rather than superannuation or retirement benefits.

Funded lump sums attributable to pre-1983 employment receive very favourable taxation treatment, but the costs of this are decreasing as the proportion of the labour force with substantial pre-1983 service has decreased. Over the next 20 years or so the cost of this tax concession will continue to decrease. It also can be considered to be a cost of the pre-1983 tax provisions for superannuation rather than an inherent part of the current provisions.

The final item in the table, <u>undertaxation</u> of post-1983 lump sums, shows a fairly steady increase, apart from the drop in 2000-01 attributable to decrease in personal income tax rates associated with the New Tax System. This reflects growth in the payment of retirement benefits attributable to post-1983 employment service. This will generate a growing stream of taxation for government, a revenue stream that would be stronger if contributions and earnings were not taxed.

Table 5: ASFA update of cost of tax concessions – expenditure tax basis ($m)

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Overtaxation of contributions & earnings **(a)**	-2,391	-2,043	-3,244	-3,866	-4,895	-4,763	-6,469	-5,445(b)
Undertaxation of unfunded lump sums	1,110	1,120	1,080	1,090	1,110	1,110	1,120	870
Undertaxation of funded lump sums pre-83	1,515	720	540	540	450	450	380	380
Undertaxation of funded lump sums post-83	290	310	320	360	400	450	370	400
Total	**524**	**107**	**-1,304**	**-1,876**	**-2,935**	**-2,753**	**-4,599**	**-3,795**

(a): Estimates derived from revenues under the 'superannuation' tax in Budget Papers 2000-01 adjusted for superannuation business conducted by life insurance companies.
(b): ASFA Research Centre estimate

In summary, using the Access Economics methodology the overtaxation of superannuation and other retirement benefits has risen from $1,304 million overtaxation in 1996-97 to a projected massive $4,599 million in 2000-01.

In comparison, Treasury estimates using the flawed income tax benchmark claim that the cost of tax concessions on superannuation and other employment termination tax concessions was a very large $9,160 million in 1996-97, falling to $8,745million in 2000-01 as a result of the cut in personal income tax rates.

Taxes on superannuation funds are a significant and increasing proportion of total Commonwealth tax revenues. Extracting another $8 or $9 billion from super, as suggested by the Treasury Tax Expenditure estimates, would be extracting the last drop of blood from the superannuation stone given the substantial blood donation already provided by superannuation funds to the Budget. However, even the Treasury Tax Expenditure Statements acknowledge that removing all tax concessions for superannuation would not lead to increased tax revenue commensurate with the claimed tax expenditure, at least in any other year apart from the year in which such a change was made. This would especially apply in the medium to long term as the effect of taxes eroded the aggregate assets invested and led to fewer discretionary contributions being made.

Analysis by the ASFA Research Centre also indicates that proper application of an income tax base might lower the Treasury estimates of tax expenditures on superannuation and retirement benefits by $1 billion or more a year. One reason for this is that the Treasury methodology appears to take as its benchmark the application of the average marginal tax rates of members to fund earnings. However, around $3 billion of fund and life company earnings are exempt income because they are paid out to holders of pensions and annuities and taxed at the marginal rate of the pensioner and annuitant.

Removing this $3 billion from the calculation of tax expenditures relating to fund and life company investment earnings in regard to superannuation has a significant impact on the measure. Replication of the Treasury estimates suggests that this has not been done, but the evidence is not conclusive. More detailed provision of information supporting the Treasury estimates would help clarify the treatment of earnings supporting annuities and the basis of the estimates more generally.

The second reason is that part of the Treasury benchmark for individuals is that only 50% of nominal capital gains should be included, provided that the asset is held for more than 12 months. In the case of funds, two-thirds of capital gains are included in taxable income. Consistent use of benchmarks for capital gains would reduce the recorded tax expenditures for superannuation on an income tax basis. Hopefully, this will be done when the Treasury next reviews the tax expenditure estimates. The next release by Treasury of tax expenditure estimates is not expected before the end of calendar year 2000.

4. Impact of personal income tax cuts

4.1 Where persons with employer contributions fit in the personal income tax scale

An important part of the Government's New Tax System are the personal income tax cuts made across much of the rate scale. As well, for individuals only 50% of capital gains now are included in taxable income, while two-thirds of capital gains are included for superannuation funds. These changes have implications for the taxation of superannuation. For instance, if the relative tax treatment of superannuation was about right prior to the reduction in personal income tax rates and changes to the capital gains tax, then subsequent to the changes, superannuation taxation is now heavier than desirable.

What is important in terms of individual savings and investment decisions is how superannuation compares in taxation terms to other investments. However, if the tax attractiveness of superannuation is reduced in relative terms this is not a reason to reverse the income tax cuts. Nevertheless, such a finding strongly suggests that the taxation arrangements applying to superannuation should also be reviewed.

Table 6 sets out the personal income tax scale applying in 1999-2000 together with estimates of contributions by income level derived from estimates of contributions by household income published in Harding et al, 1997. The latter estimates are derived by estimating the proportion of total superannuation contributions that are made on behalf of individuals at various income and marginal tax levels. In simple terms the contributions data are used to reflect the relative importance of low, medium and upper income earners as contributors to superannuation.

Table 6: 1999-2000 personal income tax scale and distribution of contributions by income range

Taxable income range ($)	Marginal income tax rate	Percentage of contributions associated with income range
0 - 5,400	0%	0%
5,401 - 20,700	20%	15%
20,701 - 38,000	34%	20%
38,001 - 50,000	43%	20%
50,000+	47%	45%
Weighted Average	39.6%	

When estimates are made of the overall tax advantage attached to superannuation this type of calculation can be helpful. In the case of the Treasury Tax Expenditure Statement, for instance, Treasury's claimed cost to the revenue of the 15 per cent tax rate applying to fund earnings is calculated by comparing the 15 per cent rate with the average income tax rate that would otherwise apply to contributors.

The estimates of the proportion of contributions by income level set out in Table 6 produce an overall average which is consistent with what Access Economics understands was the equivalent average underlying the Treasury Tax Expenditure Statement for 1999-2000 and earlier years. The estimate of the proportion of contributions made on behalf of individuals with an income in excess of $50,000 is also consistent in broad terms with the taxes raised to date from the contributions surcharge.

The majority of contributions appear to have been made on behalf of individuals with an income in excess of $38,000, with a concentration of contributions on behalf of those with incomes in excess of $50,000 per annum. Higher income earners have greater contributions to superannuation than lower income earners in both absolute terms and as a percentage of earnings. However, superannuation as a form of savings and as a holding of wealth is more evenly spread than most other forms of financial wealth.

There are a substantial number of relatively low paid individuals who have some or a moderate amount of superannuation even though they might have no other financial asset. Further increases in the rate of compulsory superannuation contributions will also increase the share of superannuation contributions received by lower income earners. The equity of current superannuation arrangements and of ASFA's proposals is the subject of a forthcoming paper being prepared by the ASFA Research Centre.

The overall weighted marginal income tax rate at around 40 per cent substantially exceeded the combined effect of the standard taxes on contributions and benefits, which amounts to around 29 per cent where superannuation benefits exceed the benefits tax-free threshold ($100,696 in 2000-01). However, there are significant differences in the tax attractiveness of superannuation at different income levels, and as well the recent personal income tax changes have had an impact on the relative attractiveness of superannuation.

Table 7 sets out ASFA Research Centre estimates of the proportion of superannuation contributions made on behalf of taxpayers in the various marginal income tax bands applying after 1 July 2000, along with an estimate of the weighted average marginal tax rate for individuals receiving the benefit of superannuation contributions.

Table 7: Current personal income tax scale and distribution of contributions by income range

Taxable income range ($)	Marginal income tax rate	Percentage of contributions associated with income range
0 - 6,000	0%	0%
6,001 - 20,000	17%	15%
20,001 - 50,000	30%	40%
50,001 - 60,000	42%	5%
60,001+	47%	40%
Weighted Average	35.5%	

Comparison between Tables 6 and 7 indicates that the income tax rate reductions will make superannuation less attractive in a relative sense for an increased proportion of contributions and contributors.

At the lower income end there is very little difference between the 15 per cent contributions tax and the 17 per cent marginal income tax rate. If benefits are taxable to any extent then superannuation contributions are not tax effective.

In the middle of the earnings distribution individuals responsible for around 20 per cent of contributions will move from a 43 per cent tax rate to a 30 per cent personal income tax rate. Individuals associated with a further 20 per cent of contributions can be expected to move from a 34 per cent income tax rate to a 30 per cent rate. And at the top of the earnings scale individuals will still have to confront the combined impact of tax on contributions plus the surcharge.

The tables indicate that on average the personal income tax rate faced by individuals contributing to superannuation will fall from around 40 per cent to 35 per cent which would substantially reduce the tax attractiveness of superannuation contributions. Many superannuation contributions attract contributions and benefits taxes of the order of 29 per cent, and those contributions subject to the surcharge attract tax at even higher rates.

4.2 Tax attractiveness of employer contributions to superannuation

One of the main attractions for saving in the form of superannuation is that there is a capacity for all or the bulk of contributions to be in effect paid from pre-tax employment earnings. In most cases this delivers a tax concession, as noted above, relative to taking after tax salary and investing it in, say, a bank account. However, there are other forms of saving, such as owner-occupied housing and geared share or property investment, which also are relatively tax advantaged and which form alternative destinations for the bulk of discretionary household savings.

As well, for most individuals the tax incentives for superannuation must be weighed against the restrictions that apply to withdrawing benefits prior to preservation age. Superannuation savings are required to be preserved for retirement and related purposes, and are not available for discretionary spending as is the case with most other investments. Possible changes to tax and other rules and reduced social security entitlements also are factors which can reduce the incentives to save through superannuation and hence highlight the need for tax concessions if superannuation is to be perceived favourably by savers.

Superannuation is not highly tax advantaged at the lower income end of the workforce. As noted above, the 15% tax on contributions is only marginally lower than the 18.5% rate (including Medicare levy) that applies to individuals with taxable income less than $20,000. Employer contributions would be tax disadvantaged for individuals with taxable incomes less than $6,000 per annum, but there would be very few individuals taxable income of this level who would be in employment and receiving employer contributions. Employees who earn less than $450 per month fall outside the compulsory superannuation system.

As well, individuals who are lower income earners when employed tend to be the largest recipients of government social security benefits, including the Age Pension. Low income earners may receive only a little from superannuation tax concessions, but they receive other substantial benefits instead.

The contributions surcharge can also erode the tax attractiveness of superannuation contributions made for employees at the other end of the income scale. For individuals with combined taxable income, reportable fringe benefits and surchargeable superannuation contributions exceeding a combined total of $81,493 in 2000-01, a surcharge is paid on contributions of up to 15%. The maximum rate of surcharge occurs when the total reaches $98,955. The combined effects of contributions tax, the surcharge and lump sum benefits tax are equivalent to a tax rate of 41.6%. This is lower than the top marginal tax rate of 48.5% (including the Medicare Levy), but is very little different to the 43.5% rate applying to individuals with an income between $50,001 and $60,000.

With the inclusion from 2000-01 onwards of reportable fringe benefits in the earnings base for surcharge purposes, around 1 in 13 Australian employees will be subject to payment of the surcharge in regard to their superannuation contributions.

There are cases where little or no tax benefit is delivered for superannuation contributions. Of the assumed 45 per cent of contributions where the individual has an income in excess of $50,000 per annum, for a substantial minority of this group the surcharge can lead to an effective tax rate on contributions of 80 per cent or more, which is far higher than the top marginal personal income tax rate. These very high marginal rates apply where there is a significant amount of contributions being made and an additional dollar of contributions will both attract the surcharge and increase the rate of surcharge applying to all contributions.

That said, superannuation contributions are tax advantaged for the vast majority of contributors relative to saving through a mechanism subject to full income tax. This is indicated by the difference in the typical tax rate for superannuation and the average marginal income tax rate of superannuation contributors. Superannuation is even more tax advantaged in cases where an individual does not exceed the tax free threshold for lump sum benefits or receives the 15% rebate applicable to certain income stream payments.

4.3 Tax attractiveness of member contributions to superannuation and earnings within a fund environment

While one of the primary incentives to save through superannuation is the ability to apply pre-tax dollars of income to savings, there are also other reasons to do so. For individuals on a marginal income tax rate greater than 29% (the combined earnings and benefits tax rate) it is advantageous for earnings to accumulate within a superannuation environment. It is particularly advantageous for those on the 43.5% and 48.5% rates given that no surcharge tax rate applies to earnings within the fund.

For individuals on the 18.5% marginal tax rate accumulating earnings with a superannuation fund is marginally attractive in taxation terms provided that the tax free threshold of $100,696 (in 2000-01, indexed to AWOTE) for benefits is not breached.

4.4 Treasury quantification of the tax advantage of superannuation contributions and earnings

In a recent paper (Rothman 2000) the Retirement Income Modelling Unit of the Commonwealth Treasury has provided estimates of the tax advantages of investment in superannuation relative to investment in a similar asset portfolio outside superannuation. These estimates are very similar to estimates for common cases published by AMP and by BT Funds Management.

Charts 1 and 2 (reproduced from the Rothman paper) provide a graphical representation of these findings. The various lines relate to the major marginal tax rates applying after July 2000, with Chart 2 also taking into account the rebate available to certain member contributions made by low income individuals.

Chart 1

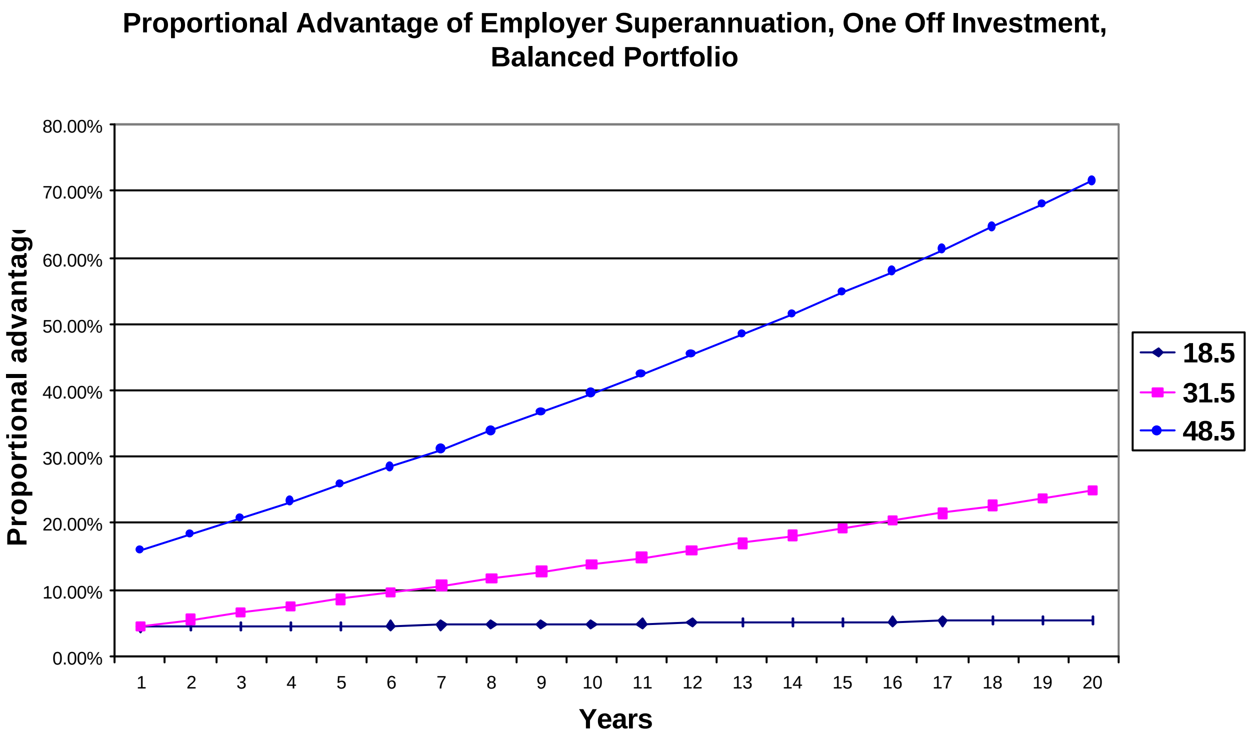
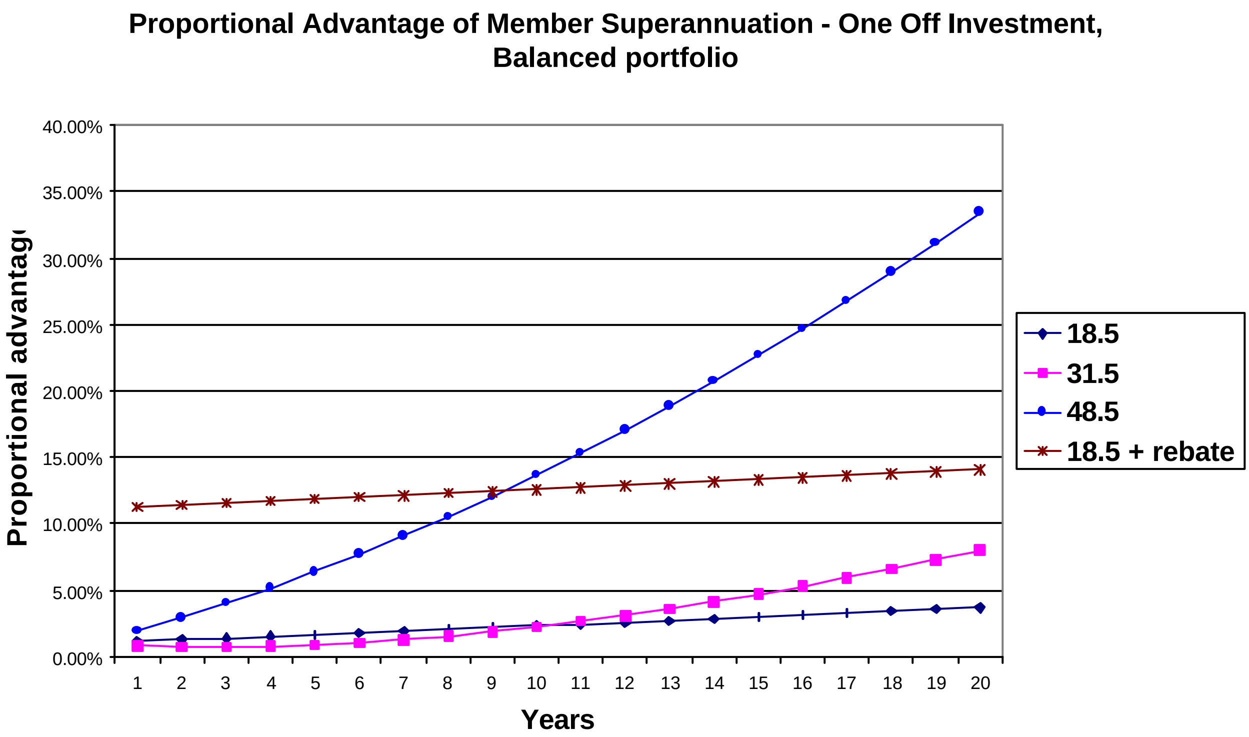


Chart 2



Source: Rothman 2000

As shown by Chart 1, the tax advantage in the first year of investing in superannuation by way of salary sacrifice is not large for most income ranges. Chart 2 indicates that apart from the benefits of any low income or spouse rebate that might be available, in year one there is very little advantage from member contributions. The small advantage shown in the chart is due to assumed lower entry costs to a managed investment by way of superannuation compared to achieving a similar managed portfolio outside of super.

However, superannuation is a favourable environment in tax terms for the long term investment of funds accumulated from either pre- or after-tax earnings. This is particularly the case for taxpayers on a personal income tax rate of 31.5% and above, as shown by the upwards sloping lines for such taxpayers in each of the charts. However, for a low income individual the tax advantages will not be as great.

The spouse rebate, which provides for an 18 per cent rebate for contributions up to $3,000 made on behalf of a low income spouse, also provides an incentive for low income fund members to have contributions made on their behalf. The rebate and the attractive earnings rates usually achieved within superannuation funds can make superannuation contributions attractive even when the member is on a zero tax rate. Spouse contributions even without the benefit of the tax rebate also can be part of a strategy to achieve a low or largely tax free income stream in retirement.

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