

# The equity of government assistance for retirement income in Australia

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## Purpose of the paper

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This report has been prepared in the context of recent debate about superannuation tax concessions and the proposal currently before the Parliament to increase the rate of compulsory superannuation (the Superannuation Guarantee) over time from nine per cent to 12 per cent. This paper is a contribution to that policy debate.

This paper primarily focuses on the various dimensions of equity relating to government assistance for retirement income provision. It provides both a conceptual framework and a range of empirical material in order to allow judgements to be made in regard to this. In particular, it examines what the impact on equity between individuals has been from the caps on concessional superannuation contributions, changes in marginal personal income tax rates and changes in the level of the Age Pension.

The paper also evaluates the impact of the proposed increase in the Superannuation Guarantee and the low-income earners contribution tax rebate.

The paper also explains why the Tax Expenditures Statement published by the Treasury overstates the amount of tax assistance provided to superannuation.

Finally, it explains why the Henry Review recommendations in regard to the taxation of superannuation contributions and fund investment earnings should not be adopted.

## Executive summary

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This paper makes use of new available data and information to assess the current level of tax and other assistance provided to superannuation and what would be the distributional impact of the Government proposals to increase the Superannuation Guarantee (SG) to 12 per cent and boost the superannuation savings of low-income workers.

### The distributional impact of assistance for superannuation

- A commonly quoted statistic in public debate about the percentage of superannuation contributions associated with higher income employees relates to 2005-06 when much higher contribution caps applied.
- In 2009-10 around 90 per cent of employer contributions related to individuals on less than the top marginal tax rate, with over 50 per cent of contributions relating to individuals on a marginal income tax rate of 30 per cent or less.
- The top five per cent of employees (in terms of income) accounted for less than 20 per cent of the total superannuation contributions (in terms of value) in 2009-10. This figure is well down on what would have applied in 2005-06.
- The bulk of tax concessions for superannuation contributions flows to those on either the 30 per cent or 38 per cent tax rates. Such taxpayers make up a very large part of the full-time workforce in Australia.
- The self-employed have lower superannuation coverage than wage and salary earners and receive a smaller proportion of tax concessions than their share of the total number employed in the economy. For those in certain industries, such as construction and transport, the self-employed are particularly disadvantaged by the absence of compulsory coverage.
- A major step in improving the equity of superannuation arrangements would be to extend compulsory superannuation to the self-employed, particularly those in the construction and transport industries undertaking very similar roles to employees.

### Age Pension and superannuation tax concessions combined

- A considerable part of recent public debate has focused on the level of assistance provided to superannuation through tax concessions. However, such commentary fails to take into account the direct link between the level of retirement savings and the subsequent reduction in the Government Age Pension.
- Research indicates that the total amount of government support for retirement income does not vary much across the income deciles or by gender. The proportion of assistance provided in the form of tax expenditures for superannuation increases with higher income, with a more or less equivalent decrease in the value of Age Pension expenditures.

### The impact of the increase in the SG and measures to assist the super of low-income earners

- Government proposals on superannuation (currently in legislation that has been passed by the House of Representatives and is being considered by the Senate) would further increase the proportion of assistance flowing to low and middle-income earners.
- The combined effect of the proposed measures would have, if they had applied in 2009-10, increased the aggregate tax assistance for retirement saving for employees earning less than \$80,000 a year from \$5,920 million to around \$7,580 million. Expressed as a percentage of total government tax assistance for retirement saving, the share of those earning less than \$80,000 a year would have increased from 46.2 per cent to 50.2 per cent.

### Current tax expenditure estimates

- The current tax expenditure estimates produced by the Treasury greatly overestimate the additional tax revenue that would result if current tax concessions for superannuation were abolished.
- The concessional contribution caps have had a significant impact on contributions by upper income earners, reducing the ongoing cost of the tax concession for contributions by over \$3 billion a year compared to previous historical levels.
- The Treasury tax expenditure estimates appear to be based on the unrealistic assumption that if the investment earnings in superannuation accounts were taxed on the basis of each individual's tax rate then there would be no discount for capital gains on assets held for more than 12 months.
- All of these factors taken together suggests that the tax expenditures for superannuation may actually be around half those reported in the Tax Expenditures Statement.

- A more definitive assessment would be possible if Treasury released the detailed calculations and assumptions underlying the estimates in their publication. Principles relating to transparency and good governance are driving reforms to superannuation and this also should apply to the Tax Expenditures Statement.

### The Henry Review proposals in regard to the taxation of superannuation

- Adoption of the Henry Review proposals in regard to the taxation of superannuation contributions would lead to the introduction of considerable new forms of complexity in the taxation of superannuation. They would also lead to a reduction in take-home pay for most individuals and would reduce taxation collections by the Government.
- The Henry Review proposals in regard to the taxation of superannuation fund investment earnings would also have a negative impact on taxation revenue for many decades with unclear impacts on equity between fund members.
- An increase in the SG to 12 per cent and the introduction of a low-income earners contribution tax rebate will have more favourable take-home pay, equity and government revenue impacts.

This paper covers:

- The framework for considering the equity and effectiveness of government assistance for retirement incomes.
- Newly available data and analysis on the amount of tax assistance provided in regard to the superannuation contributions of taxpayers at various marginal tax rates.
- Examples of the amount and pattern of government assistance, including the Age Pension, provided to persons with different levels and patterns of income over their working life.
- Previously unpublished projections of the impact of the increase in the Superannuation Guarantee (SG) and of the introduction of the low-income earners contribution tax rebate on the pattern of assistance by income level.
- The limitations of the figures in the Treasury Tax Expenditures Statement in regard to accurately reporting the aggregate assistance provided to superannuation.
- Gaps in current coverage of superannuation, particularly in regard to the self-employed.

Key objectives behind the provision of government assistance for retirement income provision are to encourage savings, help ensure adequate and sustainable retirement incomes, and to treat individuals equitably both in their working life and in retirement.

Superannuation tax concessions both encourage and provide assistance for individuals to save for their retirement. This allows them to obtain a more optimal spread of consumption over their lifetime. Without such concessions Australians generally would not save enough to generate an income that would provide dignity in retirement. While the Age Pension provides sufficient income to just avoid poverty in retirement, it does not, in itself, support dignity or adequacy in retirement.

Currently, and for the foreseeable future, most individuals will rely on a mixture of private savings, principally superannuation, and the Government-provided Age Pension for their income in retirement. Private savings provide a supplement to the Age Pension but also have the effect of reducing the reliance on social security. This has implications for the call on government expenditures.

Perceptions as to adequacy, equity and fairness of these various arrangements are important if voluntary and compulsory savings through superannuation and the Government's retirement income strategy are to have the confidence and support of the community.

Equity clearly 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 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.

Attachment A provides further details on the theoretical framework and dimensions of equity that are commonly considered in the development of public policy. While each of these is important, the focus in this paper is on the current level of government assistance by income and asset level, and on the impact of the proposed changes to the SG and direct assistance to low-income earners.

One statistic that has gained some currency is that five per cent of individuals account for 37 per cent of concessional contributions. This is a figure quoted on page 22 of the report of the Australia’s Future Tax System (the Henry Review)’s [Retirement Incomes Consultation Paper](#).

This figure has been quoted numerous times in public debate, including by [David Ingles](#) in [a paper for the Australia Institute](#), [Eva Cox](#) on [Crikey](#), and [Tim Lyons](#) of the Australian Council of Trade Unions at the Tax Forum.

The Australian Council of Social Service (ACOSS) has also published figures which deal with the amount of tax concessions going to those on the top marginal tax rates in its [2012-13 Budget Priority Statement](#) and its paper, [A fairer, more efficient tax and social security system](#).

The Treasury figures relate to 2005-06 when superannuation policy settings were significantly different to now. For instance, in 2005-06 a maximum 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.

By 2009-10 a new set of concessional contribution caps were in force (after a number of variants along the way). These caps permitted annual contributions of no more than \$25,000 a year for those aged less than 50 and \$50,000 a year for those aged 50 and over. However, the \$50,000 a year cap is a transitional one and is due to expire on 30 June 2012. The Government announced its intention to replace these caps with a general cap of \$25,000 a year except for those aged 50 and over with less than \$500,000 in superannuation, where a \$50,000 a year cap would apply.

Concessional contributions include:

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

The table below sets out the standard contributions cap in the current and recent financial years.

Income year	Amount of cap
2011-12	\$25,000
2010-11	\$25,000
2009-10	\$25,000
2008-09	\$50,000
2007-08	\$50,000

## 2.1 Tax assistance for super after the new concessional contribution caps

Clear empirical evidence indicates that the contribution caps have reduced the concessional contributions made by upper income earners.

This is reflected in Table 2.1 which 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 2009-10. These estimates are based on data especially extracted for ASFA from a large scale survey of Australian households, namely the *Household, Income and Labour Dynamics in Australia (HILDA) Survey*.

These estimates of employer contributions are consistent in broad terms and produce overall results consistent with aggregate superannuation contributions as reported by Australian Prudential Regulation Authority (APRA) and Australian Taxation Office (ATO) statistical publications.

Table 2.1 Employer contributions by income range, 2009-10

Taxable income range (\$)	Marginal income tax rate	% of wage earners	Value of employer contributions (a) \$m	% of employer contributions (a)
0 - 6,000	0%	5.4	54	0.1
6,001 - 37,000	15%	31.5	4,255	7.9
37,001 - 80,000	30%	42.7	23,120	43.0
80,001 - 180,000	38%	18.0	20,280	37.7
180,001+	47%	2.4	6,050	11.3

(a) Based on data extracted for ASFA from Wave 10 of the HILDA survey.

As is clear from the table, superannuation contributions are not spread entirely evenly across all taxpayers or income ranges. This is because one of the basic characteristics of superannuation is that contributions are linked to employment, particularly full-time employment. Those taxpayers on very low incomes are not receiving superannuation contributions or are receiving the benefit of only relatively small contribution amounts.

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 when they are studying or have family responsibilities that prevent them from undertaking full-time work. However, 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. 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. This is explored further in Section 3 of this paper.

However, even in regard to a single year, as indicated by Table 2.1, around 90 per cent of employer contributions relate to individuals on less than the top marginal tax rate, with over 50 per cent of contributions relating to individuals on a marginal income tax rate of 30 per cent or less.

The top five per cent of employees (in terms of income) accounted for less than 20 per cent of the total superannuation contributions in 2009-10.

While upper income earners typically have more superannuation contributions than lower income earners, the amount related to upper income earners is now much lower than some figures in public debate have suggested. While a higher figure may have applied back in 2005-06, the impact of the contribution caps has been considerable. The various changes that have been made to the superannuation tax rules also may have impacted on confidence in contributing to superannuation, also leading to lower discretionary contributions.

Table 2.2 provides estimates of the amount of tax concession by personal income tax rate. It also factors in the receipt of the co-contribution, which is only available to low-income earners making personal contributions.

The Table indicates that less than 15 per cent of the government assistance for superannuation contributions flows to those on the top marginal rate. This compares to the around 30 per cent of aggregate personal income tax collections that is paid by that group of taxpayers. 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.

The Table also indicates that the bulk of government assistance for superannuation flows to those on 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. Providing the bulk of tax assistance to this group makes sense from a public policy point of view. In contrast to very low-income earners and those who never have significant wage income during their life, they have the potential to finance through savings significant income in retirement.

For those on the top marginal tax rate, 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.

**Table 2.2 Employee tax concessions on contributions by income range, 2009-10**

Taxable income range (\$)	Marginal income tax rate	Value of tax concession (a) \$m	% of total tax concession for employer contributions	Value of tax concession and co-contribution \$m	% of total tax concession and co-contribution
0 - 6,000	0%	-8	-0.1	192	1.5
6,001 - 37,000	15%	68	0.6	1,068	8.3
37,001 - 80,000	30%	4,462	39.2	4,662	36.4
80,001 - 180,000	38%	4,968	43.6	4,968	38.8
180,001+	47%	1,906	16.7	1,905	14.9
All employees		11,397	100	12,797	100

(a) Takes into account the Medicare levy, the phasing out of the Low Income Tax Offset, and the phasing in of the Medicare liability.

## 2.2 Superannuation and the self-employed

A major gap in the Australian superannuation system is the coverage of the self-employed.

As described in Attachment B, low and nil balances are relatively common for the self-employed across most industries. The construction and transport industries are ones where there are significant numbers of the self-employed together with large proportions with nil or low superannuation.

Self-employment is relatively common in primary production, construction, property and business services, retail trade, and transport services. On the other hand, there are very few self-employed persons in government administration and defence, or mining.

Compulsory superannuation contributions in the form of the SG are largely restricted to employees. However, some of the self-employed are covered by the SG due to the definition of wage and salary earners in the legislation.

The net effect is that while a minority of the self-employed, principally those on higher incomes, make significant contributions to superannuation, most, particularly those on lower incomes, do not.

Tables 2.3 and 2.4 set out figures for contributions and tax concessions for the self-employed, based on ATO statistics for 2008-09.

A higher proportion of the tax benefits flow to the self-employed on the top marginal tax rate relative to employees. As noted, this is because superannuation is not compulsory for the self-employed and fewer contributions are made by the self-employed with low taxable incomes.



Table 2.3 Self-employed deductible contributions by income range, 2008-09

Taxable income range (\$)	Marginal income tax rate	% of self-employed with super	Value of deductible contributions \$m	% of contributions
0 - 6,000	0%	9.4	580	9.4
6,001 - 37,000	15%	20.3	1,250	20.3
37,001 - 80,000	30%	29.5	1,813	29.5
80,001 - 180,000	38%	22.8	1,405	22.8
180,001+	47%	18.0	1,107	18.0

(a) Based on ATO Taxation Statistics, 2008-09.

Table 2.4 Self-employed tax concessions by income range, 2008-09

Taxable income range (\$)	Marginal income tax rate	Value of tax concession \$m	% of total tax concession for contributions
0 - 6,000	0%	-87 (a)	-8.9
6,001 - 37,000	15%	20	2.0
37,001 - 80,000	30%	350	35.9
80,001 - 180,000	38%	344	35.3
180,001+	47%	349	35.7
All		975	100

(a) Figure is negative because the tax on contributions exceeds the marginal personal income tax rate. Based on ATO Taxation Statistics, 2008-09.

The self-employed have lower superannuation coverage than wage and salary earners and receive a smaller proportion of tax concessions than their share of the total number employed in the economy. For those in certain industries, such as construction and transport, the self-employed are particularly disadvantaged by the absence of compulsory coverage.

A major step in improving the equity of superannuation arrangements would be to extend compulsory superannuation to the self-employed, particularly those in the construction and transport industries undertaking very similar roles to employees.

## 2.3 Tax concessions on the investment earnings of account balances

Tax concessions on investment earnings associated with account balances are spread over a larger group than just wage and salary earners and the self-employed, 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 one-third of superannuation assets relate to individuals who have retired and 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.

As shown by Table 2.5, Australian Bureau of Statistics data indicate that there are only around 316,000 individuals with more than \$500,000 in superannuation with the great bulk of these aged over 50. Only 14,600 individuals aged under 50 indicated that they had more than \$500,000 in super. Most individuals have less than \$100,000 in their superannuation account but the proportion with higher balances increases with age given the effect of additional contributions and compound interest.

While the tax concession applying in any given year is obviously higher for those with higher account balances, when comparing individuals over their lifetimes, the tax concessions are much more evenly spread. Low account balances are generally associated with younger individuals, who generally become older with higher account balances.

A significant number of the high net wealth individuals would hold some of their wealth in the form of accounts with

superannuation funds. However, for the relatively few extremely or very high net worth individuals, the bulk of their wealth will be in the form of shareholdings or property.

The ability that applied between May 2006 and 30 June 2007 to contribute up to \$1 million in un-deducted contributions into superannuation, as part of transitional arrangements put in place by the Howard Government, resulted in significant contributions being made during that period. However, clearly the current contribution caps are much tighter.

Self-managed superannuation funds (SMSFs) were a major destination for large contributions in the 2006-07 period, with over \$56 billion in such member contributions made. This was well up on the trend level of member contributions of around \$10 billion or \$11 billion a year. For funds regulated by APRA, the increase was from \$33.3 billion to \$95.2 billion.

While a significant proportion of these contributions have remained in superannuation funds, there was also an increase in the amount of benefits paid out after 2006-07. In the case of SMSFs, benefit payments increased from around \$7 billion in 2005-06 to about \$17 billion a year in 2007-08 and subsequent years. For APRA-regulated funds there was an increase in lump sum benefits from \$22.7 billion to \$37.9 billion and an increase from \$18 billion to \$26 billion in pension payments.

More details of the distribution of account balances by age and gender are provided in an October 2011 report published by ASFA, [Superannuation and above average account balances](#).

Table 2.5 Number of persons by superannuation account balance group, persons aged 25-74 years, 2009-10

	SUPERANNUATION BALANCE GROUP (A)										
	NIL	\$1 to \$99,999	\$100,000 to \$199,999	\$200,000 to \$299,999	\$300,000 to \$399,999	\$400,000 to \$499,999	\$500,000 to \$599,999	\$600,000 to \$799,999	\$800,000 to \$999,999	\$1,000,000 and over	TOTAL
NUMBER OF PERSONS ('000)											
<b>MALE</b>											
25 to 29 years	137.0	659.6	n.p	n.p	-	-	-	-	-	-	806.7
30 to 34 years	116.6	588.8	n.p	n.p	n.p	**1.8	-	n.p	-	-	737.0
35 to 39 years	161.7	552.9	45.9	11.5	**1.9	n.p	n.p	**1.3	-	-	779.1
40 to 44 years	125.2	470.8	97.8	36.3	*6.2	n.p	n.p	n.p	**1.8	n.p	743.2
45 to 49 years	138.6	407.0	107.6	55.2	26.7	14.5	n.p	*4.7	-	n.p	761.4
50 to 54 years	122.0	323.3	114.3	60.4	36.9	18.7	*14.5	*7.0	n.p	n.p	705.0
55 to 59 years	150.2	227.1	82.1	58.3	31.8	27.3	18.5	21.4	*8.5	*10.6	635.8
60 to 64 years	168.8	184.6	71.5	48.5	31.5	18.2	14.5	17.8	*8.6	24.0	587.9
65 to 69 years	213.6	99.1	46.9	23.8	13.1	*10.9	*9.2	*6.7	*2.4	15.1	440.8
70 to 74 years	220.7	41.6	22.5	n.p	n.p	n.p	n.p	n.p	n.p	n.p	331.2
<b>TOTAL</b>	<b>1,554.3</b>	<b>3,554.7</b>	<b>623.0</b>	<b>313.7</b>	<b>155.9</b>	<b>103.7</b>	<b>68.2</b>	<b>65.1</b>	<b>29.7</b>	<b>59.8</b>	<b>6,528.1</b>
<b>FEMALE</b>											
25 to 29 years	184.8	601.8	n.p	n.p	-	-	-	-	-	-	791.1
30 to 34 years	178.9	552.1	n.p	n.p	n.p	-	-	n.p	-	-	747.1
35 to 39 years	213.3	555.6	29.2	*6.1	**1.9	n.p	n.p	-	-	-	808.1
40 to 44 years	196.2	498.7	48.6	*11.0	*9.3	n.p	n.p	n.p	-	n.p	768.2
45 to 49 years	184.2	505.4	54.7	17.3	*13.6	*4.3	n.p	**2.1	-	n.p	785.7
50 to 54 years	161.7	444.8	71.8	26.3	*11.0	*5.1	*4.5	*3.5	n.p	n.p	729.8
55 to 59 years	200.3	310.9	64.3	28.6	24.3	*8.5	*5.9	**4.0	**1.6	*7.2	655.8
60 to 64 years	250.7	181.8	57.4	37.9	20.6	*12.6	10.9	*6.5	*4.4	*12.4	595.1
65 to 69 years	268.5	68.1	45.7	27.8	15.4	*7.7	*3.5	**2.7	**2.4	*4.7	446.6
70 to 74 years	258.4	47.5	16.5	n.p	n.p	n.p	n.p	n.p	n.p	n.p	357.8
<b>TOTAL</b>	<b>2,097.1</b>	<b>3,766.8</b>	<b>404.2</b>	<b>171.6</b>	<b>106.0</b>	<b>46.2</b>	<b>30.5</b>	<b>21.1</b>	<b>12.0</b>	<b>30.0</b>	<b>6,685.5</b>

	SUPERANNUATION BALANCE GROUP (A)										
	NIL	\$1 to \$99,999	\$100,000 to \$199,999	\$200,000 to \$299,999	\$300,000 to \$399,999	\$400,000 to \$499,999	\$500,000 to \$599,999	\$600,000 to \$799,999	\$800,000 to \$999,999	\$1,000,000 and over	TOTAL
	NUMBER OF PERSONS ('000)										
PERSONS											
25 to 29 years	321.9	1,261.4	*11.9	*2.7	-	-	-	-	-	-	1,597.8
30 to 34 years	295.5	1,140.9	38.7	*5.2	**0.6	n.p.	-	n.p.	-	-	1,484.1
35 to 39 years	375.1	1,108.5	75.1	17.5	*3.8	*4.8	**1.2	**1.3	-	-	1,587.3
40 to 44 years	321.4	969.4	146.4	47.2	*15.5	*6.7	**1.2	n.p.	*1.8	n.p.	1,511.4
45 to 49 years	322.8	912.4	162.3	72.4	40.3	18.7	*9.1	*6.9	0.0	**2.3	1,547.1
50 to 54 years	283.7	768.1	186.1	86.7	47.9	23.8	19.0	10.5	*5.4	**3.6	1,434.8
55 to 59 years	350.5	538.1	146.4	86.9	56.1	35.8	24.4	25.4	*10.2	*17.8	1,291.7
60 to 64 years	419.4	366.4	128.8	86.4	52.2	30.8	25.4	24.2	*13.0	36.4	1,183.0
65 to 69 years	482.1	167.3	92.6	51.6	28.4	18.6	*12.7	*9.5	*4.8	19.9	887.4
70 to 74 years	479.1	89.2	38.9	28.6	17.1	n.p.	*5.7	n.p.	*6.5	n.p.	689.0
<b>TOTAL</b>	<b>3,651.4</b>	<b>7,321.5</b>	<b>1,027.2</b>	<b>485.2</b>	<b>261.9</b>	<b>149.9</b>	<b>98.7</b>	<b>86.3</b>	<b>41.6</b>	<b>89.8</b>	<b>13,213.5</b>

\* estimate has a relative standard error of 25% to 50% and should be used with caution.

\*\* estimate has a relative standard error greater than 50% and is considered too unreliable for general use.

n.p. cell has not been published due to sample quality issues.

cells with (-) either have a zero balance or have been rounded to zero.

The next session illustrates how over a lifetime the amount of tax and other assistance for retirement income largely evens out.

A considerable part of recent public debate has focused on the level of assistance provided to superannuation through tax concessions. However, such commentary fails to take into account the direct link between the level of retirement savings and the subsequent reduction in the Government Age Pension. In considering the equity of government assistance for retirement income it also is necessary to take into account the amount of Age Pension that will eventually be provided on average to persons on various levels of earnings and superannuation during their working life.

This was done in research conducted in 2009 by Dr George Rothman of the Treasury Retirement & Intergenerational Modelling & Analysis Unit, [Assessing the equity of Australia's retirement income system](#).

This research places emphasis on a 'whole of life' or lifecycle perspective where Age Pension benefits in the retirement phase are included. The cost to government of its retirement income policies as a whole is modelled using Treasury's comprehensive RIMGROUP model.

The base case for this analysis is the retirement income framework following the 2009 Budget. Significant changes in that Budget included:

- A significant increase in Age pension payments of \$32.49 a week for single pensioners and \$10.14 a week combined for couple pensioners, together with changes to the income test whereby the pension taper rate for new pensioners is 50 per cent rather than 40% per cent.
- A gradual increase in the age for eligibility for an Age Pension beginning in 2017 so that this age reaches 67 in 2023.
- A reduction in the annual cap on concessional superannuation contributions from \$50,000 to \$25,000 for those aged under 50 and the transitional cap for over 50s from \$100,000 to \$50,000.

The analysis in the Treasury paper indicates that two key measures in the 2009 Budget have added considerably to the equity of Australia's retirement income system, both by gender and income. The first was the increase in Age Pension payments together with the accompanying increase in the income taper rate. The concessional contribution caps budget measure also was found to add even more vertical equity to the system with the saving to government revenue impacting mostly on the top two deciles of the income distribution for both men and women.

The research also indicates that the total amount of government support does not vary much across the income deciles or by gender. Table 3.1 sets out the Treasury forecasts of government assistance for those born in 1960 and retiring in 2027. The proportion of assistance provided in the form of tax expenditures on superannuation increases with higher income, with a more or less equivalent decrease in the value of Age Pension expenditures.

Table 3.1 Net present value of cost to government of retirement income system by income level

Decile	NPV1-women	NPV1-men	NPV1-both
	\$m	\$m	\$m
1	\$1,750	\$1,600	\$3,350
2	\$1,700	\$1,600	\$3,350
3	\$1,650	\$1,600	\$3,300
4	\$1,650	\$1,600	\$3,300
5	\$1,650	\$1,600	\$3,200
6	\$1,650	\$1,750	\$3,400
7	\$1,900	\$1,800	\$3,700
8	\$1,850	\$1,950	\$3,800
9	\$1,850	\$2,050	\$3,950
10	\$1,800	\$2,450	\$4,250
All	\$17,500	\$18,050	\$35,550

Overall government support for the Age Pension was found to account for 82 per cent of the government assistance to women for their retirement and 68 per cent of the assistance provided to men.

One group that receives above average assistance is men in the top income decile. For the other income deciles, the withdrawal of the Age Pension largely matches the assistance given to higher superannuation contributions. However, this becomes irrelevant for those who are not entitled to even a part Age Pension. Limiting the concessional contribution cap to \$25,000 a year for those aged 50 and over with more than \$500,000 in superannuation is a policy response to this distributional finding.

Other recent [research undertaken by Mercer](#) also compared the relative level of total government assistance (tax concessions for superannuation and Age Pension expenditure) across a variety of income levels. This confirms the findings of the Treasury research and also provides illustrations at both the individual and couple level. This helps explain why the total level of government assistance in the form of superannuation tax concessions and Age Pension expenditures varies very little with the income of an individual or couple.

The research uses as representative examples seven individuals and seven couples with different lifetime experience ranging from low to high incomes. The examples include various patterns of real income growth over the career of the individual. At the low income end it is assumed that an individual has an initial income of \$40,000 a year and retires on the same amount in today's dollars after a 40-year career.

Other examples include those starting with a higher salary (namely \$62,500 a year) with final salaries (again in today's dollars) of up to \$272,330 a year. Clearly the examples cover a wide range of salaries and individuals and include those who could be regarded as relatively high income, including those who are on the top marginal tax rate for most of their career.

The results from this modelling highlight the following:

- As expected, higher income individuals receive a higher level of superannuation tax concessions but are also likely to receive a lower level of Age Pension.
- Similarly, those individuals who receive higher salary increases during their career receive a higher level of superannuation tax concessions but a lower level of Age Pension payments.
- Most individuals who receive a higher level of employer contributions (either through salary sacrifice or a higher SG) receive a lower level of total government support due to the effect of superannuation on the projected Age Pension payments.

Box 1 provides some specific examples drawn from the Mercer analysis.

### EXAMPLE 1

**Single male on an initial salary of \$40,000 a year with salary growth of four per cent a year.** In the labour force for 40 years receiving super contributions at nine per cent.

Present value of the superannuation tax concessions is \$53,740.

Present value of Age Pension payments is \$331,445.

*Total government support for retirement income of \$385,185.*

### EXAMPLE 2

**Single male on an initial salary of \$40,000 a year with salary growth of six per cent a year.** In the labour force for 40 years receiving super contributions at 12 per cent.

Present value of the superannuation tax concessions is \$102,200.

Present value of Age Pension payments is \$263,780.

*Total government support for retirement income of \$365,980.*

### EXAMPLE 3

**Single male on an initial salary of \$62,500 a year with salary growth of four per cent a year.** In the labour force for 40 years receiving super contributions at nine per cent.

Present value of the superannuation tax concessions is \$83,965

Present value of Age Pension payments is \$293,420.

*Total government support for retirement income of \$377,385.*

#### EXAMPLE 4

**Single male on an initial salary of \$62,500 a year with salary growth of six per cent a year.** In the labour force for 40 years receiving super contributions at 12 per cent.

Present value of the superannuation tax concessions is \$197,240

Present value of Age Pension payments is \$151,260.

*Total government support for retirement income of \$348,500.*

#### EXAMPLE 5

**Male on an initial salary of \$40,000 a year with salary growth of four per cent a year.**

Partner (female) working full-time for two periods (initially 10 years and then 15 years at the end). Same salary and contribution rates as for male.

Male In the labour force for 40 years receiving super contributions at nine per cent, with partner also receiving nine per cent.

Present value of the superannuation tax concessions for both is \$86,680

Present value of Age Pension payments is \$543,040.

*Total government support for retirement income of \$629,720.*

#### EXAMPLE 6

**Male on an initial salary of \$62,500 a year with salary growth of six per cent a year.**

Partner (female) working full-time for two periods (initially 10 years and then 15 years at the end). Same salary and contribution rates as for male.

Male In the labour force for 40 years receiving super contributions at 12 per cent, with partner also receiving 12 per cent.

Present value of the superannuation tax concessions for both is \$294,720

Present value of Age Pension payments is \$231,965.

*Total government support for retirement income of \$526,585.*

*Source: Mercer, The fairness of government support for retirement income, February 2010.*

The most important result from this research is that the total level of government support towards retirement income is almost constant across most individuals, notwithstanding their different lifetime incomes. Indeed, according to the Mercer analysis, the lowest support is for the individual who commences earning the average wage, makes additional superannuation contributions and receives a salary increase of six per cent per annum throughout their career so that their final income is about twice average earnings.

Because of the impact of the concessional contribution caps and the introduction or proposed introduction of measures focused on lower income earners, tax concessions and other government assistance for superannuation contributions are more evenly spread than some analysts have suggested based on relatively old or incomplete information.

As well, the Government proposals to (currently in legislation that has been passed by the House of Representatives and is being considered by the Senate) would further increase the proportion of assistance flowing to low and middle-income earners. Specifically, as initially announced in the Government's response to Australia's future tax system review and confirmed in the 2010-11 Federal Budget, the Government proposes to provide a new super contribution of up to \$500 annually for eligible low-income earners from the 2012-13 income year. The payment will be 15 per cent of the eligible concessional contributions (including employer contributions) made by or for individuals with adjusted taxable incomes of up to \$37,000. Individuals will also need to meet a test where at least 10 per cent of their income must be from employment or business sources and they are a resident of Australia or New Zealand.

By its very nature, this measure will only provide assistance to low-income earners on either the zero or 15 per cent tax rate.

Legislation is currently being considered by the Senate which will increase the rate of compulsory superannuation to 12 per cent, with this to be phased in over a period of years. This will have its greatest impact on low and middle-income earners given that those on higher incomes commonly already receive the benefit of contributions in excess of 9 per cent of wages and/or will adjust salary sacrifice contributions if there is an increase in compulsory contributions.

Table 4.1 compares the distribution of government assistance for superannuation in 2009-10 for employees on the basis of current policy settings and what it would have been if a 12 per cent SG, the low-income superannuation contribution payment and the current rate of co-contribution had applied in that year. While it will be some years before all the measures are fully in place, this approach illustrates what the eventual impact on the distribution of government assistance by income level will be.

**Table 4.1 Current and proposed government assistance for superannuation contributions by income range**

Taxable income range (\$)	Marginal income tax rate	Current value of tax concession and co-contribution (a) \$m	% of current total tax concession and co-contribution	Value of proposed total tax concession and government contributions (a) \$m	% of proposed total tax concession and government contributions
0 - 6,000	0%	192	1.5	210	1.4
6,001 - 37,000	15%	1,068	8.3	1,640	11.0
37,001 - 80,000	30%	4,462	36.4	5,732	38.3
80,001 - 180,000	38%	4,968	38.8	5,465	36.6
180,001+	47%	1,905	14.9	1,905	12.7
All employees		12,797	100	14,953	100

(a) 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 2009-10 tax rates.

The combined effect of the Government proposed measures would have, if they had applied in 2009-10, increased the assistance for retirement saving for employees earning less than \$80,000 a year from \$5,920 million to around \$7,580 million. Expressed as a percentage of total government assistance, the share of those earning less than \$80,000 a year would have increased from 46.2 per cent to 50.2 per cent. Clearly the measures strongly favour those on lower incomes.



The Treasury regularly publishes (in January each year) a Tax Expenditures Statement (TES). Amongst many other figures are estimates of the tax expenditures on superannuation.

The Treasury make use of an income tax benchmark for calculating these figures. The income tax benchmark treatment of superannuation is that contributions are taxed like any other income in the hands of the fund member, earnings are taxed like any other investments in the hands of the investor, and benefits from superannuation are untaxed. Any costs associated with superannuation investments are deductible under the benchmark.

However, arguably their methodology goes against international best practice. In most Organisation for Economic Co-operation and Development (OECD) countries the practice is to tax private pensions (superannuation) at the stage benefits are received, rather than at the contributions or fund investment earnings stages.

Accordingly, the preferred tax benchmark of a number of major OECD countries such as Belgium, France, Germany, Netherlands and Portugal, is that the appropriate point for taxation is when benefits are received.

As the [Retirement Income Consultation Paper](#) of the Henry Review noted, another alternative way to calculate the value of the tax concession is to use an expenditure tax benchmark. The two types of expenditure tax benchmarks are: a pre paid expenditure tax based on direct taxation of labour income with an exemption for saving; and a post paid expenditure tax based on the taxation of a direct measure of expenditure or of goods and services.

Under the pre paid expenditure tax benchmark, the value of the concession is the difference between the tax paid if the superannuation contribution were taxed as income at the individual's personal tax rate (plus the Medicare levy) and the tax paid in the fund, less the tax paid on earnings in the fund. Benefits are tax exempt under this benchmark, which is consistent with the tax exemption of superannuation benefits in Australia's retirement income system. Under this benchmark, the superannuation tax concessions would have an estimated aggregate cost to revenue of \$4.6 billion in 2007-08.

Under the post paid expenditure tax benchmark, both contributions and earnings would be tax exempt but benefits would be fully taxable when paid. Under this benchmark the tax concession is expected to be less than under the pre paid expenditure tax benchmark, as individuals will generally have a lower tax rate on their retirement income than their income while working.

Under all these benchmarks, superannuation is taxed concessionaly but clearly the amount of the concession is much smaller using an expenditure tax benchmark compared to the income tax benchmark currently used by the Treasury.

## 5.1 A more realistic estimate of the revenue impact of the super tax concessions

It is not unusual for commentators to point to the tax expenditure estimates and argue that the amounts could be spent on other government programs. However, as the Treasury itself has explained in its [TES](#), the tax expenditure estimates for superannuation should not be interpreted as a time series of the ongoing amount of revenue that could be obtained if superannuation concessions were eliminated. This is because the application of higher taxes would lead to lower contributions and lower account balances, reducing the tax from superannuation investment earnings as well.

In this context the Treasury has produced estimates of the tax expenditures for superannuation based on a revenue gain approach, albeit still using a comprehensive income tax base as the benchmark.

In these estimates it is assumed that the SG remains and therefore compulsory contributions continue. Voluntary contributions are assumed to be directed to alternative tax preferred investments such as negative gearing. Because more voluntary contributions come from those with higher marginal tax rates, the average tax rate for residual compulsory contributions is lower. As a result, the revenue gain from removing the tax concession for employer contributions would (according to Treasury in the 2011 TES) be \$10,500 million for 2010-11 rather than the \$14,500

million in the traditional tax expenditure estimates. A similar pattern of differences is shown for later years in the TES published by the Treasury on 31 January 2012.

In the accumulation phase, voluntary concessional contributions are assumed by Treasury to cease if the concessions are removed and most non-concessional contributions are also assumed to be not invested in superannuation after the start date. Over time this reduces the superannuation asset base and thus the revenue gain on withdrawing the earnings tax concession. Additionally, a significant proportion of funds in the retirement phase (not preserved) are withdrawn. Because of other tax concessions for older Australians (particularly the Senior Australians Tax Offset), Treasury has indicated that the funds withdrawn attract minimal tax in the new investments chosen.

The impact of such changes in behaviour are cumulative. Treasury has estimated that if the tax concessions were removed in 2010-11, by 2013-14 the tax expenditure on the concessional taxation of superannuation entity investment earnings would be \$11,150 million rather than \$17,900 million. This is a very significant difference and one that would continue to grow.

When higher Age Pension expenditures are also taken into account, the net revenue impact from removing the tax concessions for superannuation would be relatively small if not minimal.

## 5.2 Apparent errors and shortcomings of the tax expenditure estimates for super

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It is difficult to test the various tax expenditures estimates produced by the Treasury for superannuation as they make considerable use of unpublished estimates and projections produced by the ATO. As well, while the high-level approach in calculating the estimates is described, there is little or no description of the details and assumptions that are applied.

However, examining the pattern of the estimates (including in regard to inter-related components of the estimates) and making use of historical ATO and other data, raises a number of questions about the estimates. In particular, the assumptions adopted appear to have generated estimates that are higher than they should be even if it were accepted that the high level conceptual approach being adopted by the Treasury is valid.

More specifically, the HILDA data on contributions by income level indicates that the total tax concessions for employer contributions were around \$11,400 million. This is in contrast to the figure of \$14,100 million in the 2011 Treasury Tax Expenditures Statement. However, the 2012 TES figure for 2009-10 had come down to \$12,550 million, not dramatically different from the HILDA-based figures. The HILDA-based estimates also provide a breakdown of the amount of tax assistance by income tax bracket.

ATO data for 2008-09 indicates that the aggregate tax concession for the concessional taxation of personal contributions (principally the self-employed) was in the order of \$975 million (Table 2.4) rather than the \$1,750 million in the 2011 Tax Expenditures Statement.

One of the reasons for these differences is that when the 2011 TES was prepared there were no actual figures for either 2008-09 or 2009-10 and the estimates were prepared on the basis of historical experience. As this paper has indicated, the contribution caps have led to outcomes which have differed to those in earlier years. In this context the 2012 TES has the value of the concessional tax treatment of personal contributions plunging from \$1,500 million in 2009-10 to \$920 million in 2010-11, presumably because of the projected impact of the new (reduced) contributions caps applying to contributions made in 2009-10 and later years.

There also are indications that the TES estimates of the tax concessions relating to superannuation fund investment earnings are too high. This particularly applies to the capital gains components of the investment earnings.

The TES estimates appear to have been developed on the basis of calculating concessional amounts based on when tax bills are paid rather than on the basis of the year in which the capital gain occurred. For instance, the 2011 TES has an above average amount in the concessional treatment of superannuation investment earnings in 2008-09, a year in which investment earnings were low with insignificant capital gains. The implied pattern of capital gains for this item is also inconsistent with the pattern of the TES estimates of the capital gains tax discount for funds. This does not engender confidence in the estimates.

More fundamentally the TES estimates appear to use as a benchmark what the tax liability of individuals would be if they received capital gains personally and did not have access to the 50 per cent discount for capital gains on assets held for

more than one year. In some years this approach leads to a TES estimate which is \$5 billion or more than would be the case if the actual tax rate applying to individuals (which includes the capital gains discount applying to individuals) was used.

Similarly the TES estimates appear to assume that an average tax rate of 20 per cent applies to the income of retirees. This is inconsistent with what Treasury has stated elsewhere in the TES document, namely that if investments of retirees were moved from the superannuation sector to be held directly by individuals, minimal tax would be paid because of the Senior Australians Tax Offset. Given that assets in the retirement phase make up around one-third of total superannuation assets, this suggests that application of a more appropriate benchmark would reduce the TES estimates by \$3 billion or more on an ongoing basis.

All of these factors taken together suggest that the tax expenditures for superannuation may actually be around half those reported in the Tax Expenditures Statement.

A more definitive assessment would be possible if Treasury released the detailed calculations and assumptions underlying the estimates in their publication. This greater release of information is something that should be encouraged. Public policy debate deserves more than the current TES estimates making use of a number of undisclosed assumptions and projections rather than hard data.

There has been some canvassing in recent public debate of the Henry Review proposals in relation to the taxation of superannuation contributions and fund earnings. However, adoption of those proposals would be adverse to the interests of both current and future members of superannuation funds.

The Henry Review was an important process as it looked at the possible future of the Australian taxation system as a whole.

One complication in considering individual recommendations from the Review is that the Henry recommendations were designed to be considered (and adopted) as a package. In particular, the recommendations on superannuation interact with other recommendations relating to personal income tax.

More specifically, the arithmetic and costing of the superannuation recommendations are based on the personal income tax system having:

- a high initial income threshold before any tax is paid; and
- a relatively flat income tax rate structure over a broad range of income.

There is no indication that such a tax structure is to be adopted and this in itself raises questions about the viability of a number of the Henry Review superannuation recommendations regardless of the merits or otherwise of specific superannuation recommendations.

Official Treasury modelling in the working papers released by the Government in October 2010 concerning the costing of the recommendations in the Australia's Future Tax System Report (Henry Report), indicates both revenue and distributional considerations would make adoption of the Henry Review personal tax recommendations very problematic.

There would be a very substantial ongoing cost to tax revenue from the changes proposed by the Henry Review, with the first year impact being the greatest.

Most households and individuals would be adversely affected, with an even greater impact on low to moderate-income individuals who have heavy medical expenses, self-funded retirees, and those living in remote areas. The combination of each of these factors could have an extremely significant impact on some households.

As a result, the package of recommendations would be difficult to justify on either economic management or equity grounds.

## 6.1 Henry superannuation tax recommendations

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The superannuation tax recommendations made in the Review were designed to mesh with personal tax recommendations. If, as seems very likely, the personal tax recommendations are not adopted, then there would be even greater challenges in implementing the superannuation tax recommendations for two reasons:

1. the inclusion of employer superannuation contributions in interactions between personal taxable income and the various tax thresholds; and
2. the limited access to various tax offsets.

In summary, the Henry Review recommendations would lead to abolition of the flat rate of tax of 15 per cent on employer and other taxable contributions when they are received by a superannuation fund. Instead Recommendation 18 of the Review proposes:

- Employer superannuation contributions would be treated as income in the hands of the individual, taxed at marginal personal income tax rates, and would receive a flat-rate refundable tax offset. (Presumably when an individual is a member of a defined benefit fund their taxable income would include any notional contributions applicable to them).

- An offset would be provided for all superannuation contributions up to an annual cap of \$25,000 (indexed). The offset would be set so the majority of taxpayers would not pay more than 15 per cent tax on their contributions. The cap should be doubled for people aged 50 or older.
- An annual cap on total contributions would continue to apply.
- The offset would replace the superannuation co-contribution and superannuation spouse contribution tax offset.
- Compulsory superannuation contributions made by employers would not reduce eligibility for income support or family assistance payments. They would also not form part of the calculation for child support.

## 6.2 Commentary on the taxable contributions proposals

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Implicit in the Henry Review recommendations is the recognition that net contributions need to be higher than they currently are. With a 15 per cent contributions tax, a nine per cent of wages contribution becomes a 7.65 per cent contribution (after tax). This Henry Review recommendation implies that a net nine per cent contribution is more appropriate. This is equivalent to a 10.6 per cent of wages contribution before a 15 per cent contributions tax.

As such the increase would be half what is needed to bring contributions to the 12 per cent that is generally regarded as being the minimum necessary to bring about dignity in retirement for retirees in the future. Even at a contribution rate of 12 per cent it will take some time to increase average living standards in retirement.

There are significant problems with the remaining elements of the recommendation. If adopted as an overall package there would be significant adverse outcomes in terms of public policy:

- It would require funds to report actual or notional superannuation contributions to the ATO for inclusion in the taxable income of individuals. It would bring about most of the valuation and equity problems associated with the superannuation surcharge which was introduced in 1996 and later discontinued because of its inherent design defects.
- Rather than there being surcharge debts payable when benefits are taken, individuals would have to pay the tax (which could be 30 per cent or even 45 per cent of some or all of the contributions) out of what was previously take-home pay.
- A superannuation contributions tax regime of this type would be much more difficult to administer than the superannuation surcharge as the ATO would need to issue assessments and undertake matching of contributions with every individual receiving the benefit of superannuation contributions.
- Adoption of the recommendation would also require every individual who has received the benefit of employer superannuation contributions to lodge a tax return each year. There would be tens of millions of superannuation transactions that would need to be matched for over 10 million Australians.
- There also would be significant difficulties in applying the proposed regime to constitutionally protected superannuation schemes (which some state governments still have for their employees and officials).

This is not a recipe for equity or efficiency. While the Henry Report claims that the recommendation would reduce complexity, it would be more accurate to say that it would change the nature of the complexity in the tax treatment of superannuation contributions.

The model proposed is not one that has been adopted in any other country. ASFA is not aware of any country that attempts to apply income tax to notional contributions by employers into a defined benefit fund. Similarly no other country has moved from having superannuation contributions not taxable in the hands of an employee to becoming taxable.

There would also be substantial impacts on take-home pay for many individuals if the recommendations were adopted. The Treasury analysis released in October 2010 indicates that the aggregate reduction in disposable income for the 13 million Australians affected would be a massive \$12 billion. There also would be a \$3 billion per annum cost to government revenue as the loss of contributions tax and the proposed contributions tax rebate would substantially exceed the additional personal tax collected from individuals at the new proposed tax rates.

Treasury projections indicate that these figures would, by 2017-18, result in a decrease in household disposable income of nearly \$16 billion and a loss of government revenue of over \$4 billion.

In terms of the distributional impact of the proposed changes, there would be a reduction in disposable income for everyone with taxable income over \$30,000. For an individual on \$100,000 the reduction in taxable income is projected to be \$4,000 a year, or around \$80 a week. While there would be an increase in disposable income for those with taxable incomes under \$30,000 a year, the increase is projected to be on average only around \$2 to \$3 a week.

These are average figures. For certain individuals with actual or notional employer contributions in excess of nine per cent of wages, the impact would be greater. For superannuation schemes with cliff vesting, such as the arrangements applying to certain Commonwealth and State parliamentarians, the impact would be even greater with possible personal tax liabilities for some members of \$10,000 or more a year.

In general, the impact of the Henry Review superannuation proposals on members of defined benefit superannuation funds would be potentially severe, leading to substantially lower take-home wages without any offsetting increase in superannuation benefits eventually received.

Along with the direct reduction in take-home wages, it's also likely that inclusion of employer superannuation contributions in assessable income would push many taxpayers over various thresholds, leading to them paying higher marginal tax rates than they would otherwise face.

In contrast, a phasing in of an increase in the SG means that take-home pay will not generally decrease in absolute terms as the increased contributions will be a trade-off from future wage increases.

## 6.3 Henry recommendations on the tax of super fund earnings

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Along with changes to the taxation of contributions, the Henry Review recommended substantial changes to taxation of fund earnings in Recommendation 19 of the Report:

- The rate of tax on superannuation fund earnings should be halved to 7.5 per cent.
- Superannuation funds should retain their access to imputation credits.
- The 7.5 per cent tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.

There are some attractions to this recommendation:

- A lower tax rate on investment earnings would assist individuals in accumulating retirement savings. The magic of compound interest is assisted by there being a higher after-tax earnings rate. The Henry Report includes some numbers based on such a higher earnings rate.
- Tax reporting and administration of funds would be simpler with only one set of unit prices or crediting rates for both accumulation and pension products with the same investment choice.
- The transition from accumulation to pension phase would be simpler with a level playing field between all types of funds. Currently some funds find it difficult or impossible to move capital gains to the pension phase from the accumulation phase.

However, for many individuals this new tax during the retirement phase would largely negate the benefits from a lower tax rate during the accumulation stage.

## 6.4 Commentary on the taxation of super fund earnings proposal

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The projected benefits to individuals that are set out in the Henry Report relate to the accumulation stage. The measure would also remove the only remaining incentive to take an income stream in retirement rather than continue with an accumulation account with no drawdown requirements.

Preliminary calculations by the ASFA Research Centre suggest there would not be much difference, in terms of the arithmetic, whether an individual would be advantaged or disadvantaged over their lifetime by a uniform investment earnings tax rate applying to both accumulation and drawdown phases.

However, whether an individual will be advantaged or disadvantaged depends on a variety of factors, including opening balance and period over which a retirement balance is drawn down. More specifically:

- For a wage earner on \$50,000 a year in the workforce for 35 years, halving the investment tax rate would boost the eventual accumulation balance from \$246,000 to \$258,000. If they seek a target income (including Age Pension) of \$30,000, this lump sum would be exhausted at age 90. This is the same age at which the lump sum would be exhausted with a 15 per cent tax rate during accumulation and zero rate during drawdown, but the uniform tax rate would lead to the lump sum being exhausted around six months later.
- For someone starting with \$200,000, on a salary of \$100,000 and with a further 20 years of accumulation, they would have their accumulation boosted from \$603,000 to \$626,000. However, they would be disadvantaged by a uniform investment earning tax rate. Assuming a \$50,000 income in retirement, the lump sum would run out at age 84 rather than 85. Amongst other things, the Age Pension means test impacts more on those with higher accumulations.
- For individuals who currently postpone the realisation of capital gains until the retirement phase, the impact of the Henry Review proposals would be adverse.

There would also be many transitional issues from such a tax. For instance:

- How should an individual who has accumulated their retirement savings under the old regime be treated compared to someone who accumulates their savings under the new regime?
- What about those who have already commenced income streams?
- What about the treatment of providers of annuities and life pensions currently in payment?
- What would it do to the funding requirements of existing defined benefit schemes run by large companies?
- Would it provide a major incentive for individuals to have their investments outside the super system post-retirement, especially if there is a relatively high income threshold before any income tax is payable?

In the papers released by the Government there was no estimate of the distributional impact of the proposed changes to the taxation of the investment earnings of funds in both the accumulation and pension phases. This would be a very complicated exercise.

Estimates were published of the aggregate impact on tax revenue over the period to 2017-18. The estimates suggest that given there are more assets in the accumulation phase than in the pension phase, adoption of the Henry proposals would lead to a substantial reduction in tax revenue to the government.

There also would be substantial pressures for 'grandfathering' of the tax treatment of investments supporting pensions in payment. The argument would likely be that a change in tax treatment would be unfair where assets supporting the payment of the pension paid a higher rate of tax on investment earnings during the accumulation phase. The employer sponsors of defined benefit funds also would face increases in required employer contributions to pay pensions if there were no grandfathering.

Apart from the equity aspects, there would also be substantial tax revenue implications if the Henry Review proposals on the taxation of fund investment earnings were adopted.

If there was no grandfathering of investment earnings attributable to pensions currently in payment, Treasury has estimated that the revenue cost would be around \$2 billion in 2011-12 rising to nearly \$5 billion in 2017-18. If there were grandfathering, then the cost to tax revenue would be even greater, rising from \$2.8 billion in 2011-12 to nearly \$6 billion in 2017-18.

However, this cost to tax revenue would not necessarily lead to any significant increase in average retirement incomes. This is apparent from the examples for individuals at different income levels presented above.

The aggregate revenue cost is largely due to there being more assets in the accumulation phase than in pension paying phase, with this likely to continue for some decades. On an individual basis, whether or not a 7.5 per cent tax rate for investment earnings in both the accumulation and pension phases would deliver net benefits would depend on: a) how long were the respective periods of accumulation and pension drawdown?; and b) what was the starting balance?

A greater distributional and adequacy impact would be obtained by using the same cost to revenue to finance a targeted tax rebate aimed at low-income earners and/or those with low superannuation account balances.



## 6.5 Henry and Government proposals compared

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Analysis undertaken by the ASFA Research Centre indicates that superior outcomes for individuals and for tax revenue would flow from adoption of the package of an increase in the SG and the introduction of a tax rebate in regard to contributions made on behalf of low-income earners that is currently before the Parliament.

In particular, the low-income superannuation contributions rebate proposed by the Government would lead to substantially higher net contributions flowing to the benefit of lower income earners compared to the Henry proposals.

More generally, across a range of income levels the Government proposals for increasing the SG to 12 per cent and for a low-income contributions tax rebate generally deliver both higher take-home pay and higher retirement savings than the Henry Review proposals.

A more detailed commentary prepared on the Henry Review proposals is available from the May 2011 report published by ASFA, [Spotlight on Henry: A comparative analysis of the Henry Recommendations with the proposed increase of the Superannuation Guarantee to 12 per cent](#).



### A.1 Horizontal equity

Horizontal equity means that people in similar positions should be treated equally. In tax terms, people with equal ability to pay should pay the same amount in tax. In social security terms, people with equal needs should receive equal assistance. This relates to both the quantum of assistance provided and to treating individuals with equivalent private means in the form of assets and/or income, equally.

Developing a policy which reflects horizontal equity generally requires reference to the characteristics of different types of individuals or their physical, domestic or medical circumstances, for example, a single person, a married person with or without dependants, or a person with a disability or medical condition. Treating like-persons alike requires a judgement to be made on who is like and who is unlike.

Currently, both tax and social security notions of horizontal equity are applied. The tax system focuses on the individual as the unit to which horizontal equity applies, while the social security system generally also takes notice of the circumstances of dependants or partners to a marriage or defacto relationship. This can lead to some apparent inconsistencies. For instance, a married couple do not have the ability to combine their concessional contribution caps for superannuation purposes, but they are required to combine their assets for the purpose of the assets test for the Age Pension.

An added complication in the case of superannuation is determining the appropriate timing point for comparing individuals. Currently the focus is on yearly amounts of contributions although in the past there also was consideration of total superannuation assets accumulated through a Reasonable Benefits Limit system.

### A.2 Vertical equity

Vertical equity requires that people should pay taxes or receive government benefits according to their ability to pay.

The compulsory superannuation arrangements have arrangements relating to both the lowly paid and the highly paid, despite the application of a flat percentage tax rate on concessional superannuation contributions.

The Age Pension is means tested on the basis of separate income and assets tests. Payment is based on the test that gives the lower rate of pension. Under the income test, a single person's Age Pension is reduced by 50 cents in the dollar for each dollar of income in excess of \$150 per fortnight. Under the assets test, for a single homeowner the Age Pension is reduced if assets apart from the family home exceed \$186,750. These various levels, current at January 2012, are adjusted over time, and differ between singles and couples, and between homeowners and non-homeowners.

The rates of withdrawal of Age Pension benefits for an additional dollar of private income or \$100 of assets (over the threshold amounts) are relatively high by the standards of the personal tax system with an effective marginal tax rate (EMTR) at the flat rate of 50 per cent. In comparison the highest marginal tax rate is now 45 per cent (plus Medicare Levy) and that only applies to incomes over \$180,000 a year.

Apart from the excess contributions tax applying when contributions caps are exceeded, most superannuation tax arrangements are at a flat rate of 15 per cent of contributions. However, there are a variety of mechanisms such as the contribution caps (which limit the amount that upper income individuals can contribute) and the co-contribution, which benefit low-income earners. The proposed low-income earners contribution rebate also will provide substantial assistance to low-income earners.

### A.3 Preservation of past entitlements and expectations

In situations where an asset makes up a large proportion of an individual's total wealth or where the asset has a high value in absolute terms, equity and fairness can require past entitlements to be maintained. This is particularly the case when an individual may have made decisions based on past arrangements and/or intends in the near future to make use of their accrued benefits.

This dimension of equity is one that does not always feature significantly in regard to policy changes generally made by government. However, superannuation is for most individuals the second most important financial asset after the family home. It is not surprising that any policy change that impacts on the value of that asset can arouse strong feelings within the community in regard to equitable treatment, and accordingly governments give attention to this aspect of equity when considering policy changes impacting on superannuation.

Preservation of past entitlements can take the form of 'grandfathering' where assets or the like acquired before a certain date continue to receive tax or other treatment that applied before that date. Another possible approach is a 'sunset clause' where individuals can make use of past provisions or privileges only up to a future set date. After that date the new provisions uniformly apply. Sometimes such provisions are only available to individuals who have an entitlement current at the time a change is announced, with new entrants subject to the new provisions from their date of entry.

Surveys of fund members conducted for ASFA indicate that a lack of stability in taxation arrangements for superannuation is commonly regarded as being inequitable.

### A.4 Equity and employment circumstances

Equity in the taxation treatment of superannuation is of little joy to an individual if they have not had the opportunity to access superannuation in the first place. Equality of opportunity can relate to requiring superannuation to be offered or provided on a uniform basis to all employees.

While equivalent rules relating to the making of contributions currently apply to both employees and the self-employed, there are no compulsory contributions for individuals who are not covered by the Superannuation Guarantee definition of employee. Employment circumstances clearly impact on superannuation outcomes.

Attachment B to this paper provides data on superannuation coverage and account balances of the self-employed. The data clearly indicates that in the absence of compulsion only a relatively small minority make superannuation contributions. For the self-employed in the construction and transport industries, superannuation coverage, account balances and deductible contributions are particularly low.

To achieve greater equity between employees and individuals who are self-employed in roles very similar to employees, the coverage of compulsory superannuation would need to be extended.

### A.5 Actuarial equity

Where there are insurance elements within retirement income arrangements, notions of actuarial fairness or equity may arise. Particularly where there are voluntary private insurance arrangements, the ongoing success of arrangements can depend on whether participants (both suppliers and purchasers) perceive that the rates being charged are fair. If a rate or premium is perceived as being excessive, then the individual may choose not to participate. If the rate or premium offered is lower than the actuarial risk then there is the danger of adverse selection, with high risk individuals taking opportunity of the insurance product being offered. This can place the viability of the overall scheme at risk if claims subsequently exceed the premiums that have been received.

Actuarial equity can also be a consideration when options are made available to individuals, such as delaying the take-up of benefits in return for a higher annual benefit payment. Actuarial equity would require that the benefit offered be commensurate with the cost involved in the short-term for an individual.

## A.6 Inter-generational equity

Individuals can receive differential treatment in terms of the requirement to make contributions or pay taxes and/or receive different retirement benefits depending on when they were either born, worked or retired. Changing patterns of work, taxes and retirement lead to changes in the way resources are distributed between different age groups. Along with these underlying changes there also can be changes in the rules that apply, sometimes to the detriment and sometimes to the benefit of particular generations.

Any changes to current superannuation arrangements need to take into account the actual or perceived impact on the equity between generations

The self-employed make up a substantial proportion of the paid labour force in Australia. In 2009-10 there were around 754,000 individuals who were classified as self-employed by the Australian Bureau of Statistics. This compares to 9,258,000 wage and salary earners.

Self-employment is relatively common in primary production, construction, property and business services, retail trade, and transport services. On the other hand, there are very few self-employed persons in government administration and defence, or mining.

Compulsory superannuation contributions in the form of the Superannuation Guarantee (SG) are largely restricted to employees. However, some of the self-employed are covered by the SG due to the definition of wage and salary earners in the legislation. The SG covers a person who works under a contract that is wholly or principally for their labour. This means that a contractor may be considered an employee under the SG. This is the case even if the individual concerned quotes an Australian Business Number (ABN). The [Australian Taxation Office website](#) has further details. However, enforcement can be difficult in cases which purport to establish a contractor relationship.

As well, many individuals who are currently self-employed at some stage in the past were employees. As a result they have accumulated compulsory superannuation benefits. The tax concessions which apply to superannuation also mean that some of the self-employed make voluntary superannuation contributions.

However, on average the self-employed are less likely to have superannuation than employees (Table B.1). Around 29 per cent of the self-employed have nil superannuation, with no superannuation being more common for males than females. This reflects, amongst other things, self-employed males being employed in industries which are less likely to pay superannuation. Some of the coverage of superannuation of the self-employed also would flow from having an inactive account related to a previous job as an employee.

In contrast, only around 13 per cent of wage and salary earners have no superannuation (presumably part timers below the threshold for SG or the survey respondent not knowing about their superannuation).

Table B.1  
Distribution of superannuation by main source of income and sex of person, Australia, 2009-10

SUPERANNUATION BALANCE GROUP (A)					
	NIL	LOW	MIDDLE	HIGH	TOTAL
Distribution of population (%)					
<b>MALE</b>					
Wage and salary	12.9	46.1	21.8	19.2	100.0
Self-employed	30.5	40.4	17.8	11.2	100.0
TOTAL (a)	16.8	44.4	20.6	18.2	100.0
<b>FEMALE</b>					
Wage and salary	13.5	58.5	17.4	10.5	100.0
Self-employed	25.8	52.7	12.8	8.7	100.0
TOTAL (a)	16.0	57.1	16.5	10.4	100.0
<b>PERSONS</b>					
Wage and salary	13.2	51.8	19.8	15.2	100.0
Self-employed	29.2	43.9	16.4	10.5	100.0
TOTAL (a)	16.5	50.1	18.8	14.7	100.0

The incidence of high superannuation balances (over \$100,000) is relatively low amongst the self-employed. For males, wage and salary earners are around twice as likely to have high balances compared to the self-employed.

While 42 per cent of wage and salary earners achieved a superannuation balance in 2009-10 of more than \$100,000 in the run-up to retirement, only around 18 per cent of the self-employed managed to do so.

### B.1 Differences in superannuation coverage by industry and occupation

In terms of the split by industry, there is a minority with high balances in each of the agricultural, construction, retail trade, property and business services, and health and community services industries (Table B.2). This most likely means that there are a significant number of farmers, builders, shopkeepers, real estate agents, financial planners, doctors and dentists with a reasonable amount of superannuation.

Low and nil balances are relatively common for the self-employed across most industries. The construction and transport industries are ones where there are both a significant number of the self-employed and large proportions with nil or low superannuation.

Table B.2  
Number of self-employed by superannuation group, 2009-10

SUPERANNUATION BALANCE GROUP (A)					
	NIL	LOW	MIDDLE	HIGH	TOTAL
Distribution of population (%)					
<b>HIGHEST QUALIFICATION</b>					
Degree or higher	35.5	66.0	25.5	35.9	162.9
Diploma	23.9	37.2	*9.0	9.1	79.2
Certificate	50.3	121.4	58.0	16.2	245.9
No post-school	107.3	98.1	27.6	15.7	248.7
Other	*3.0	*8.9	*3.6	**2.1	17.6
TOTAL	220.0	331.5	123.8	79.0	754.3
<b>INDUSTRY OF MAIN JOB</b>					
Agriculture, forestry & fishing	13.5	58.5	17.4	10.5	100.0
Mining	25.8	52.7	12.8	8.7	100.0
Manufacturing	16.0	57.1	16.5	10.4	100.0
Electricity, gas, water & waste services	n.p.	**1.0	n.p.	**1.8	**3.9
Construction	43.4	87.8	27.7	*6.3	165.2
Wholesale trade	*7.7	*8.0	*3.5	**1.1	20.4
Retail trade	*16.8	20.8	*7.3	*5.7	50.6
Accommodation & food services	*6.5	12.2	**2.4	**1.5	22.7
Transport, postal and warehousing	33.6	*12.2	*7.0	**1.4	54.3
Information media & telecommunications	**1.5	*5.7	**3.1	0.0	*10.4
Financial & insurance services	n.p.	n.p.	n.p.	n.p.	*5.7
Rental, hiring and real estate services	n.p.	*5.9	n.p.	**0.7	*9.1
Professional, scientific and technical services	14.5	43.4	20.8	23.3	102.1
Administrative and support services	*17.1	27.4	*3.9	*2.8	51.1

Public administration and safety	0.0	n.p.	0.0	n.p.	**0.6
Education and training	*3.1	*8.1	**4.2	*4.4	19.8
Healthcare and social assistance	*9.0	17.2	*7.0	*12.8	45.9
Arts & recreation services	*2.2	*6.2	**1.4	0.0	*9.8
Other services	25.8	28.9	*10.2	**2.3	67.2
TOTAL	220.0	331.5	123.8	79.0	754.3
<b>OCCUPATION IN MAIN JOB</b>					
Managers	41.6	47.9	19.8	*13.9	123.3
Professionals	26.7	62.1	35.7	38.7	163.3
Technicians & trade workers	56.0	110.7	34.6	12.7	214.0
Community & personal service workers	*10.7	*15.5	**1.8	**1.4	29.5
Clerical & administrative workers	*18.7	23.7	*12.1	*5.9	60.4
Sales workers	*8.1	*12.4	*7.0	**2.3	29.7
Machinery operators & drivers	28.5	*16.8	*5.5	**2.1	52.8
Labourers	29.4	41.1	*7.1	*2.1	79.7
TOTAL	220.0	331.5	123.8	79.0	754.3

\*estimate has a relative standard error of 25% to 50% and should be used with caution.

\*\*estimate has a relative standard error greater than 50% and is considered too unreliable for general use.

n.p. cell has not been published due to sample quality issues.

(a) For more information on superannuation groups refer to Explanatory Note (5).

(b) The (-) cell has no value or has not been published as no relative standard error (RSE) could be obtained.

For more information refer to Explanatory Note (6).

Along with differences in the pattern of superannuation account balances, there are very significant differences in the pattern of deductible contributions by the self-employed. In 2008-09 (the latest year for which data are available) there was a general concessional contribution cap of \$50,000 a year and a higher cap of \$100,000 for those aged 50 and over.

For the self-employed in some industries (including health, property and business services, and finance and insurance), the caps were well utilised (Table B.3). On the other hand, average contributions by the self-employed in the construction and transport industries were relatively low.

Table B.3  
Self-employed tax deductible superannuation contributions by industry

Industry	No. claiming	Aggregate amount claimed (\$m)	Average deduction
Agriculture, forestry & fishing	7,415	306	\$41,130
Mining	170	6.6	\$39,700
Manufacturing	2,250	36	\$16,100
Electricity, gas & water supply	125	2.7	\$21,900
Construction	17,475	168	\$9,600
Wholesale trade	1,025	24	\$23,550
Retail trade	3,775	116	\$30,670
Accommodation, cafes & restaurants	970	21	\$21,950
Transport & storage	4,315	52	\$12,050

Communication services	390	10	\$25,880
Finance & insurance	49,625	1,832	\$36,920
Property & business services	5,985	315	\$52,670
Education	1,640	38	\$34,975
Health & community services	13,570	582	\$42,940
Cultural & recreational services	2,010	57	\$28,520
Personal & other services	5,120	62	\$12,190

Source: ATO Taxation Statistics, 2008-09

**The Association of Superannuation Funds of Australia Limited**

Level 6, 66 Clarence Street, Sydney NSW 2000

PO Box 1485, Sydney NSW 2001

T 02 9264 9300 or 1800 812 798 (outside Sydney)

F 1300 926 484

W [www.superannuation.asn.au](http://www.superannuation.asn.au)

ABN 29 002 786 290 ACN 002 786 290

