



# Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011: reform of the tax treatment of superannuation contributions.

Submission to the Senate Economics Committee

ACOSS Paper 180

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## 1. Summary

As the peak body for community welfare organisations, ACOSS has a long standing interest in taxation and superannuation policy. Our main goals in regard to tax policy are to improve the fairness of the system and to ensure that Governments collect the revenue they need for essential services and payments in a way that minimises harm to the economy.

ACOSS participated in the Australia's Future Tax System Review (AFTS) process and advocated reforms to make the personal income tax system and the tax treatment of superannuation fairer and more efficient. On the whole, we strongly supported the recommendations of that review. We believe the AFTS Report is a useful road map for progressive tax reform over the coming decade and advocated a number of its key proposals at the recent Tax Forum.

Specifically, ACOSS supported:

- The introduction of a form of mining resources tax to tax the exploitation of this key resource in a more efficient way and ensure that the benefits of mining flow to the broader community;
- More consistent tax treatment of investment incomes based on a 40% discount off marginal personal tax rates (in effect, higher tax rates for capital gains and lower tax rates for interest income than apply at present), to reduce the tax bias in favour of speculative investment in assets such as property and shares, and to improve fairness.
- A fairer and simpler tax regime for superannuation contributions, replacing existing tax concessions including the flat 15% tax on employer contributions with a capped annual rebate.

Comparing the Government's policy response to the AFTS Report with the above reform proposals, we conclude that:

- The proposed mining tax in the *Minerals Resource Rent Tax* Bill is more limited in its scope and revenue potential than that proposed in the AFTS Report, but **should be supported** as a major step towards efficient and effective taxation of the use of our mineral resources and important source of public revenue.
- The 15% rebate for employer superannuation contributions for low income earners included in the *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011* offsets the 15% tax penalty that applies to contributions made on behalf of those on the lowest incomes, but falls well short of the reforms to the taxation of superannuation contributions envisaged by the AFTS Report. In particular, it retains the regressive flat 15% tax for employer contributions which delivers almost half of the \$16 billion in annual tax breaks on employer contributions to the top 12% of taxpayers. However, the Government Contribution **should be supported in the absence of the more substantial reforms proposed below.**

- The Government's proposed increase in the concessional contributions cap from \$25,000 to \$50,000 for individuals over 50 years of age with less than \$500,000 in superannuation assets is a step in the wrong direction that would mainly benefit high income earners, along with a minority of people on lower incomes who have sufficient financial assets to transfer over \$25,000 to their superannuation account in a single year. The Treasury estimates that less than 5% of people with incomes below \$100,000 a year made over \$25,000 in concessional contributions, compared to over half of those on incomes above \$300,000 per year. This poorly targeted increase in tax breaks to individuals who are already relatively well-off would cost more than \$500 million per year. **We recommend that this measure be opposed once the legislation is introduced.**
- The increase in the Superannuation Guarantee contributions proposed in the *Superannuation Guarantee (Administration) Amendment Bill 2011* should boost the retirement incomes of low and middle income earners but at the cost of lower wage increases, hence lower pre-retirement incomes. Whether this trade-off is financially beneficial for low and middle income earners depends critically on the tax treatment of employer contributions. In our view, as long as a flat 15% tax applies to employer contributions there is not sufficient benefit for people on low incomes, notwithstanding the proposed 15% Government contribution. We also consider that an increase in compulsory contributions is the ideal time to reform the tax treatment of superannuation contributions generally, as any 'losses' in future after-tax contributions incurred by superannuation funds (other than self-managed funds) as a result of revenue-neutral progressive tax reform in this area could be offset to a significant degree by the higher compulsory contributions.
- **We therefore recommend that passage of this legislation be made conditional on more substantial revenue-neutral reform to equalise the tax concession for each dollar contributed to superannuation for low, middle and high income earners.** In addition to the proposed Government contribution for low income earners, that would require a substantial reduction in the tax concessions for contributions for those in the top two tax brackets, and a substantial further increase in tax concessions for those below the tax free threshold. A proposal to achieve fair and revenue neutral reform of this kind is presented in this submission.
- The legislation before the Committee does not include the proposed *50% discount on the personal tax paid for interest income*, as the Government decided to defer this measure as part of the savings measures included in the Mid Year Economic and Fiscal Outlook statement. Since this proposal is not linked to an increase in the personal tax rate on capital gains as proposed by the Henry Report and it is unlikely to have a substantial impact on private saving, we believe that **it should be opposed once legislation is introduced.** This would help ensure that the overall legislative package of tax reforms associated with the Minerals Resource Rent Tax is fiscally sustainable in future years.



The remainder of this submission deals specifically with the superannuation measures.

## **2. Why the present system of tax concessions for superannuation should be reformed**

The Federal Government supports the incomes of retired people in three ways: the age pension, compulsory employer superannuation contributions through the superannuation guarantee, and tax breaks for superannuation.

The pension provides a minimum income 'floor', the superannuation guarantee will lift retirement incomes for many people substantially above pension levels, and the tax breaks support both compulsory and voluntary saving for retirement.

ACOSS considers there is a strong case for each of these three elements of public support for retirement incomes, but that the third component – superannuation tax concessions – are poorly targeted and inefficient.

Since we lack a national social insurance scheme (a Government-managed superannuation system), Australia relies more on tax concessions for private superannuation saving than any other OECD country.<sup>1</sup> The cost of tax breaks for superannuation is roughly equal to that of the age pension: \$30 billion in 2010-11 compared to \$32 billion for age pensions.<sup>2</sup>

Tax concessions for both compulsory and voluntary saving through superannuation are justified to the extent that they compensate individuals for forced saving through compulsory superannuation and encourage voluntary saving to achieve an adequate income in retirement and reduce reliance on the age pension. This means that they should ideally be targeted towards low and middle income earners since they are less likely to save for retirement, and more likely to rely on the age pension, in the absence of compulsion or tax incentives. This has long been recognised by experts in this field including the OECD and the AFTS Review Panel.<sup>3</sup>

However, despite the extension of superannuation to most workers, its tax treatment harks back to a time when superannuation was a perk for the well-off.

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<sup>1</sup> The OECD estimates that these tax concessions cost 3% of GDP in 2007, well above the next highest 'spender' on retirement income tax concessions, Canada at 2.2%. OECD Social expenditure data base.

<sup>2</sup> Treasury (2011) Tax Expenditure Statement 2010-11; FAHCSIA (2011) Annual Report 2010-11

<sup>3</sup> Antonin et al 2004, Long term budgetary implications of tax favoured retirement plans, OECD Economics Department Working Paper No16, AFTS Panel (2009) Report to the Treasurer.

The main tax breaks for superannuation are the flat 15% tax rate that applies to contributions made by employers on behalf of their workers, and the flat 15% tax rate that applies to the annual earnings of superannuation funds. For most taxpayers, but not those below the tax free threshold, this is lower than the tax rate that would otherwise apply to their wages or interest income.

**Table 1: Cost of major superannuation tax concessions (2011-12)**

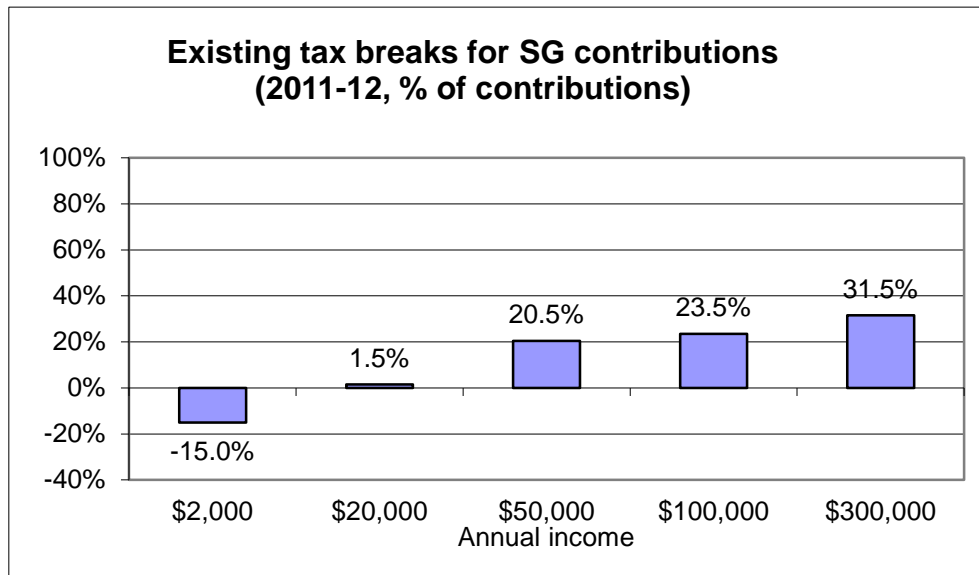
15% tax on employer contributions	\$15.8 billion
15% tax on super fund earnings	\$13.6 billion
Deduction for contributions by self employed individuals	\$1.0 billion
Total (including minor concessions)	\$30.5 billion
Cost of age pension in 2010-11	\$32.0 billion

SOURCE: Treasury (2011), Tax Expenditure Statement 2010-11; FAHCSIA (2011), Annual Report,

The flat 15% tax rate on employer contributions undermines the progressivity of the progressive personal tax rate scale. Compared with the marginal tax rate an employee pays on their wages, this means that earnings contributed to superannuation by their employer are taxed 32 cents per dollar less in the case of a high income earner, but 15 cents per dollar *more* for an employee below the tax free threshold (currently \$16,000 taking account of the Low Income Tax Offset). **That is, employer superannuation contributions for these low income earners are *penalised* by the tax system.** This makes it less worthwhile for them to save for retirement and means that an increase in compulsory employer contributions could potentially disadvantage them.

The graph below compares the tax savings per dollar contributed compulsorily by an employer (under the superannuation guarantee) on behalf of employees at different wage levels. This is calculated as the difference between the marginal rate of tax that would normally apply to wages (taking account of the Medicare Levy and Low Income Tax Offset) minus 15%.

Graph 1



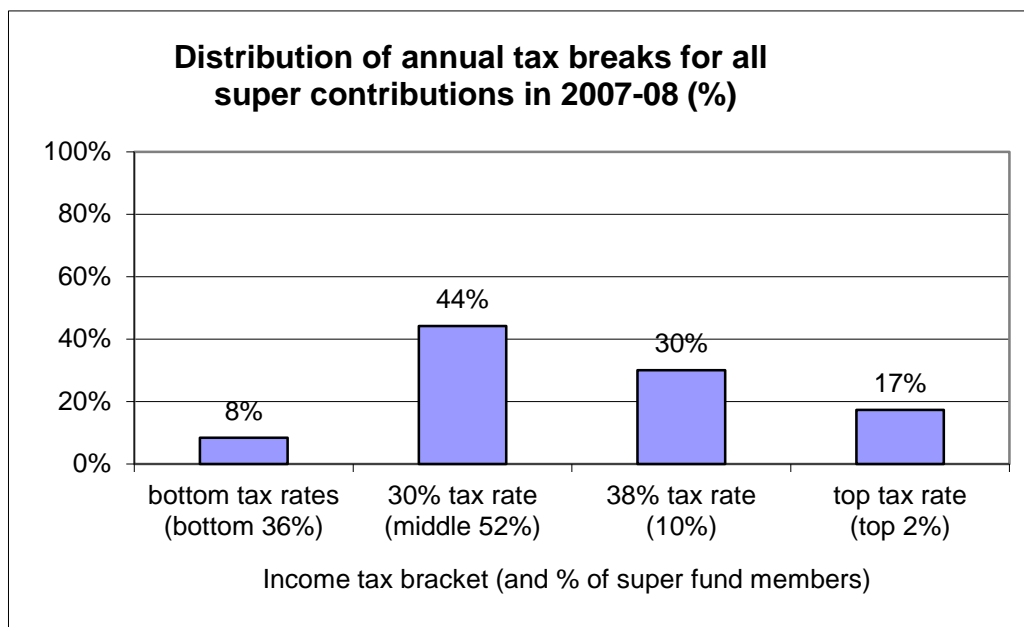
Note: 'SG' refers to Superannuation Guarantee contributions of 9% of wages. The graph takes account of the Low Income Tax Offset, so that an individual earning up to \$16,000 does not normally pay income tax on their wages and an individual on \$50,000 pays an additional 4% in tax as the LITO is clawed back. It also takes account of the 1.5% Medicare Levy, from which an employee on \$2,000 is exempted.

The distributional effect of the present tax treatment of employer contributions is the same as replacing the current progressive income tax scale with a flat 15% tax. While the pension is targeted towards low and middle income earners, the tax breaks are targeted to high income earners. The graph below shows that of the \$15 billion in tax breaks on superannuation contributions in 2008, almost 20% went to the top 2% of income earners (those over \$150,000) and almost 50% went to the top 12%. In fact, the top 20% of income earners receive more in tax concessions over their lifetimes than they would have received if paid the maximum rate of age pension.<sup>4</sup>

<sup>4</sup> Rothman (2009), Assessing the Equity Of Australia's Retirement Income System, 17th Colloquium of Superannuation Researchers, University of NSW, July 2009



Graph 2



ACOSS estimates based on Gallagher (2011), Treasury Measurement of Retirement Income Adequacy and Tellis (2009), Projecting the Distributions Of Certain Superannuation Tax Expenditures On Contributions, 17th Colloquium of Superannuation Researchers, University of NSW, July 2009.

This inequity especially disadvantages women, many of whom are employed part time on low wages. It contributes to their low levels of retirement savings and high levels of reliance on the age pension.

The latest ABS data from 2007 showed that working age women have just over half the retirement savings that men have. In 2004, half of all women aged between 45 and 59 had \$8,000 or less in superannuation, while men had \$31,000<sup>5</sup>. Statistics also show that more women (38%) than men (26%) do not have superannuation and more women than men have dormant accounts.

<sup>5</sup> Figure quoted in speech by Elizabeth Broderick, Sex Discrimination Commissioner and Commissioner responsible for Age Discrimination, Australian Human Rights Commission (15 September 2009): *Accumulating poverty: Women's experiences of inequality over the lifecycle*, from: Simon Kelly, *Entering Retirement: the Financial Aspects* (Paper presented at the Communicating the Gendered Impact of Economic Policies: The Case of Women's Retirement Incomes, Perth, 12-13 December 2006) p 12.

While this is mainly in older age groups, the differences will increase as younger women workers take on unpaid family responsibilities, via part time work and fewer possible promotions. This tension shows in the 2007 data, with lone females aged 35-44 years having 89% of male balances versus coupled females with only 60% of the male mean, This raises questions on what is the public obligation to contribute to an adequate retirement income for those whose social contributions reduce their time in paid work.

The gender differences point to ongoing flaws in a system that relies on people being in continuous paid work until retirement. Women's lifetime earnings are generally less than men's because of the time demands of higher domestic and care responsibilities and the generally lower pay rates for many jobs, identified as primarily female. The current hourly wage gap is around 17% and has remained more or less static over many years and discrimination is a factor as found in a recent Fair Work Australia judgement on the community services industry. They are also more likely to be casual workers as the only way that they can achieve family need flexibility, and fewer casuals are also covered.

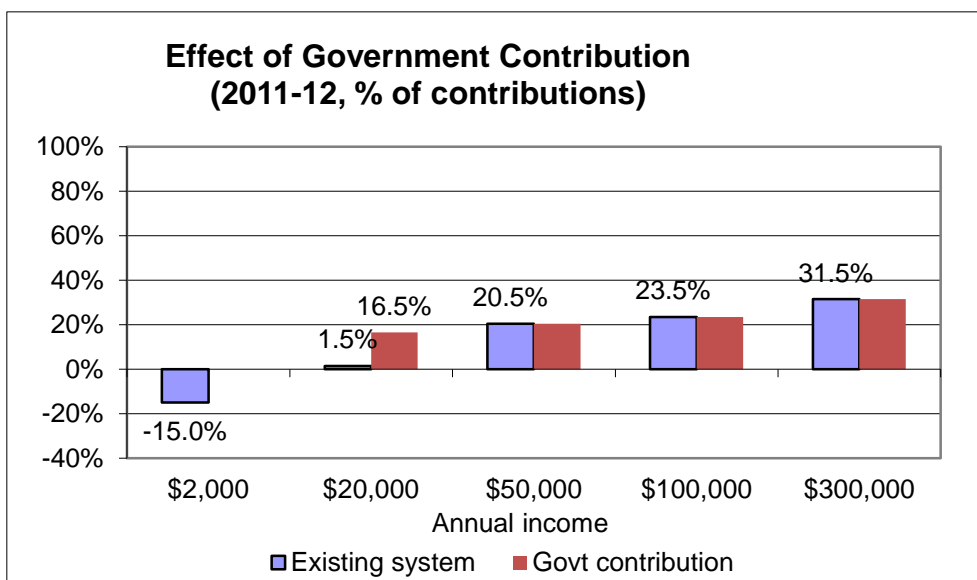
These gender biases in the superannuation system are exacerbated by the inequities in the tax treatment of contributions described above. They cannot be resolved by giving mature age women the opportunity to 'catch up' by increasing the cap on concessional contributions for those over 50 years of age, as the Government proposes, because only a small minority of relatively well-off mature age women can afford to make contributions in excess of \$25,000 in a single year. The majority of women, who earn less than average wages, would benefit far more from a redistribution of tax concessions towards those on lower incomes. This is because every dollar contributed by their employers earlier in their careers would result in higher (after tax) deposits into their superannuation accounts, the benefits of which would grow over time as fund earnings compound.

### 3. The Government’s proposals regarding superannuation tax concessions

The Government’s proposal to introduce a 15% ‘Government Contribution’, capped at \$500 per year, to supplement employer contributions for individual employees earning less than \$37,000 is intended to offset the 15% tax penalty for superannuation guarantee contributions on behalf of low income employees in the bottom two tax brackets. As graph 3 shows, the Government Contribution would:

- Increase the tax concession per dollar contributed from -15% to zero.  
- However, it would still leave them with no net tax support for contributions from their employer.
- Increase the tax concession for superannuation guarantee contributions for those in the 15% tax bracket (those earning from \$16,000 to \$37,000) from 1.5% to 15%.
- However, it would not affect the tax breaks for average and higher income earners, so that an individual in the top tax bracket would still receive at least twice the tax break per dollar contributed as a low income earner.

Graph 3



The Government Contribution would therefore significantly improve the equity of the system for low income earners, but would still leave those below the tax free threshold with no net tax concession for employer contributions. Further, it would not reduce the excessive tax concessions for those in the top two tax brackets.

In order to equalise the tax concessions for employer contributions for individuals in different tax brackets (so that every dollar contributed by employers up to the concessional caps attracts roughly the same tax break), the Government would have to do much more than introduce a 15% Government Contribution for those in the zero and 15% tax brackets. It would have to:

- Double the proposed Government Contribution from 15% to 30% for those below the tax free threshold;
- Increase the 15% contributions tax by approximately 7.5% for those in the 37% tax bracket and by 15% for those in the top (45%) tax bracket.

We outline a much simpler way to achieve the same objective below.

The Government also proposes to increase the annual cap on concessional contributions (those attracting a tax break) from \$25,000 to \$50,000 for people over 50 years who have less than \$500,000 in superannuation assets. This is a partial reversal of a decision announced in the 2009 Budget to improve the fairness of superannuation by capping tax concessions for those on higher incomes.

As the AFTS Strategic Issues Paper on Retirement Incomes noted, very few low or middle income earners contribute over \$25,000 to superannuation in a single year.

- Less than 5% of those earning less than \$100,000 contributed more than this in 2009-10.
- On the other hand, more than half of those on \$300,000 and above contributed more than \$25,000 a year.

Clearly, unless they have less than \$500,000 in superannuation assets, this measure will heavily favour high income earners. We note that this level of superannuation assets is well above the median.

It is likely that many of those on middle incomes who contribute (or receive in employer contributions) more than \$25,000 in a single year are not increasing their savings by doing so. Since this is almost half of an average fulltime wage, it is clear that few middle income earners could afford to make such a high level of contributions unless they are transferring existing financial assets into superannuation, 'churning' their wages through superannuation accounts through 'transition to retirement' arrangements, or the contribution is gifted by a family member. In these cases, it is very doubtful that the proposed extension of tax concessions would boost private saving levels.

It is also doubtful that an increase in tax concessions for those contributing more than \$25,000 in a single year would target those most in need of more public support for their retirement saving. Those who can afford to contribute such amounts are, generally speaking, more likely than the average person to enjoy a comfortable income in retirement as the financial and other assets available to their family are likely to be well above average.

The cost to revenue of the proposed increase in the contributions cap to \$50,000 is estimated to be \$545 million in 2012-13, which is two thirds of the projected revenue saving from the original 2009 Budget proposal to reduce it to \$25,000 (which suggests that limiting the concession to those with less than \$500,000 in superannuation reduces the cost of this measure by only one third). This is a very poorly targeted way to assist people to improve their retirement savings and the money would be better spent supporting the retirement savings of low income earners, for example by doubling the proposed Government Contribution for those below the tax free threshold.

#### **4. AFTS Report superannuation proposals**

If taxation subsidies were more fairly distributed – if each dollar of contributions attracted the same rebate of tax up to an annual limit - the savings obtained by reducing tax breaks for high income earners could be used to substantially increase after-tax contributions for those on low and middle incomes. A reform of this kind, as proposed in the AFTS Report, could raise annual after-tax contributions for workers in the zero and 15% tax marginal tax brackets by at least 3% of their wages. That is, it could *double* the increase in after-tax contributions and retirement savings resulting from the proposed increase in the superannuation guarantee.

The AFTS Report proposed that employer contributions be taxed at each employee's marginal tax rate (which is known to the employer) and that existing tax breaks for superannuation contributions be replaced by an annual capped rebate. An indicative rebate modelled in the AFTS Report was 20% of all contributions up to the (then) concessional contributions cap of \$25,000 per year. Compared with the existing tax concessions shown in graph 1, this would substantially increase the concession per dollar contributed for those in the zero and 15% tax brackets, roughly maintain the existing tax concessions for middle income earners, and substantially reduce them for those in the top two tax brackets.

Another key benefit of this reform is that by taxing employer contributions at marginal rates, it is possible to equalise the tax concessions for all contributions, whether they come from employers, employees or self employed people. This is because all contributions would be made from after-tax income and the tax on contributions would be offset by a uniform rebate. This would greatly simplify the system by replacing at least five different tax treatments of contributions (including the employee co-contribution) with a single tax concession. Importantly, it would encourage saving by low and middle income earners by making the annual tax concession for their contributions more visible and transparent.

A further advantage of this approach is that, unlike previous attempts to improve the equity of the system by taxing excessive superannuation *benefits* at a higher rate, the new tax treatment would only apply to new saving. The absence of any element of retrospectivity means that complex and inequitable ‘grandfathering’ arrangements would not be needed. The changes would only apply to new contributions made from the date of effect of the reform.

The Report also advocated an important measure to prevent people over 55 years of age from taking advantage of tax concessions on superannuation contributions to reduce the tax on their earnings without actually saving more for their retirement. This increasingly common tax avoidance strategy involves the ‘churning’ of income through superannuation accounts through salary sacrifice arrangements and the simultaneous payment of benefits to maintain current disposable income. This strategy is often associated with ‘transition to retirement’ products for the over 55s. It was also facilitated by the removal of taxes on benefits for the over 60s in 2007. To curb this tax avoidance strategy, the Report recommended that tax breaks for superannuation contributions should only apply to the extent that contributions made exceed benefits paid in any given year (that is, the fund member is using the superannuation system to save for retirement, as public policy intends).

The main weakness of the AFTS proposals is that the proposed contributions tax would be deducted from employee’s wages – a form of forced saving in all cases where the contributions tax (at marginal tax rates) exceeds the value of the proposed rebate. This would reduce the current disposable incomes of many families and is unlikely to attract public support. In any event, this form of forced saving would not be necessary if the superannuation guarantee is increased as proposed by the Government. We prefer the option of increasing the superannuation guarantee, **provided the tax concessions are reformed at the same time.**

A further problem with the option modelled in the AFTS report is that the replacement of the flat 15% tax on employer contributions and other tax breaks for contributions with a 20% rebate on contributions up to the current concessional cap (\$25,000) would not be revenue neutral. Subsequently released Treasury modelling suggests that this option would cost at least \$4 billion per year. The main reason for this is the retention of the \$25,000 contributions cap.



## 5. ACOSS proposals for superannuation reform

We propose that, in conjunction with the proposed increase in the Superannuation Guarantee, the tax concessions for superannuation contributions be reformed along the lines advocated by the AFTS Report, but with a few significant differences:

- Employer contributions would be taxed in the hands of the employer at each employee's marginal tax rate (as is the case with wages), except that the tax would be deducted from the employer's contributions to the fund, not from wages. In this way, the contributions tax would reduce superannuation savings rather than current income (as is the case now with the 15% contributions tax).
- All public subsidies for superannuation contributions (including the deduction for self employed people, the spouse contributions rebate and the Government Co-contribution) would then be replaced by an annual rebate on all contributions (regardless of source) which would be paid by the ATO to the nominated superannuation account (an end of year tax adjustment could also be made at this time, as is the case with the taxation of wages).
- In order to assist those on the lowest incomes to save for retirement and to minimise the number of 'losers' among those who use the Government Co-contribution, the rebate could be two-tiered. For example, the rebate could match contributions dollar for dollar up to a low annual level (for example 0.5% of average earnings or around \$350) and be fixed at a lower level such as 20% for additional contributions up to a higher annual cap (for example 12% of average earnings or around \$8,000).
- The rebate would be designed so that the reform is revenue neutral, tax concessions for low and middle income earners are substantially increased or at least not reduced, and individuals on average fulltime earnings or less have an incentive to save at least 3% of their wages in addition to superannuation guarantee contributions (which the Government proposes to increase from 9% to 12% of earnings).

The table below compares the existing system with our proposed reforms.

**Table 2: Existing tax treatment of superannuation contributions and ACOSS proposal**

Source of contribution	Current tax treatment	ACOSS proposal
Employer	<p>No tax on that part of earnings contributed to super (super guarantee or salary sacrifice) is collected by the employer.</p> <p>Flat tax of 15% on transfer to super fund of the first \$25,000 p.a.</p> <p>New Govt. proposals: 15% Government contribution for employer contributions (capped at \$500p.a.) for an employee on up to \$37,000 p.a. Increase contributions cap to \$50,000 if 50 years or over and super assets are below \$500,000.</p>	<p>All contributions paid from after-tax earnings (employers deduct tax from their contributions to the super fund).</p> <p>A two tier co-contribution or tax offset for all contributions up to a specified annual limit, paid into the fund at end of each year.</p> <p>For example, 100% for the first 0.5% of AWE (approx. \$350), plus 20% for additional contributions up to an overall cap of 12% of AWE (approx. \$8,000).</p>
Employee	<p>Earnings taxed at marginal rates.</p> <p>Capped co-contribution for personal contributions by low &amp; middle income earners</p>	<p>The overall cap could be increased from 12% of AWE to 15% of AWE if the Superannuation Guarantee increases from 9-12%</p>
Self employed	<p>Earnings taxed at marginal rates.</p> <p>Tax deduction for personal contributions up to the contributions cap</p>	
Spouse	<p>Earnings taxed at marginal rates.</p> <p>Capped annual tax offset for contributions on behalf of a spouse</p>	

The proposed reforms would simplify and equalise tax concessions per dollar contributed for low middle and high income earners, up to the annual contributions cap.<sup>6</sup> It would shift the incidence of the concessions from high income earners to low and middle income earners and thus boost retirement incomes for low and middle income earners without any cost to the Budget. They are very similar in both their design and quantum to proposals advanced by the Industry Super Network.<sup>7</sup>

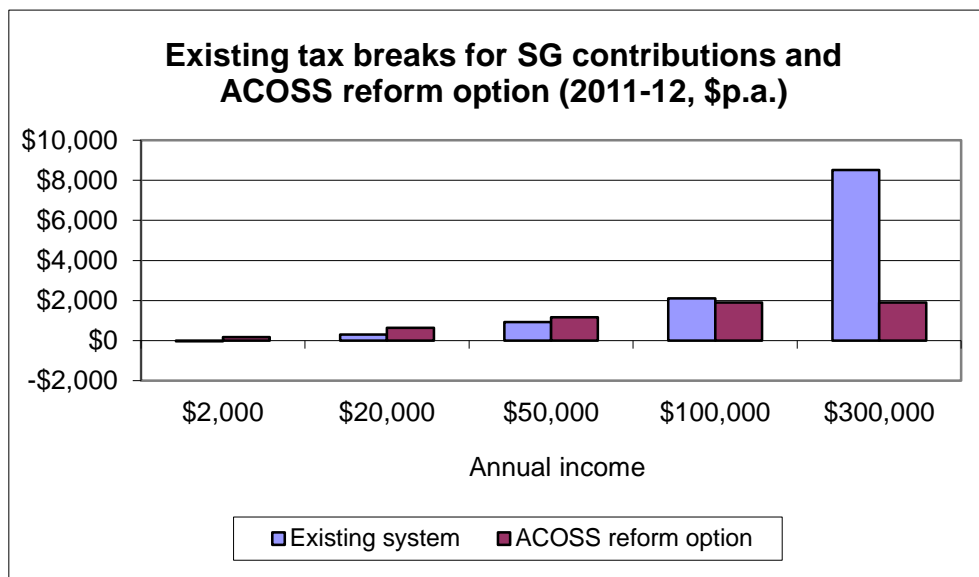
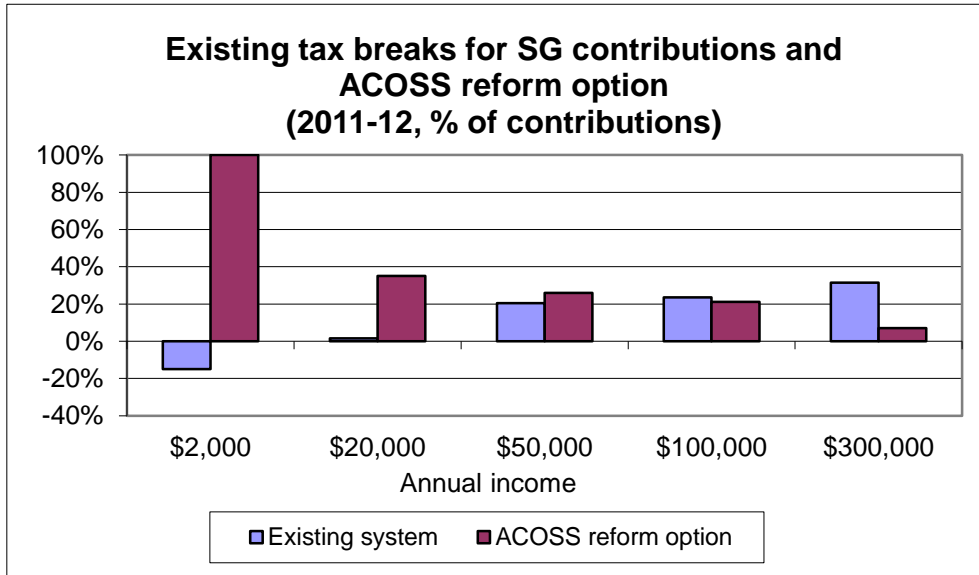
Existing tax concessions for superannuation guarantee contributions and the indicative rebate described above are compared in graph 4.

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<sup>6</sup> If a two tier rebate were introduced there would be a slight bias in favour of contributions made by low income earners.

<sup>7</sup> Industry Super Network (2009), Supplementary submission on retirement incomes to the AFTS review.

Graph 4



Source: ACOSS calculations

The impact of the proposed reform on tax concessions for voluntary contributions would depend on the level of such contributions and the income of the individual.

We acknowledge that within the broad reform ‘framework’ of replacing existing tax concessions with a capped rebate, our objectives could be achieved in a number of different ways. For example, the contributions tax could be calculated as the individual’s marginal tax rate minus a percentage as advocated by the Australian Council of Trade Unions.

It is important to note that the distributional impact of the proposal (including the income threshold below which the vast majority of taxpayers ‘gain’) can be varied by changing the value of the rebate and the contributions cap. Within a revenue neutral reform, there is a trade off between a higher rebate (which increases the gains for low and middle income earners) and a lower contributions cap (which reduces the income threshold below which the vast majority gain). In our indicative rebate model, superannuation savings would be substantially boosted for the vast majority of individuals in the zero and 15% tax brackets, **and the vast majority of individuals earning less than around \$100,000 would gain.**

The rebate could however be adjusted to achieve different distributional outcomes. The existing tax breaks are so skewed in favour of high income earners that it would be possible to design the rebate so as to ensure that **at least the bottom 80% of superannuation fund members with current contributions were financially better off in retirement, at no cost to public revenue.**