Chapter 7

Equity and Tax Concessions

Introduction

7.1 The key determinant of equity in the superannuation system is the level of tax concessions provided. A number of key submissions received during the inquiry from peak industry and professional bodies questioned the way that aggregate tax concessions applicable to superannuation are measured and reported. Suggestions were made to change the current approach. This chapter examines the suitability of two different concepts for measuring the level of tax concessions by considering the:

- income or expenditure approach; and
- aggregate level of tax concessions.

7.2 In addition, much of the evidence to the inquiry raised the central issue of whether superannuation taxation should be considered on an annual or whole of life basis, in the context of providing equity within the superannuation system.

7.3 These issues are discussed in the following material.

7.4 A description of the taxation treatment of superannuation is at **Appendix 8**. This material provides an update on a previous Committee publication, *Super Taxing – an information paper on the taxation of superannuation and related matters*.[1]

7.5 In 1995-96, tax receipts from superannuation were $1.6 billion. In 2001-02, tax receipts from superannuation were $4.4 billion. It is projected that in 2005-06, tax revenue from superannuation funds will be $5.8 billion. Superannuation taxes as a proportion of gross domestic product are projected to double from 0.3 per cent in 1995-96 to 0.6 per cent in 2002-03.[2]

Income or expenditure approach

7.6 Since front-end taxes were first implemented in 1988 there has been occasional debate about whether it is best to measure the quantum of tax concessions available to superannuation on the basis of income or expenditure (consumption). In other words is the benchmark for measuring superannuation tax concessions other income in the year that contributions and earnings are allocated to a persons superannuation account, or the payment stage when the superannuation is actually available for consumption?

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1 Senate Select Committee on Superannuation, *Super – an information paper on the taxation of superannuation and related matters – Taxing,* February 1998.

2 2002-03 Budget Paper No 1, *Budget Strategy and Outlook* , pp. 5.33, 5.25, 5.35. See also ATO, *Annual Report 2002*.

7.7 The Australian Council of Social Service (ACOSS) noted in its written submission that there are two methods of measuring superannuation tax concessions – either on an income tax basis or an expenditure tax basis. The Council submitted that it preferred concessional income tax treatment rather than expenditure tax treatment since in its view, it is the fairest way to compensate people for the compulsion to save, to encourage voluntary saving, and to boost the savings of those on the lowest incomes.[3]

7.8 ACOSS also presented in its written submission a table comparing the effective tax subsidy to individual employees per dollar of employer contributions. This is reproduced in **Table 7.1** below.

Table 7.1: Effective tax subsidy per dollar of employer contributions

Income	**$6,001-$20,000**	**$20,001-$50,000**	**$50,001-$60,000**	**$60,001-$85,242**	**$103,507+**
Marginal tax rate[4]	17-18.5%	31.5%	43.5%	48.5%	48.5%
Tax subsidy per dollar contributed	2-3.5 cents	16.5 cents	28.5 cents	33.5 cents	18.5 cents

Source: Submission 65, ACOSS, p. 20.

7.9 At the Canberra roundtable discussion on 8 October 2002, Mr Brake from Treasury provided the following comments in support of the current expenditure tax arrangements applicable to the measurement of superannuation tax concessions:

> I have a couple of comments, firstly one on an issue that is related to equity: tax expenditures and how they should be measured. At present, we measure tax expenditure on the counterfactual basis that superannuation is part of someone's remuneration—that is, if you were to receive that superannuation from your employer, as an employee you would be taxed at your marginal tax rate, and therefore the different tax treatment of contributions from those marginal tax rates gives rise to the tax expenditure.[5]

7.10 In response to questions from the Committee about expenditure tax treatment, Treasury submitted that 'RIM is not in a position to model this new tax expenditure benchmark proposal for the Committee.'[6]

7.11 Treasury further advised that it was of the view that an income tax benchmark is appropriate as the benchmark against which to measure superannuation tax concessions. Its arguments for this position included:

- the fact that historically income tax has been the relevant base;

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3 *Submission* 65, ACOSS, pp. 12-14.

4 Includes Medicare levy. Many tax-payers on the lowest marginal tax rate are exempted from the levy.

5 *Committee Hansard*, 8 October 2002, pp. 694-695.

6 *Submission* 142, Treasury, p.7.

- no major country has a wholly expenditure-based tax system; and
- where government uses tax incentives deliberately, the comprehensive income tax base provides guidance on structuring measures to achieve the desired outcomes in the most efficient and cost-effective manner possible.[7]

The level of tax concessions

7.12 The following material provided by ACOSS demonstrates the aggregate level of superannuation tax concessions available for superannuation in 2001-02 on the basis of the Treasury income test for determining the level of those tax concessions.

Table 7.2: Tax concessions for superannuation in 2001-02[8]

Contributions:	
flat 15% tax on employer contributions *	$4,530m
Deduction for self-employed/un-supported	$190m
10% rebate for low income earners	$15m
18% rebate for contributions on behalf of low income spouse	$10m
Sub-total:	$4,745m
Fund earnings:	
flat 15% tax on fund earnings *	$4,340m
Capital Gains Tax concessions	$370m
Sub-total:	$4,710m
Benefits:	
Under-taxation of un-funded lump sums (minus tax on funded benefits)	$30m
Total:	**$9,485m**

Source: Treasury, Tax Expenditure Statement (2001), cited in Submission 65, ACOSS, p. 15.

*Compared with a benchmark income tax at the marginal rate of each fund member, plus Medicare Levy.

7.13 In its submission ACOSS advised the Committee that the annual cost of superannuation tax concessions, based on an income tax benchmark, was estimated by the Treasury to be $9.5 billion in 2001-02.[9] According to ACOSS, this is equivalent to around 60 per cent of expenditure on age pensions, or all federal government expenditure on hospitals and ancillary health care services.

7.14 ACOSS submitted that **Table 7.2** above shows that the flat 15 per cent taxes on employer *contributions* and fund *earnings* are the largest of these tax concessions.

7 *Submission* 142, Treasury, p.7.

8 *Submission* 65, ACOSS, p. 15.

9 See footnote in ACOSS submission: ‘Treasury, *Tax Expenditure Statement* (2001). Note that this is the estimated cost in a single year only. The cost over time is somewhat less than this, since tax concessions increase the value of superannuation assets, thereby boosting the future stream of fund earnings and benefits subject to taxation. For the purpose of tax expenditure analysis, it is not appropriate to take into account future Age Pension savings brought about by superannuation tax concessions, as some commentators have. This should be calculated separately as a future saving in Government expenses. See *Submission* 65, ACOSS, p. 15.

According to ACOSS, these flat taxes mean a large tax saving to individuals on the highest marginal income tax rates, but offer little relief from taxation for those on lower marginal tax rates. In ACOSS' view, they are therefore highly regressive.[10]

7.15 In response to ACOSS' estimates, ASFA argued in its written submission that ACOSS' estimates suffered from a number of conceptual problems, including the fact that income tax is imposed on assets which cannot be accessed by the individual at the point of taxation.[11] ASFA identified that the principal finding coming from the research was that, on the basis of the preferred expenditure tax approach, superannuation contributions and fund earnings are overtaxed.[12]

7.16 ASFA submitted that Access Economics' preferred benchmark is an expenditure tax approach where the appropriate point of taxation is on receipt of benefits, an approach which has been adopted in many Organisation for Economic Co-operation and Development (OECD) countries including Belgium, France, Germany, Netherlands, and Portugal.[13]

7.17 **Appendix 9** contains a summary of the taxation arrangements in different countries.

7.18 The Committee asked the Treasury to provide information about the level of tax concessions, if any, and what those concessions would be if measured against an expenditure benchmark rather than the income tax benchmark. In requesting this information, the Committee sought to assess the extent of concessions, taking account of the timing delay between making contributions and receiving benefits.

7.19 In response, Treasury provided the following general comments on the level of taxation under an expenditure approach:

> Because superannuation in Australia is (concessionally) taxed at up to three points, rather than fully taxed at a single point as in the expenditure tax model, the conclusion has often been drawn that the overall level of taxation is higher than it would be under an expenditure tax. There is some analysis that indicates that this conclusion may be wrong.[14]

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10 *Submission* 65, ACOSS, p.15

11 *Submission* 108, ASFA, pp. 9-10.

12 ASFA referred to the following research papers: Access Economics 1998, *The cost of superannuation tax concessions,* Report commissioned by ASFA, FPA, ASX, and IFSA, Sydney, September, 1998 and ASFA, 1999, Association of Superannuation Funds of Australia, *Superannuation tax concessions – recent trends and levels*, Sydney, April 1999. See *Submission* 108, ASFA, p. 25.

13 *Submission* 108, ASFA, p. 9.

14 *Submission* 142, Treasury, p. 7.

Annual and whole of life equity issues

7.20 There are three taxation equity measures currently in place, which, taken together provide a mix of annual and whole of life approaches:

- the global whole of life assessment of access to concessional tax under the Reasonable Benefit Limit arrangements;
- the annual age-based limits of deductible employer contributions; and
- the surcharge.

7.21 A number of submissions considered that the equity arrangements are important, but indicated that they could be rationalised. For example, CPA submitted:

> CPA Australia recognises the need for a degree of control in our superannuation system in mitigating the abuse of taxation concessions and ensuring superannuation is directed towards retirement income purposes. The existing controls of both the age based deduction limits and the RBLs are arduous and at conflict with the principle of providing incentives for savings and ensuring a simple and easily understood system. We consider that both the age based deduction limits and the RBLs should be reviewed in order to reconcile with the retirement needs of the community. This may require significant alteration or complete removal of either limit.[15]

7.22 Dr David Knox perhaps best summed up the relative merits of annual and whole of life equity measures at the Canberra roundtable discussion on 8 October 2002. He noted that policy tends to consider equity on a series of micro issues; the surcharge; deductible contributions; and the tax area. He indicated that Australia actually gets equity wrong by looking at the annual considerations and not the whole of life consideration that recognises that people are in the system for a lifetime. He concluded in the following terms:

> In that sense, I believe the best way of looking at equity is to look at the total system and recognise, as best we can, revenue constraints, look at the total benefit accrued within the system and tax the total benefit in a fair and equitable manner.[16]

7.23 Ms Smith from ASFA also made a strong claim that equity is best achieved over the longer term:

> The strategies that we see include both individual effort and effort by government, whether by extra incentives, co-contributions or reducing tax rates. In terms of equity we see the current tax arrangements—the tax on contributions, the tax on earnings and the tax on end—as bringing in a particular set of anomalies and inequities for people with fluctuating incomes or interrupted work patterns. If I had to name one area … it would be the tax arrangements taking income on a year by year basis rather than on

15 *Submission* 43, CPA, p. 7.

16 *Committee Hansard*, 8 October 2002, p. 684.

> the lifetime savings of that person. We think it would be much fairer to look at the lifetime savings of the person and then look at the equity implications of that in terms of the tax arrangements and benefits.[17]

Committee view – equity of tax concessions

7.24 The Committee notes that the majority of the evidence received during the inquiry indicated that the equity of superannuation tax arrangements should be considered on a whole of life basis rather than on an annual basis.

7.25 The majority of the evidence to the Committee also supported the view that it is only at the end benefit stage that the access to superannuation tax concessions can be judged accurately.

7.26 The Committee notes that there are strong differences of opinion between Treasury and key industry groups about the way in which superannuation tax concessions are quantified, with a number of industry bodies supporting an expenditure tax approach rather than the Treasury income tax approach. The Committee considers that resolution of this debate is central to the equity of the superannuation tax concessions issue.

7.27 The Committee notes that the Treasury was not in a position to provide any information about the level of tax concessions if they were measured on an expenditure basis.

7.28 The Committee also notes that there appears to be a wide difference in the level of tax concessions under the two approaches. On the one hand, the income tax approach suggests that tax concessions are of the order of some $9.5 billion; while on the other hand, the expenditure tax approach suggests that superannuation is overtaxed. The Committee therefore considers that there is a case for the Government to review the basis of assessing the tax concessions available to superannuation, in order to find some agreement on the methodology.

7.29 The Committee found it difficult to have a meaningful debate about the distribution of aggregate concessions to individuals or groups where there is no consensus on the level of concessions or how those concessions are assessed. The Committee considers that the proposed review should be undertaken in the context of any changes implemented from the recommendations of this report and that appropriate Government models should be made available to industry to facilitate this process.

7.30 The Committee considers that resolution of the debate about the preferred method of measuring the impact of taxation concessions is essential to the equity of the superannuation tax concessions issue. For this reason the Committee sees merit in the Government working with industry to resolve the matter of determining the appropriate benchmark for measuring the impact of superannuation tax concessions.

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17 *Committee Hansard*, 8 October 2002, p. 686.

Recommendation

7.31 **The Committee recommends that, together with industry, the Government conduct a review of the appropriate benchmark for measuring the impact of superannuation tax concessions.**