Telephone: (02) 6263 3766
Facsimile: (02) 6263 3044

THE TREASURY

Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

16 October, 2002
File:

Sue Morton
Secretary
Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

INQUIRY INTO SUPERANNUATION AND STANDARDS OF LIVING IN RETIREMENT

The Senate Select Committee has sought the Treasury's views on a number of issues which have been raised during their hearings into superannuation and standards of living in retirement. This letter responds to the questions taken on notice on 19 July and the Committee's request for further information in letters dated 26 July, 16 August, 21 August and 19 September. In line with convention, Treasury provides policy advice only to the government or at the request of government.

Questions on notice

The committee requested the Treasury to take the following questions on notice.

What is the value of the Senior Australians Tax Offset in the hypothetical examples modelled in the submission and what effect does this have on the replacement rates. (reference is p504 of Proof Committee Hansard)

Table 1 shows the real (CPI deflated) value of the Senior Australians Tax Offset in each hypothetical example in the body of the submission. Table 2 shows the impact on the replacement rate of the offset. As explained in evidence, by 2032 modelled differences in indexation means that the Age Pension Rebate as indexed would provide the value for the seniors offset.

Table 1: Real Value of Senior Australians Tax Offset for modelled cases

Scenario	Retire Age	Career	AWOTE	1st Year Rebate	Avg Rebate over Retirement
Male	65	40	1	2,210	2,817
Male	65	30	1	2,060	2,835
Male	65	25	1	1,969	2,895
Male	65	40	0.75	2,062	2,835
Male	65	30	0.75	1,953	2,913
Male	65	25	0.75	2,136	3,016
Female	65	30	1	1,379	2,263
Female	65	30	0.75	1,761	2,613
Broken Female	65	35*	1	1,485	2,361
Broken Female	65	35*	0.75	1,858	2,693
Couple	65	40**	1	1,316	2,076
Couple	65	40**	0.75	2,128	2,819

* Indicates 25 years full-time and 10 years part-time
** Male has 40 years in workforce, female has 24 years full-time and 10 years part-ti

Table 2: Impact of the Senior Australians Tax Offset on Rebate Calculations

				Replacement Rates	
Scenario	Retire Age	Career	AWOTE	Submisssion Modelling	No Rebate
Male	65	40	1	73%	67%
Male	65	30	1	67%	61%
Male	65	25	1	63%	57%
Male	65	40	0.75	78%	71%
Male	65	30	0.75	72%	64%
Male	65	25	0.75	68%	60%
Female	65	30	1	62%	57%
Female	65	30	0.75	72%	65%
Broken Female	65	35*	1	63%	58%
Broken Female	65	35*	0.75	73%	66%
Couple	65	40**	1	53%	51%
Couple	65	40**	0.75	60%	56%

* Indicates 25 years full-time and 10 years part-time

** Male has 40 years in workforce, female has 24 years full-time and 10 years part-time

How do RIM assumptions vary to ASFA's?

A comparison of the RIM methodology of projecting the retirement income for hypothetical individuals with that used by ASFA is include in the Treasury's response to the Institute of Actuaries Report on modeling assumptions.

What are the value of the upfront fees and lump sums after ETP tax used in Treasury's modelling of hypothetical cases for its submission? (reference is p509 of Proof Committee Hansard)

The value of annual upfront fees used was $128 in 2001-02 dollars or $131 in 2002-03 dollars. This amount is evenly divided between administration fees and group insurance. As discussed in testimony, the effect of investment fees is effectively modelled as a 1 or 1.2 per cent reduction in the earning rate of the fund.

The values of real Eligible Termination payment taxes on the lump sums for Table 2 of the Treasury submission is shown in the table below.

Table:

Retirement Age	65	65	65	65	65	65
Career Length	25	30	40	25	30	40
Multiple of AWOTE:	0.75	0.75	0.75	1	1	1
ETPs in Table 2 of treasury sub. ($2001-02)	$130,596	$167,256	$225,596	$175,671	$225,079	$304,495
Real ETP Tax ($2001-02)	$0	$766	$10,392	$2,154	$10,307	$23,410

Request for copies of Government statements on the objectives of retirement income policy.

Please find attached an extract from *Savings: Choice and Incentive* (Statement by the Hon Peter Costello MP, 13 May 1997). This outlines the current government's objectives in relation to retirement income policy.

What would be the effect of varying the superannuation fund earnings rate assumption on final benefits and retirement income in Treasury's modelling of hypothetical cases for its submission? (reference is p512 of Proof Committee Hansard)

The submission assumed a superannuation fund crediting rate of 7 per cent nominal per annum (4.5 per cent real). The gross lump sum benefits and average retirement expenditure which would result from 6, 7 and 8 per cent crediting rates is shown in the table below.

Table A: Effect of Crediting Rates on Final Benefits and Average Retirement Incomes – Cases in Table 2 of the Treasury Submission

Retirement Age		65	65	65	65	65	65
Career Length		25	30	40	25	30	40
Multiple of AWOTE:		0.75	0.75	0.75	1	1	1
Super Fund Earnings Rate							
6%	**Gross Lump Sum ($2001-02)**	$116,036	$144,830	$189,673	$156,075	$194,882	$255,926
7%	**Gross Lump Sum ($2001-02)**	$130,596	$167,256	$225,596	$175,671	$225,079	$304,495
8%	**Gross Lump Sum ($2001-02)**	$147,043	$193,988	$269,711	$198,290	$261,074	$364,154

Super Fund Earnings Rate							
6%	**Average Retirement Expenditure ($2001-02)**	$26,730	$28,325	$30,440	$28,936	$30,648	$32,883
7%	**Average Retirement Expenditure ($2001-02)**	$27,543	$29,531	$31,811	$29,862	$31,793	$34,499
8%	**Average Retirement Expenditure ($2001-02)**	$28,465	$30,613	$33,354	$30,782	$33,059	$36,380

Response to Letter of 26 July 2002

In your letter of 26 July 2002 you have requested RIM to model the AMP's proposal to remove the tax on contributions and earnings and replace it with a combination of a withholding tax and a tax on benefits.

RIM is not in a position to model this new policy proposal for the Committee.

Response to Letter of 16 August 2002

On 16 August you requested that RIM undertake additional modelling using the ASFA assumptions to assist the committee to understand and reconcile the difference produced by the two models.

An explanation of the differences between the RIM and ASFA models is included in our response to the Institute of Actuaries Report. There is very little difference in replacement rates and nearly all of the apparent difference in retirement dollars is due to RIM's consumer price index deflation of future values.

Response to Letter of 21 August 2002

On 21 August Senator Watson sought the Treasury's comment on a number of options which the Committee wished to explore.

Superannuation tax concessions

Request for information on the level of tax concessions that would be available if superannuation was taxed on an expenditure tax basis and savings made through reductions in the age pension and Senior Tax Offset under an expenditure and income tax model.

RIM is not in a position to model this new tax expenditure benchmark proposal for the Committee.

Estimates of the level of tax concessions provided to Australia's superannuation arrangements are published in the 2001 Tax Expenditures Statement, together with an extensive explanation, particularly in Appendix B, of the scope and interpretation of the estimates provided.

Estimation of any tax expenditure requires specification of the benchmark tax regime specifying the regular tax arrangements that would apply in the absence of concessions. The benchmark for superannuation is defined in Section 3.4 of the Publication as the 'normal taxation treatment of remuneration and saving'. Essentially this means that in the benchmark, proceeds of employment are fully taxable at personal income tax rates and savings are made from after tax income, with investment earnings also taxed.

Treasury is 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 include:

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

Accordingly Treasury has not calculated any estimates of concessionality using an expenditure tax benchmark.

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.

The Committee also asks about savings in age pension and the tax system derived from the provision of the superannuation tax concessions. Clearly, through the concessional arrangements, retired Australians have and will continue to have substantially greater private retirement incomes; the Government makes some saving through paying lower pensions and gaining some additional tax revenue from retirees. These impacts are fully factored into projections of the long term cost of the Age and service pensions such as published recently in the Intergenerational Report.

A related study on the impact of the introduction of the Superannuation Guarantee on long term pension costs has been published by the Retirement and Income Modelling Unit[1].

Transition arrangements for the "baby boomer" generation

While we are not in a position to provide views on possible transitional issues that the Committee may wish to explore, we note that our submission discussed the fiscal implications of further outlays or tax concessions designed to further improve retirement incomes.

The self-employed

The question of the coverage of the SG arrangements to the self-employed is a matter of policy. Government policy is not to mandate superannuation contributions by the self-employed, but rather encourage voluntary contributions, through the provision of taxation concessions. The Government recently increased the fully deductible amount for the self employed from $3,000 to $5,000 from 1 July 2002. Contributions above this amount are 75% deductible, with a maximum deduction equal to the taxpayer's age-based limit.

Imposing a cap on the amount of fully deductible contributions limits the fiscal cost of the provisions. In addition, it is worth noting that employees who make personal contributions do not receive a tax deduction for those contributions.

By not mandating superannuation contributions, the self-employed are able, if they choose, to devote more of their income into building up the value of their business. The law encourages small business owners to use the proceeds of the sale of their business for retirement purposes by disregarding a capital gain where the proceeds of the sale of an asset are rolled-over into a superannuation fund and used for retirement (up to a lifetime limit of $500,000).

Equity arrangements

The formulation of equity measures within the superannuation system is a matter of policy. Government policy is to limit tax concessions available to persons on both an annual and lifetime basis. This policy is achieved through the design of the age-based limits and the reasonable benefits limit systems. In the absence of age-based limits, for example, very large superannuation contributions could be made in only a small number of years. As the age-based limits increase with age, they provide opportunities for older workers who may have had relatively less capacity to save earlier in their lives to contribute relatively greater amounts of superannuation.

An additional consideration is that the age-based limits do not limit the amount of undeducted contributions which can be made to superannuation, and therefore the value of concessionally taxed earnings which can be derived on those contributions. The RBL, therefore, is important to the integrity of the superannuation system in limiting the overall value of concessionally taxed benefits which can be received by any one individual over their lifetime.

---

[1] **Rothman, George** - Projections of Key Aggregates for Australia's Aged, The Sixth Colloquium of Superannuation Researchers, University of Melbourne, July 1998, Conference Paper 98/2

The Committee notes that they have been told that equity is best considered at the benefit payment time because that is the only time when an individual's access to the tax concessions available to superannuation can be assessed with any certainty. Again, this is value judgement. In terms of taxation, it is worth noting that superannuation can be considered as part of the overall remuneration a person receives in a given year. Against this benchmark, the taxation concessions for superannuation are best considered against the counterfactual that superannuation was instead paid in the form of wages in the relevant year. This is the approach adopted in the annual Tax Expenditure Statement.

Taxation Revenue

Breakdowns of last years revenue from contribution, earnings, surcharge, and taxes on income streams and lump sums.

Available breakdowns are given on Pages 5-25 and 5-26 of Budget Paper No 1, 2002. ETP taxation estimates are given in Table B1 of the Tax Expenditure Statement.

Age pension

What targets are appropriate for the level of age pension and a breakdown of SATO in each cameo and long term costings to 2042 for SATO

The Treasury submission did not express a position on appropriate targets. Treasury has already advised the Committee of its long term projections of the Age and Service pension as a percentage of GDP and its projections of the proportions of the retired receiving full age pension, part age pension and no age pension. Based on this work the OECD considers Australia's Age pension arrangements to be sustainable in the long term.

The breakdown of SATO in the cameos is detailed in our responses to the questions on notice. RIM is not in a position to give a long term costing of the SATO or seniors rebates more generally to the Committee at this stage.

Access to RIM modelling

Whether it is possible to provide RIM models to outside organisations.

The resources of RIM are currently more than fully occupied doing quantitative analysis of ageing, retirement income and personal income tax policies for the Government, and cannot be redirected to work in collaboration with private organisations.

There would be a considerable cost in supporting the external use of RIM models because of their complexity. The use of RIMHYPO and RIMGROUP requires an understanding of superannuation, taxation and social security policy – and this combination is not common, and takes a long time to teach. RIMGROUP is so complex that it can take six months to gain proficiency in its use, and RIM is not in a position to do extensive training and support. If the models were to be made commercially available, it could take RIM a year to acquire and train staff who could support external users. To recoup costs, fees for the models would need to be high.

There would also be potential for conflicts of interest to arise if government officials were to work on issues identified by external organisations without the agreement of the government.

Response to Letter of 1 September 2002

Your letter of 19 September 2002 sought our advice on various questions requested of the Australian Taxation Office (ATO) and the Department of Finance and Administration (DOFA) but which fall within the Treasury portfolio.

Surcharge administration

You have sought our response as to whether the administration of the superannuation surcharge should be transferred to the ATO. The transfer of administration of the surcharge would require a change in current government policy. As such we are not in a position to comment on this matter.

The Intergenerational Report

The Committee requested DOFA for its views on possible policy responses to the findings in the Intergenerational Report (IGR). The IGR highlighted the need for sound and sustainable economic policies, including retirement income policies, in the face of the budgetary pressures associated with an ageing population. At a broad level, policies which maximise sustainable economic growth, as well as overall economic and social participation directly benefit living standards in the community, including among retirees. In the retirement incomes context, increasing longevity has direct implications for the level of savings people need to accumulate prior to retirement in order to fund income in retirement.

The IGR shows the possible future impact on budget outlays of existing policy parameters. Results are also shown for scenarios that involve a higher proportion if people in older age groups, a lower proportion of people employed relative to the population, lower productivity growth, higher unemployment and higher growth in the cost of programmes that increase future pressures on government spending.

The Treasurer has stated that moderate changes to policy will need to be made as a result of the findings of the IGR. The Treasury is unable to provide the Committee with a set of possible policy options that the government could consider in responding to the IGR.

Gap between super preservation age and the age pension age

As most people's capacity to accumulate retirement savings is dependent on their participation in the workforce, this in turn has implications for policy in areas such as labour force participation (including among mature age people) and the related issue of the preservation age for superannuation. The government has already moved to gradually increase the preservation age (applying to people born after 30 June 1960) to age 60

Extending access to the health care concession card

We are unable to provide the Committee with a set of possible policy options that the government could consider in responding to the IGR.

Implications of growing personal debt and falling non-super savings

As stated in our evidence to committee on 19 July 2002, we do not have the necessary information concerning the distribution of consumer debt to determine whether the increase in personal debt is likely to be a problem in the future. The Treasury is working with the Australian Bureau of Statistics to find ways of attaining this information.

Views on super health accounts

The possible introduction of some form of 'health' related superannuation savings is a matter of policy. As noted in our evidence there is a huge variability in potential health costs in retirement. Because of this variability, the reliance on a savings mechanism such as super health accounts may have the effect that many people oversave and many people might undersave for health care costs.

Impact of tax concessions on super on age pension savings

The committee asked DOFA whether there has been any analysis of the benefits of providing tax concessions on super. The tax concessions provided to superannuation play an important role in achieving the government's objective of increasing the standard of living of Australians in retirement. The Retirement Income Modelling Unit has undertaken research which indicates that superannuation is a tax preferred investment over a working lifetime for persons in all marginal tax brackets (*Budget Strategy and Outlook 2002-03*, Budget Paper No. 1, 14 May 2002). This research is summarised in Chapter 4 of our submission to the committee.

Yours sincerely

R Brake

Roger Brake
General Manager
Superannuation, Retirement and Savings Division

SAVINGS:

CHOICE AND INCENTIVE

STATEMENT BY
THE HONOURABLE PETER COSTELLO, M.P.,
TREASURER OF THE COMMONWEALTH OF AUSTRALIA
SENATOR THE HONOURABLE JOCELYN NEWMAN
MINISTER FOR SOCIAL SECURITY
13 MAY 1997

AUSTRALIAN GOVERNMENT PUBLISHING SERVICE
CANBERRA 1997

SAVINGS: CHOICE AND INCENTIVE

Overview

This Government is committed to a retirement income policy that provides encouragement for individuals to achieve a higher standard of living in retirement than would be possible from the Age Pension alone, but also ensures that all Australians have security and dignity in retirement. This will be achieved by:

- encouraging people who are able to save for their retirement to do so, particularly through superannuation;
- ensuring the provision of an adequate public safety net in the form of an Age Pension for Australians who are unable to support themselves in their retirement years;
- ensuring the system is predictable, but facilitates choice and is equitable; and
- ensuring the system is fiscally sustainable and delivers an increase in national saving.