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A super waste of money

Redesigning super tax concessions

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TAI

Policy Brief

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Summary

Super tax concessions are increasingly being used by high income earners as a way of minimising their tax. This is not their original purpose. They were designed to encourage people to save for their retirement so they would be more self-reliant and less dependent on taxpayers.

80 per cent of those who are of eligible age are on the age pension or part pension and this is predicted to still be the case in 2050. It would seem that super tax concessions are not working. Worse, almost $18 billion (60 per cent) of super tax concessions are going to the top 20 per cent of income earners. These are the people most likely to be a part of the 20 per cent not receiving an age pension. There is no economic justification for taxpayer's money being spent on enlarging the super balances of those that are not likely to ever claim a pension. This means that about $18 billion is being wasted each year on unnecessary tax concessions.

Reform of super tax concessions is long overdue and should start from the principle that the only justification for using taxpayer's money is if it reduces long term impacts on the budget. Otherwise the benefit of the tax concession is entirely private.

The proposed reform would see super tax rates rise with income so that the benefit was greatest for low and middle income households. Growing the super balances of these households is likely to have the largest long term impact on the budget by reducing their reliance on the age pension. High income households would see a smaller super tax concession as they are less likely to need an age pension. The new super tax rates are set out in table 1.

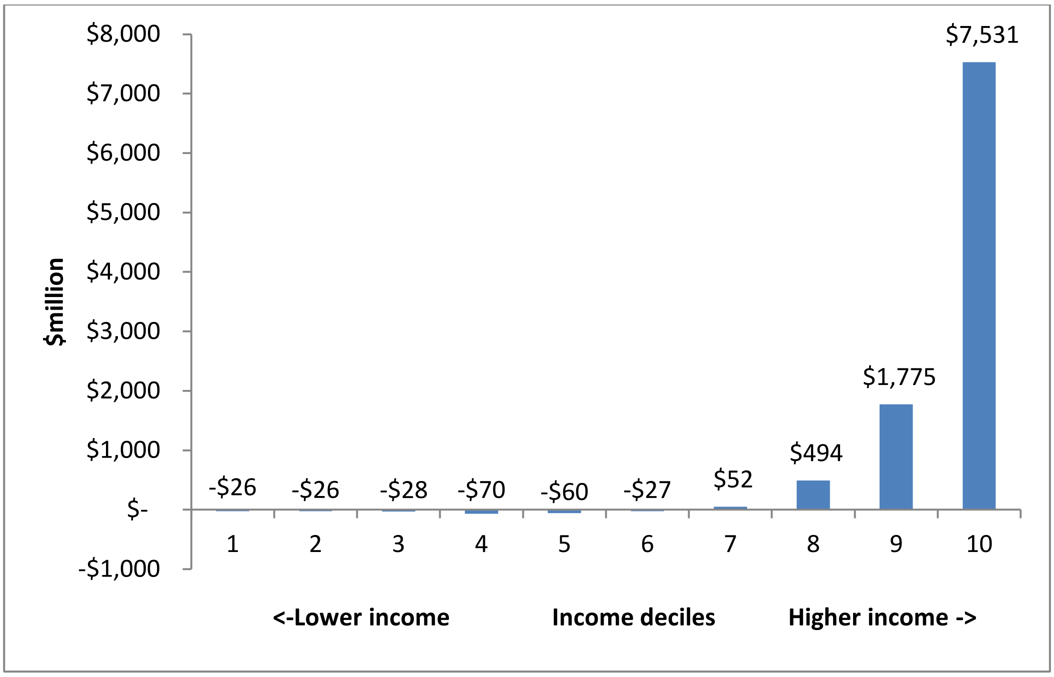
Table 1 – Proposed super tax rates

Annual Income	New tax rate	Old tax rate	Difference
$0 to $37,000	0%	15%	+15%
$37,001 to $80,000	10%	15%	+5%
$80,001 to $180,000	22%	15%	-7%
More than $180,000	45%	15%	-30%

These new super tax rates will reduce the distortion in tax policy where the tax concession is going predominately to high income people for a dubious long term benefit to the budget.

The new super tax rates will also see 60 per cent of households paying less tax on their super. High income households will see less super tax concessions and overall the policy will reduce super tax concessions by $9.6 billion. The income distribution of impacts of changes to super tax concessions are shown in Figure 1.

Figure 1 - Distribution of impacts of changes to super tax concessions by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

Introduction

Australia's superannuation system was designed to help Australians save for retirement and be less reliant on the age pension and thereby take pressure off the federal budget. To encourage contributions to superannuation savings, lower levels of tax apply to aspects of the super system – superannuation tax concessions.

Superannuation tax concessions mean the tax rate that applies to "super" is a flat rate of 15 per cent. Contributions to super funds and the earning from super funds are both taxed at a flat 15 per cent. Contributions include the 9.5 per cent of wages that are paid into super funds as well as any additional salary sacrificed contributions.

For the vast majority of people this represents a lower tax rate than they would normally be charged. Only those earning $18,200 or less a year, who face a tax rate of zero, pay more tax on their super than on their other income.[1]

Super tax concessions mean that the government forgoes tax revenue they would otherwise collect. The granting of these tax concessions means that more tax must be raised in other ways and that these taxpayers are assisting people accumulating money for their retirement. There is a real cost in granting super tax concessions in the form of increased taxation in other areas or forgone government services. This is particularly important at a time when the government is cutting health, education and the social safety net in order to reduce the budget deficit.

At present, the main super tax concessions represent foregone revenue of $29.7 billion in 2014-15.[2] Treasury expects this to grow to $49.5 billion by 2017-18.[3] The concession on contributions is valued at $16.3 billion in 2014-15,[4] while the concession on super fund earnings is worth $13.4 billion.[5]

The size of the concessions, the foregone revenue, is growing three times faster than spending on the age pension. That's an annual growth rate of 13.6 per cent. By comparison Treasury expects the age pension to grow at a far slower rate of 4.5 per cent over the same period.[6]

At this growth rate the value of super tax concession for contributions and fund earnings will exceed the cost of the age pension in 2018-19.[7] This is important since the justification for super tax concessions is to reduce people's reliance on pensions. This means the very policy that is supposed to reduce the cost of the age pension will soon cost more than the age pension itself.

Rather than taking pressure off the federal budget, super tax concessions and the revenue they forego are becoming a burden on the budget. The Australia Institute has long argued

[1] At the moment the government offsets the additional tax paid through the low income super contribution. The low income super contribution has been repealed and is set to end in 2017-18. After this time some low income earners will pay more tax on their super than if they had earned it as income. That is they will face a negative super tax concession.

[2] Superannuation tax concessions on contributions and fund earnings represented 87 per cent of all superannuation tax concessions in 2014-15. Other superannuation tax concessions available at Commonwealth of Australia (2015) *Tax Expenditure Statement*

[3] Commonwealth of Australia (2014a) *Budget Papers: Appendix B: Tax Expenditures*

[4] Commonwealth of Australia (2015)

[5] Commonwealth of Australia (2015)

[6] Commonwealth of Australia (2014a)

[7] If all superannuation tax concessions are considered then they exceed the pension a year earlier in 2017-18

that changing Australia's super tax concessions is important for the future of the federal budget.[8]

The inequity of super tax concessions

Not only are super tax concessions becoming a burden on the budget, but it is clear that they are being used more and more as a way for high income households to avoid tax rather than as a retirement income support measure.

Super tax concessions are a flat rate of 15 per for everyone earning below $300,000 per year. For those above $300,000 they are taxed at 30 per cent. This means that people on higher incomes are given larger tax concessions since income tax rates are progressive. Someone earning $250,000 per year is on the top marginal tax rate of 49 per cent[9] pays only 15 per cent tax on their super and so gets a tax concession of 34 per cent. A low-income earner on the minimum full time wage has a marginal tax rate of 21 per cent[10], but also pays 15 per cent tax on their super. They therefore get a tax concession of just six per cent. Annual incomes and the rate of super tax concession are shown in table 2.

Table 2 – Super tax concession by income

Annual Income	Super tax concession
$0 to $18,200	-15%
$18,201 to $37,000	6%
$37,001 to $80,000	19.5%
$80,001 to $180,000	24%
$180,001 to $300,000	34%
Above $300,000	19%

The Australia Institute commissioned the National Centre for Social and Economic Modelling (NATSEM) to assess the distribution of the current superannuation tax concessions by household income. NATSEM made these estimates with its extensive data on households combined with:

- Australian Tax Office (ATO) statistics from 2011-12, updated to reflect 2014-15.
- ABS Employment Arrangements and Superannuation Confidentialised Unit Record File (CURF).

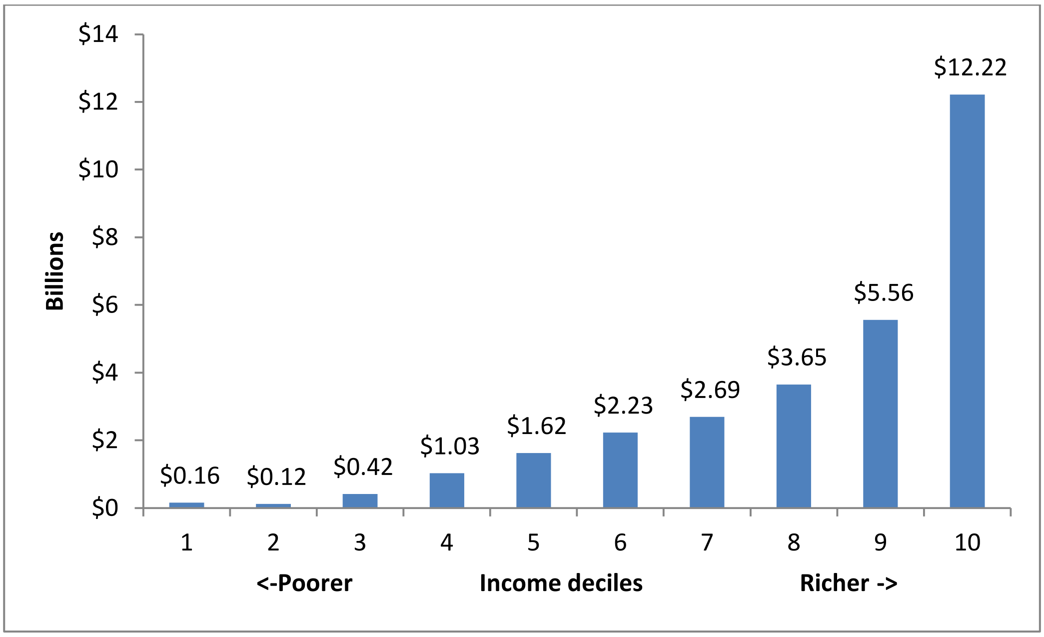
According to NATSEM's estimates, most of the benefit of super tax concessions is going to high income earners as shown in Figure 2 below:

8 Dennis et al (2011) *What price dignity?*, Dennis et al (2012) *Can the taxpayer afford self-funded retirement?*, Dennis (2013a) *Super for some*, Dennis (2013b) *Time to get engaged with super?*, Ingles (2009) *The great superannuation tax concession rort*, Ingles et al (2014) *Sustaining us all in retirement*

9 This includes a 45 per cent tax rate plus 2 per cent medicare levy and 2 per cent temporary budget repair levy

10 This includes a 19 per cent tax rate plus 2 per cent medicare levy

Figure 2 – Distribution of super tax concession benefits by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

The benefits of super tax concessions are mainly accruing to the top 10 per cent of households, who claim 41 per cent of the tax concessions, worth $12.2 billion. The top 20 per cent of households receive 60 per cent of the tax concessions, worth $17.8 billion. This is compared to the bottom 50 per cent of households who only get 11 per cent of the tax concessions, worth $3.35 billion.

Furthermore, 20 per cent of the eligible population do not currently receive any age pension and this is predicted to continue for the next 35 years.[11] The top 20 per cent of households by income are likely to be heavily represented in the 20 per cent of people who will not claim a pension in the future. These are the households that are claiming the majority of super tax concessions at a current cost of almost $18 billion. In other words, most of the $18 billion in tax breaks designed to help people get off the age pension is being gained by people who would not be able to claim the pension anyway. These concessions are having no impact on reducing the future cost of the age pension.[12]

While the government is trying to push through unpopular spending cuts that mainly impact on low income earners,[13] cutting super tax concessions to high income earners seem to be a much fairer, more popular, and more economically responsible option. A survey by The Australia Institute found that 59 per cent of people were in favour of cutting super tax concessions to high income earners, with only 19 per cent opposed.[14]

[11] Commonwealth of Australia (2014b) *Towards Responsible Government: Phase One*

[12] It should be noted that if super tax concessions were removed the increase in government revenue would not be as large as the current value of the tax concessions. This is because people are currently using super tax concessions as a vehicle to reduce the amount of tax they pay. Some of the money flowing to super would flow to other low tax vehicles. Treasury do estimate the revenue gained and this works out at $27.3 billion for contributions and fund earnings. This is about 8 per cent lower than their current estimated cost.

[13] NATSEM (2014) *NATSEM Budget 2014-15 Analysis*

[14] TAI (2015) *Australia Institute Survey - March*

Super tax concessions – rationale and reform

In general, tax concessions should only be granted if they bring a societal or budgetary benefit. An example of a societal benefit that gains a tax concession is the tax exempt status of not for profit hospitals and other benevolent institutions. These institutions are considered to provide public goods and to encourage such organisations the government exempts them from paying tax.

An example of a tax concession that has a budgetary benefit is the exemption from the GST for private importation of goods worth less than $1,000. The cost of collecting the tax is believed to be more than the amount of tax collected. It is therefore a net gain to the budget to have this tax concession.

Super tax concessions are difficult to justify on the basis of a societal benefit. Increasing the amount of money that someone has in their super fund for the purposes of retirement, which is what the tax concessions do, is largely a private benefit.

Some argue that super tax concessions could provide a budgetary benefit. If people have more money in their super accounts when they retire they may no longer be eligible for an age pension or they may be eligible for a smaller part pension. Super tax concessions are effectively the taxpayer putting money into people's super accounts. This is justified if it reduces people's later reliance on taxpayer support through the age pension.

However, there is no evidence that this is occurring. Currently about 80 per cent of Australians who are old enough to qualify claim an age pension, with about 50 per cent on full pension and 30 per cent on a part pension.[15] The National Commission of Audit predicts by 2050, 35 years from now, the proportion of people on the age pension is expected to still be 80 per cent with full pensions dropping to 30 per cent and part pensions increasing to 50 per cent. While there may be an increase in the proportion of people on part pensions, there is expected to be no decrease in the proportion of people who receive an age pension.

Super tax concessions need to be reformed so they better fit the purpose of encouraging Australians to rely more on their savings in retirement and less on the taxpayer. For this to happen there needs to be less super tax concessions flowing to those who are unlikely to ever need an age pension and more flowing to those who are likely to be on a part pension. At the moment the reverse is true. Reforms targeted in this way will take pressure off the age pension.

Proposed reforms

The Australia Institute proposes reform to charge rates of tax on super contributions and fund earnings depending on the amount of income earned. Super tax concessions should be aimed at people who are most likely to require a full or part age pension. Concessions should not provide benefit to those who are unlikely to require taxpayer support in retirement. This is achieved by increasing the rate of taxation on super contributions and fund earnings as people's income rises. Our proposed super tax rates are set out in Table 3.

[15] Commonwealth of Australia (2014b)

Table 3 – Proposed super tax rates

Annual Income	New tax rate	Old tax rate	Difference
$0 to $37,000	0%	15%	+15%
$37,001 to $80,000	10%	15%	+5%
$80,001 to $180,000	22%	15%	-7%
$180,001 to $300,000	45%	15%	-30%
Above $300,000	45%	30%	-15%

Our proposal would remove all taxation on contributions and fund earnings for people who earn up to $37,000 per year. For middle income earners there is still a strong case for super tax concessions as providing them will push people onto smaller part pensions. The reform proposal sets the super tax rate on contributions for those earning between $37,001 and $80,000 at 10 per cent which is a lower rate than the current 15 per cent that they pay.

For those between $80,001 and $180,000 the super tax rate is increased from 15 per cent to 22 per cent. Individuals on $80,000 per year are just in the top 20 per cent of income earners and so the benefit of super tax concessions is reduced.[16] Cutting super tax concessions to them completely may well push some of them onto a part pension particularly at the lower part of the income range, so there is some justification for a super tax concession, but a lesser one than is currently given.

Those on more than $180,000 are in the top two per cent of income earners and are unlikely to qualify for an age pension. There is no justification for granting any super tax concessions. The super tax rate should be set at 45 per cent.

The Australia Institute commissioned NATSEM to estimate the tax revenue that would be raised by these changes. NATSEM made these estimates with its extensive data on households combined with:

- Australian Tax Office (ATO) statistics from 2011-12, updated to reflect 2014-15
- ABS Employment Arrangements and Superannuation CURF

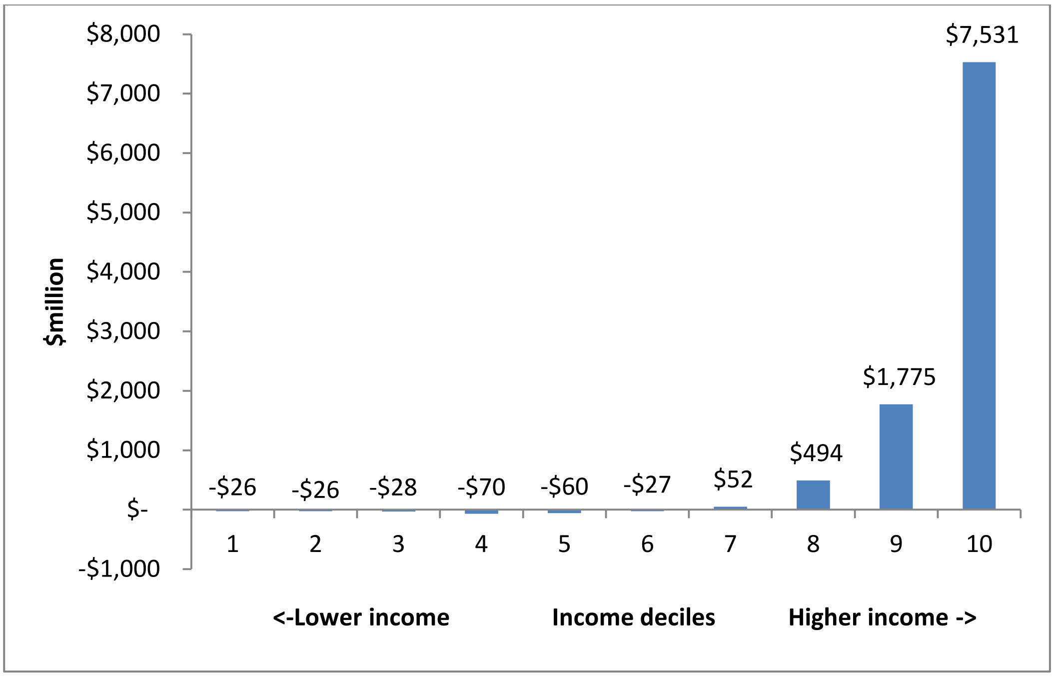
Distribution of super tax concessions

NATSEM estimates that this change to super tax concession rates would raise $9.6 billion in revenue. This policy change would see 60 per cent of households paying less tax on their super. They would reduce super tax concessions that go to those who do not need it and increase the benefit to those who do need it. A larger super balance for these households has the biggest chance of reducing pressure on the age pension.

The distributional impacts of these reforms by decile are shown in Figure 3 below:

[16] ATO (2014) *Taxation Statistics: Individual tax Table 14*

Figure 3 - Distribution of impacts of changes to super tax concessions by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

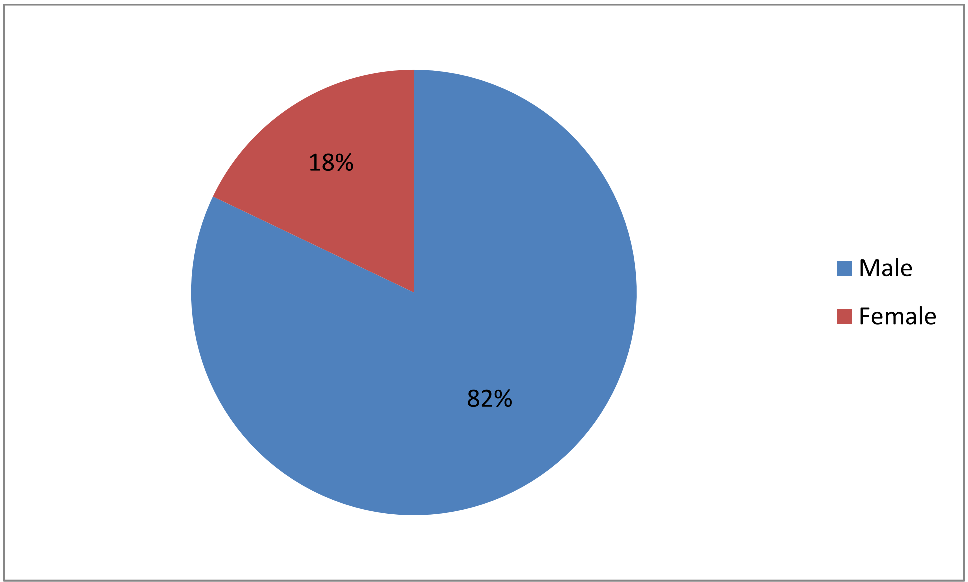
Figure 7 shows that most households (60 per cent) will be better off under these reforms. That is they will pay less tax on their super. Almost three quarters of the savings (74 per cent) come from the top 10 per cent of households. The top 20 per cent, who are least likely to be eligible for an age pension, make up 91 per cent of the savings.

Distributional impact by gender and age

NATSEM's modelling also looked at how the impacts of the proposed changes would be distributed by gender and age.

Figure 4 shows the gender distribution. It shows that over 80 per cent of the savings will come from males.

Figure 4 – Distribution of impacts of changes to super tax concessions by gender



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

Males are over represented among high income earners while females are over represented among low income earners. Males are also likely to have significantly higher super balances than females. The very high proportion of savings coming from males highlights these disparities.

Table 4 shows the age distribution of super tax concession savings. It shows that those under 30 will actually be better off because of these changes. More super in someone's account at a younger age means a larger balance later in life because the money has been used for longer and compounds to a larger amount.

Table 4 - Distribution of impacts of changes to super tax concessions by age group

Age group	Proportion of total savings
Less than 30	-0.7%
30-39	12.6%
40-49	25.8%
50-59	27.7%
60-69	31.9%
70 or more	2.8%

Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

Table 4 shows that the savings come mainly from higher age groups as workers move into higher paying jobs. Savings then rapidly decrease as people retire and stop contributing to their super accounts.

The case for superannuation tax concession reform

Any reform of super tax concessions should be focused on getting better value from taxpayer's money. It is clear that at the moment far too much of the concession is going to high income earners with a dubious long term benefit to the budget.

The purpose of superannuation has been subverted by the current concession arrangements. It is no longer just a system for improving the retirement earnings of Australians but is increasingly being used for estate planning and tax avoidance by high income earners.

A research paper from The Association of Superannuation Funds of Australia (ASFA) highlights the size and extent to which those with large superannuation balances are able to access tax free incomes.[17]

The ASFA report looks at data obtained from self-managed super funds (SMSFs). The report shows that there are 24,000 people in pension mode[18] that have account balances in excess of $2 million. These 24,000 people are effectively receiving a tax free income of $5.2 billion per year (an average income of $217,000). There are 75,700 people in pension mode with balances of a $1 million or more who receive tax free income of $10.1 billion per year (an average income of $133,000). All the remaining accounts in pension mode, 232,000 accounts, receive just $8.9 billion in income per year (an average income of $38,000).

The wealthiest super funds see 475 people whose funds are in pension mode that have account balances of more than $10 million. On average these people are receiving a tax free income stream of $1.5 million each.

The ASFA report goes on to say;

> *Income streams approaching or in excess of $1 million a year appear to be more related to tax planning and estate planning than for reasonable retirement expenditure needs.*[19]

It is clear that a substantial part of super tax concessions are being used for purposes other than to move people from publically funded pensions to privately funded retirement. The super system is now costing taxpayers substantial sums of money for little public benefit.

The focus of any government reform should not just be about reducing the large and growing size of super tax concessions going to high income earners. It should also focus on those on lower income households who are most likely to be on the pension.

Super tax concessions to lower income households are likely to give taxpayers far more value for money since increasing these super accounts will give more long term relief to the age pension. At the moment the bottom half of households get only 11 per cent of the value of super tax concessions.

After 2017-18 the situation will get even worse. This is when the Low Income Super Contribution Scheme will be abolished.[20] This scheme was set up because people under the tax free threshold paid no tax on their income but were still paying 15 per cent on their super contributions and fund earnings. Put simply they were paying more tax on their super than on

[17] Clare (2015) *Superannuation and high account balances*

[18] Pension mode is when the superannuation account is now paying out a stream of income.

[19] Clare (2015)

[20] Power (2014b) *Super tax refund for lower-income earners available until 2016/2017 year*

their income and so were getting a negative tax concession. The low income super contribution refunded the extra tax and payed it into their super fund.

When this scheme is abolished, those who are most likely to rely on the taxpayer in retirement will be penalised by super tax concessions. This will make them even more likely to require a pension in retirement. Such a situation makes no policy sense.

The principles of super tax concession reform

Some reform was started by the previous Labor government when it increased the tax on superannuation contributions and fund earnings for people on incomes above $300,000 from 15 per cent to 30 per cent.[21] More recently the now Labor opposition has proposed taxing superannuation incomes above $75,000 per year at 15 per cent and lowering the threshold for the 30 per cent tax rate on contributions and fund earnings from $300,000 to $250,000.[22]

These reforms are simply tinkering around the edges and will still see billions of dollars go to households that are unlikely to ever claim an age pension. A larger reform of super tax concessions is needed if taxpayers are to get better value for money.

Any reform of tax concessions should focus on the purpose of super tax concessions. Looked at this way super tax concessions are useful if they can reduce people's reliance on the age pension. Their purpose is not to grow the retirement incomes of those who would not claim a pension in the absence of any concessions. Its purpose is certainly not to allow high income households to minimise their taxation.

Conclusion

Reform of super tax concessions is overdue. Reform is required to get better value for taxpayer's money. The current system not only results in billions of dollars in tax revenue foregone every year, but fails to reduce the budgetary cost of the age pension. High income earners are unlikely to ever claim an age pension receive almost all of the benefit of the current tax breaks. At the same time more is needed to increase the super balances of middle and low income earners to move them onto smaller part pensions and off the pension completely.

The current tax arrangements for super contributions and fund earnings encourage high income earners to use super as a means of minimising tax. Changes made by the previous Labor government and proposed by the current Labor oppositions are little more than tinkering and will not reform the system the extent required.

Super tax rates should be based on the likelihood of those who receive them requiring an age pension. A flat rate of tax is inconsistent with this and gives more benefit to high income earners. It also encourages high income earners to use superannuation as a means to minimise their tax.

Super tax concessions were never meant as a means of tax minimisation and estate planning. It is time to reform superannuation so that it can be used in the way it was intended, as a means to make people more self-reliant in retirement.

[21] Power (2014a) *Double contributions tax for high-income earners*

[22] Australian Labor Party (2015) *Fact Sheet - Labors Plan for Fair Sustainable Super*

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