Wellard Superannuation Better Tax Submission

Justification for Superannuation

It is well documented that Australia has an aging population and consequently less workers will be available to support the increasing cost of social services, primarily the Aged Pension, and health of retired Australians.

Reducing the cost of the Aged Pension was the primary justification for the superannuation system.

Persuading all Australians to save for their retirement is a laudable goal for reducing these increasing costs.

However over time superannuation law has morphed from a system to encourage all Australians to save for their retirement to now the preferred system of taxation reduction of the middle and high income earners.

Inequity

Regardless of a taxpayer's income level or net wealth currently all taxpayers pay the same tax rate (15%) when contributing to superannuation. Consequently current superannuation taxation law conflicts with a cornerstone principal of taxation law that states that individuals with more "ability to pay tax" should pay more tax.

The following table shows the advantage (or disadvantage) of contributing to superannuation rather than taking home salary and wages at different income levels.

Taxable income	Marginal Tax Rates %	Accumulation Phase Superannuation Tax Rate %	Superannuation Advantage Disadvantage %
0 – $18,200	0	15	-15%
$18,201 – $37,000	19	15	5%
$37,001 – $80,000	32.5	15	26%
$80,001 – $180,000	37	15	35%
$180,001 and over	45	15	55%

As shown in the table above an individual with taxable income over $180,001 pays 45% tax (known as the marginal tax rate) on every $1 of taxable income over $180,001. Consequently for every $100 of wages he/she takes home $55. On the other hand if he contributes the $100 into superannuation, after subtracting the15% superannuation tax, $85 will be credited to his superannuation account. Consequently, by contributing to superannuation he has $85 in his superannuation account instead of $55 in his take home pay packet and is therefore is 55% ($85/$55 = 1.55%) financially better off.

On the other hand, as shown in the above table, an individual with a taxable income from $0 - $18,200 is 15% financially worse off by contributing to superannuation. This is clearly inequitable.

The situation is the same with earnings in the superannuation accumulation phase (typically while you are still working) because income and capital gains earned by superannuation funds are taxed at the 15% tax rate (ignoring for the moment the 50% capital gains discount if assets are held for more than 1 year), the same rate as contributions, regardless of the taxpayer's income level or net wealth.

In summary therefore during the accumulation phase, for both contributions and fund earnings, superannuation taxation is inequitable because individuals on higher taxable incomes pay the same tax rate (15%) as individuals on lower taxable incomes. As table above demonstrates the higher the taxable income level the greater the advantage for taxpayers to invest in superannuation. This is likely to encourage higher income earners to invest in superannuation and to discourage lower income earners, who actually need superannuation to avoid the privations of the Aged pension. This is the opposite of what should be happening.

During the pension phase of superannuation (typically after you retire from work) the superannuation tax rate on income and capital gains of superannuation funds is 0% and additionally there is no tax on withdrawing pensions or lump sums from the funds.

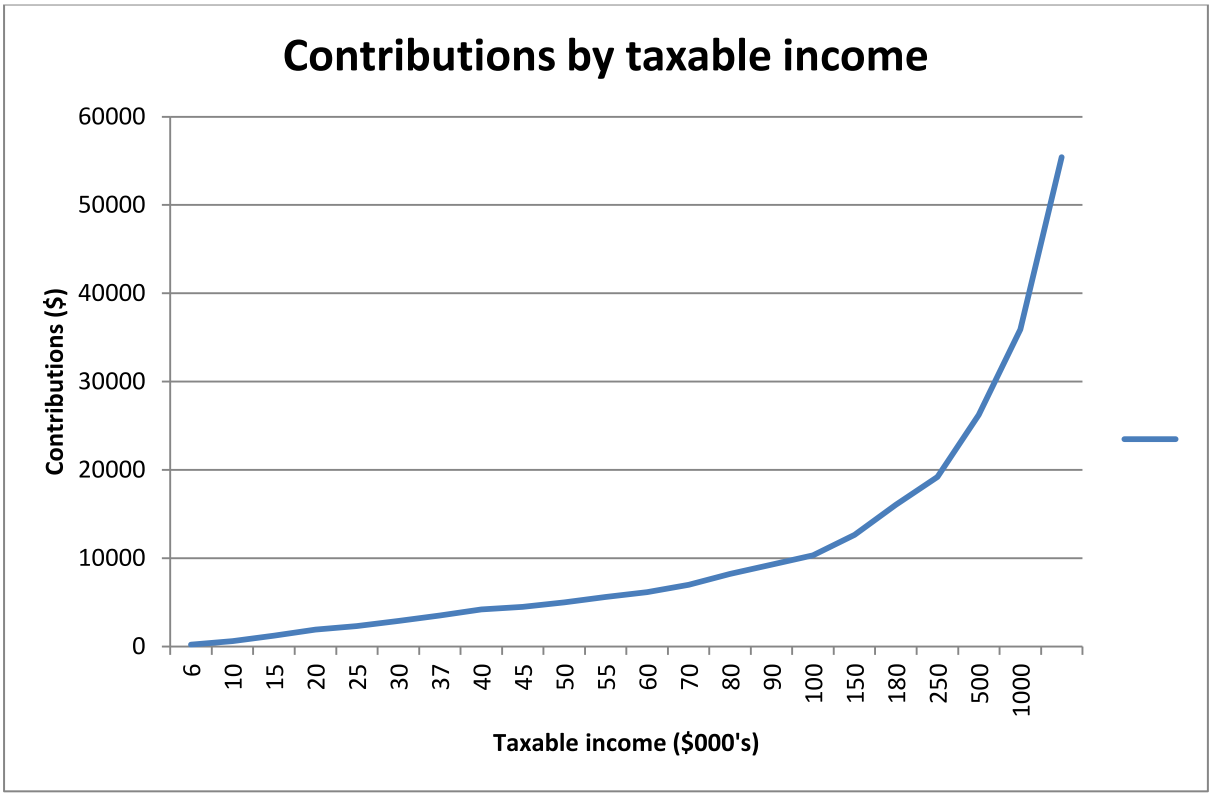
As a result both during the accumulation phase (superannuation tax rate 15%) and the pension phase (superannuation tax rate 0%) all taxpayers, whether high or low taxable income earners pay the same superannuation tax rate. Additionally other than the annual superannuation concessional (before tax) contribution limit (currently $30,000 for under 50 year olds) and the annual non-concessional (after tax) contribution limit (currently $180,000) there is currently no limit on an individuals superannuation fund balance. This contravenes the "ability to pay tax" taxation principle stated above. When taxpayers regardless of the income level and net wealth pay the same tax rate this is deemed as a regressive taxation system.

Consequently current superannuation taxation law is regressive, inequitable and consequently unethical and a rort for high income earners.

Taxpayer's contributions reflect regressive superannuation taxation law

The result of this regressive superannuation law, as shown in the table below of superannuation contribution amounts for taxpayers with taxable income greater than zero sourced from the latest ATO data available[1], is that low income earners contribute insufficient amounts to superannuation while high income earners contribute excessive amounts.

[1] ATO Taxation Statistics 2011-12 Table 3: Individual tax Selected Items, by taxable income, age, gender and taxable status, 2011-12 income year



Government superannuation taxation data is disjointed and inadequate

While superannuation taxation concessions which result in moving individuals off the old age pension is good policy, nevertheless allowing the system to become the preferred method for taxation reduction of medium and high income earners is clearly not.

The above "contributions by taxable income" graph indicates that high income earners with the combined effect of low tax (15%) on both contributions and fund earnings during the accumulation phase and compounding growth of funds are likely to accumulate excessive fund balances. While data on superannuation funds is inadequate, nevertheless ATO data for 2012-2013[2] confirms that 0.4% of SMSF have assets values of over $10million. Since earnings of these funds are tax free during the pension phase this will increasingly reduce the federal government's future individual taxation revenue from middle and high income earners.

What is required is one database of accurate detailed data covering all superannuation funds to determine the cost of the superannuation tax concessions. However there are two separate regulators of superannuation funds.

Australian Prudential Regulation Authority (APRA) regulates APRA funds (retail, industry, corporate and public sector) which typically have thousands of members. The Australian Taxation Office regulates SMSF which have a maximum of 4 members.

[2] www:ato.gov.au/super/Self-managed-super-funds/In-detail/Statistics/Self-managed-superannuation-funds—A-statistical-overview-2012-2013 (table14)

SMSF members represented 9% of approximately 11.6 million members in Australian Superannuation Funds and 30% of the $1.9 trillion total superannuation assets as at 30 June 2014. The average SMSF member account balance in 2013 reached $524,000. In the five years to 30 June 2014, SMSF assets grew by 49%. [3]

The data that is required to determine the loss of federal government individual taxation revenue for medium and high income earners is as follows:

- By Accumulation phase
  - By taxable income of taxpayer (Superannuation and other)
    - By taxpayers age
      - Showing separately for APRA and SMSF
        - superannuation fund concessional contributions
        - superannuation fund nob-concessional contributions
        - superannuation fund balances
        - superannuation fund income earnings
          - earnings taxation
        - superannuation capital gain earnings
          - capital gains taxation
- By Pension phase
  - By taxable income of taxpayer (Superannuation and other)
    - By taxpayers age
      - Showing separately for both APRA and SMSF
        - superannuation fund balances
        - superannuation fund income earnings
          - earnings taxation
        - superannuation capital gain earnings
          - capital gains taxation

Unfortunately the above data does not appear to be currently available.

The federal government data available to determine the cost of the taxation concessions of high income earners under the current superannuation law appears to be disjointed and inadequate.

Government estimated cost of the Superannuation taxation concessions

Individuals' income taxation in 2012-13 at $159.8billion accounted for 47.1% of the total Australian Government taxation revenue (See Appendix 1)

Superannuation Taxation concessions of the Australian government was $25.2 billion in 2012-13 based on the more conservative Revenue Gain Estimates (See Appendix 2). These concessions are estimated to increase at a compound rate of 6.5%.

These estimates are inadequate because they do not separate the cost of superannuation taxation concessions of low, middle and high income earners taxpayers.

[3] www:ato.gov.au/super/Self-managed-super-funds/In-detail/Statistics/Self-managed-superannuation-funds—A-statistical-overview-2012-2013 Executive Summary

Consequently it is not possible determine the cost of superannuation tax concessions to high and middle income earners.

Nevertheless these concessions significantly reduce the federal government's largest revenue source - individual tax revenue. This loss of revenue each year will compound over future years. This will increase the deficit and reduce the ability of the federal government to fund social services, schools and hospitals

Difficult to change superannuation taxation law

The current superannuation law may be politically difficult to change for the following reasons:

- Middle and High income earners will not want to lose the current excessive superannuation tax concessions
- Superannuation is a significant source of revenue for:
  - Retail superannuation industry which is largely controlled by banks and large financial institutions.
  - Accountants and lawyers who typically service Self-managed Superannuation funds.
- Both Liberal Party of Australia and the Australian Labor Party appear to have little appetite for meaningful change.
- Australian media obtains significant advertising revenue from financial institutions such as banks, financial consultants and superannuation providers, but little from low income earners.

Findings

Superannuation data which is essential to analyse the superannuation system is disjointed and inaccurate.

Low income earners will not accumulate sufficient funds in superannuation and will have to rely on the Aged pension. Our modelling indicates that even a taxpayer on the current average wage (currently about $75,000) with the current super guarantee contribution percentage of 9.5% for 40 years would accumulate less than $500,000 (in today's dollars) in a superannuation fund. At a conservative 5% earning rate this only produces annual revenue similar to the current Aged pension.

The current fixed superannuation contribution tax of 15% regardless of the taxable income or net wealth of taxpayers is regressive, inequitable and consequently unethical and a rort for high income earners.

Due to the current superannuation concessional contributions and earnings tax (both 15%) and the current concessional and non-concessional limits during the accumulation stage high income earners can accumulate excessively large superannuation fund balances at retirement. Since, during the pension phase there is zero tax on superannuation fund earnings and withdrawals, this will increasingly reduce the federal government's future individual taxation revenue from middle and high income earners.

Under the current rules there are no controls during the pension phase to restrict people from withdrawing all their superannuation balance and then disposing of the money and subsequently applying for the Aged pension.

Recommendations

Detailed superannuation data, as set out above, should be collected and made available to enable detailed analysis of superannuation taxation policy.

Superannuation contributions taxed at marginal tax rate of the taxpayer less a fixed percentage for all taxpayers of say 20%. The Henry Tax Review recommended this change to superannuation taxation law.

Reasonable benefit limit, that limits the balance level of superannuation funds for concessional taxation to say $1.5m (indexed annually), be re-introduced. At a conservative 5% earning rate a $1.5m superannuation fund produces annual revenue about three times the current Aged pension.

During pension phase no withdrawal of lump sums to reduce superannuation funds below the reasonable benefit limit should be allowed to be withdrawn unless special circumstances such as terminal illness or requiring money to enter a retirement home is demonstrated to independent government controlled agency.

Appendix 1: Individuals' income taxation

Individual taxation revenue (at 47.1%) is the largest revenue source for the federal government as shown below from the Treasury pocket tax guide Chart 9.[4]

Australian Government tax mix, 2012-13

Individuals' income taxation$159.8 billion(47.1%)
Company and resource rent taxation$76.6 billion(22.6%)
Sales taxes$49.6 billion(14.6%)
Petroleum excise $18.0 billion(5.3%)
Other excise$8.6 billion(2.5%)
Superannuation taxation$8.1 billion(2.4%)
Customs duty$7.8 billion(2.3%)
Carbon pricing mechanism$4.0 billion(1.2%)
Fringe benefits taxation$4.0 billion(1.2%)
Other taxation$2.9 billion(0.9%)

Appendix 2: Cost of the Superannuation taxation concessions[5]

Source: Australian Government The treasury "Charter of Superannuation Adequacy and Sustainability & Council of Superannuation Custodians"

Two estimates of the notional cost to the government of providing the super tax concessions are published annually by Treasury in the Tax Expenditures Statement (TES). Both estimates look at tax revenue implications and neither method looks at long-term pension savings, which are addressed by Treasury's RIMGROUP model. This process has its own methodology that seeks to assist policy makers trading off tax concessions and actual expenditures to decide what is the best use of government money. It assists this process to know what it would look like if a particular policy were exchanged for another or discontinued altogether.

The **revenue forgone** method is similar to forward estimates, and assumes the continuation of the concessional taxation treatment of superannuation. The **revenue gain** method is like a costing — it assumes that contribution and earnings concessions cease on a particular date and examines the cumulative consequences of relatively lower contributions and assets. Table 2.1 shows how this is presented in the 2012 Tax Expenditures Statement.

Table 2.1: Comparison of revenue forgone and revenue gain estimates, 2012-13 to 2015-16 from the 2012 Tax Expenditures Statement

	Concessional taxation of superannuation entity earnings							
Revenue forgone estimates ($b)					Revenue gain estimates ($b)			
2012-13	2013-14	2014-15	2015-16		2012-13	2013-14	2014-15	2015-16
17.1	19.1	21.7	25.1		13.2	14.2	15.6	17.7

Reason for difference

[4] Pocket guide to the Australian taxation system 2012-13

[5] Australian Government The treasury Charter of Superannuation Adequacy and Sustainability & Council of Superannuation Custodians

It is assumed current preservation rules remain. In the accumulation phase voluntary concessional contributions are assumed to cease (as in the table below) and most non concessional contributions are also not invested in superannuation after the start date. Over time this reduces the superannuation asset base and thus the revenue gain on withdrawing the earnings tax concession. Additionally, a significant proportion of funds in the retirement phase (not preserved) are withdrawn. Because of other tax concessions for older Australians (particularly the Senior Australians Tax Offset), the funds withdrawn attract minimal tax in the new investments chosen.

	Concessional taxation of employer contributions							
Revenue forgone estimates ($b)					Revenue gain estimates ($b)			
2012-13	2013-14	2014-15	2015-16		2012-13	2013-14	2014-15	2015-16
13.2	14.1	16.2	17.3		12.2	10.8	12.3	13.2

Reason for difference

It is assumed that the Superannuation Guarantee remains and therefore compulsory contributions continue. Voluntary contributions are assumed to be directed to alternative tax preferred investments. Because more voluntary contributions come from those with higher marginal tax rates, the average tax rate for residual compulsory contributions is lower.

Revenue forgone method

The revenue forgone method measures the difference in tax paid by taxpayers who receive a particular concession relative to similar taxpayers who do not receive that concession. It operates on the assumption that, if the super system did not exist, wages and salary currently being contributed to super would be paid directly to employees and taxed at their respective marginal rates. That is, it assumes that if super did not exist, there is no alternative universal saving mechanism where taxpayers could enjoy concessional tax rates of 15 per cent. The money otherwise contributed to super would either be spent or invested and taxed at marginal rates. The revenue forgone method assumes no behavioural change (that is, it does not take into account the likely use of other ways to reduce tax).

Revenue gain method

Under the revenue gain method, regard is had to the likely behavioural change that would see taxpayers using other strategies to reduce tax, such as negative gearing. This approach measures how much revenue could increase if a particular tax concession were removed. For example, under the revenue gain method, it is assumed that voluntary concessional contributions (that is, non-Superannuation Guarantee concessional contributions) and most non-concessional contributions would not be invested in superannuation. Voluntary contributions are assumed to be directed to alternative tax preferred investments. Because more voluntary contributions come from those with higher marginal tax rates, the average tax rate for residual compulsory contributions would be lower.

For earnings, the smaller contributions and withdrawal of non-preserved assets would reduce the superannuation asset base and thus the revenue gain on withdrawing the earnings tax concession. It is assumed that non-preserved amounts in the retirement phase would be withdrawn from the system, and invested to yield minimal tax because of the tax concessions available to retirees.

Drivers of increased notional tax expenditure

Over the past 10 years, the notional tax expenditures on superannuation, as reported in the TES under the revenue forgone methodology, have risen from an estimated $13.8 billion in 2003-04 to an estimated $31.8 billion in 2012-13. Under the revenue gain method, the notional tax expenditures on employer contributions and earnings (the only superannuation tax expenditure estimates prepared under the revenue gain methodology) were estimated at $23.4 billion in 2012-13.

Under either of the methods Treasury currently uses to measure the notional cost of the superannuation taxation concessions, the cost is rising, and increasing relative to other taxation expenditures. This is a combination of two factors:

1. the superannuation system is subject to a robust growth rate, averaging a net compound annual growth rate of approximately 11 per cent.[2] It doubles in size roughly every six or seven years; and
2. the increase in Superannuation Guarantee contributions to 12 per cent by fiscal year 2020.

Criticisms of the Treasury notional tax expenditure methodologies

The three major criticisms of these methodologies are:

- that they are not costings with assumed behaviour changes in which assets inside the system would reduce year on year;
- the assumption that taxpayers would pay full marginal tax rates ignores likely behavioural changes directed towards the use of tax-effective investments (such as negatively geared housing, shares or investments with deferred capital gains); and
- that the long-term saving in Age Pension outlays should be factored into the cost estimate.

The revenue gain estimates are Treasury's attempt to address the criticism that the revenue forgone estimates are not costings that take account of likely behavioural change. The revenue gain estimates also have low or negligible taxation for amounts newly invested outside superannuation, but they still use a full marginal tax rate for earnings remaining in the system.