

INCENTIVES TO SAVE MORE IN SUPERANNUATION

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INTRODUCTION

Most Australians' incomes in retirement will be funded from a combination of superannuation savings, other private savings and a full or part-rate government Age Pension. After allowing for the taxation system, these income sources will provide most retirees with significantly higher standards of living in retirement than would be available from the publicly funded Age Pension alone.

Saving for retirement within superannuation comprises compulsory employer superannuation contributions required by the Superannuation Guarantee (SG), employer contributions that exceed SG requirements and voluntary private saving, either through 'salary sacrifice' or member superannuation contributions (which come from after tax income). Because of these contributions and very good investment returns, on average, the superannuation system has grown strongly, with assets more than doubling over the past 7 years to their current level of about \$700 billion.

Voluntary private saving outside superannuation has many forms such as real property, shares, bank accounts, fixed interest and other non-superannuation financial assets.

Over an extended period the taxation system has offered incentives for both compulsory and voluntary saving in superannuation; for 2004-05 the tax expenditure on superannuation is estimated at 13.3 billion dollars (Treasury, 2004). There have been a number of recent government initiatives aimed at encouraging even greater superannuation saving. In particular the superannuation surcharge has been abolished from July 2005 and the co-contribution for low and middle income earners was markedly expanded from July 2004. Other relevant changes include the opportunity to contribute to superannuation even when not working and incentives to add to superannuation by working longer.

This paper aims to analyse the incentives for saving within superannuation in the light of these changes, considering the potential impact of the incentives from both the individual and aggregate points of view. It updates and extends work on the concessionality of superannuation compared

with saving outside superannuation presented to the 2003 Colloquium (Rothman, 2003). It also updates work on the adequacy of retirement incomes presented to the 2004 Colloquium (Rothman and Bingham, 2004).

The first part of the paper considers the incentives to save and concessionality for the accumulation phase, where a person is saving for retirement. The analysis covers one-off contributions for both high income earners previously subject to the surcharge and for low to middle income earners eligible for the co-contribution.

The next part of the paper extends the analysis into the retirement phase. It analyses consistent saving using the most advantageous saving opportunities within superannuation, comparing the outcome of such saving with parallel saving outside the superannuation arrangements. The equity of concessions and incentives over a wide income range is examined. In a later section the likely aggregate impacts of changes in saving behaviour are also examined.

The RIMHYPO model of the Retirement and Income Modelling Unit (RIMU), Treasury has been used to obtain many of the results presented in this paper. This model is as described in Tinnion and Rothman (1999) except for updating to include new policies such as the co-contribution, changes to the pension asset test, new tax scales and new tax arrangements such as the Senior Australians Tax Offset and Mature Age Workers Tax Offset.

CONCESSIONALITY OF INVESTING IN SUPERANNUATION IN THE ACCUMULATION PHASE

The framework follows that developed in Rothman, 2000 and Rothman, 2003. It uses Excel spreadsheets to compare the amounts accumulated at retirement after all taxes in two situations:

- the first where the person invests in the superannuation system with all its rules and taxes and;

- the second where the same person invests equivalent monies as available post income tax outside of the superannuation system, using the same investment portfolio as used for the superannuation investment.

We are trying to compare like with like and in so doing have to be careful. To make a sensible comparison we have to focus on pre tax money as the starting point. Say a person on an annual taxable income of \$40,000 wants to invest \$1000 of his or her pre tax earnings in superannuation. If he or she does this through an employer contribution (salary sacrifice), ignoring fees and charges, \$850 will be working for them in the superannuation fund. If he or she invests through member contributions only \$685 will be working for them, as full personal income tax at 31.5% (including the Medicare levy) needs to be paid first. Similarly the amount invested in the investment vehicle outside of superannuation is \$685.

All cases are assumed to be within age contribution and RBL limits. We also take a conservative simplified framework which assumes all benefits are taken as a post preservation age ETP with the full 16.5% tax rate applicable above the ETP tax free threshold (where the threshold applies). We therefore somewhat understate the relative advantage of superannuation. Those who choose retirement income stream products will not pay ETP tax on these benefits and may also gain a 15% tax rebate; generally this will result in a higher standard of living in retirement than taking all benefits as an ETP (see Tinnion and Rothman, 1999).

In the analysis we consider two recent policy changes:

- The abolition of the superannuation surcharge; and
- The expanded co-contribution introduced from July 2004.

The analysis consists of two parts. Firstly we calculate for each nominal tax bracket the effective earning tax rate for a given portfolio and rate of return. For example for a person on 31.5% nominal marginal tax rate investing outside superannuation, the effective tax rate for fixed interest is 31.5%.

Our simplified balanced portfolio consists of 40% fixed interest, 40% fully franked Australian shares and 20% international shares; for this balanced portfolio at a 7 per cent gross return, the effective marginal tax rate is 18.5% or 59% of the person's nominal marginal tax rate. The reduction reflects the impact of franked dividends and the capital gains tax rules. Thus, if the person directly receives income from interest, dividend and nominal realised capital gains totalling \$1000 the net tax payable after credits is \$185. Table 1 below sets out the results of this preliminary step.

Table 1. Effective Marginal Tax Rate On Earnings From Investments, Outside Superannuation, various investment portfolios.

	fixed term	balanced	all shares
nominal marginal tax rate		effective marginal tax rate	
16.5%	16.5%	5.0%	-2.6%
31.5%	31.5%	18.5%	10.8%
48.5%	48.5%	33.8%	25.8%

Given these effective tax rates, it is not difficult to create a spreadsheet calculator which accumulates the investment in both the within superannuation and outside superannuation tax environments and compares the results. While a considerable number of specific assumptions such as the composition and investment returns of the balanced portfolio have to be made to do the comparisons, sensitivity analysis varying the assumptions indicates that the pattern of results is quite robust.

We will use this framework to examine the relative advantage of superannuation for one off investments. We assume that the person will exceed the ETP tax free threshold over his/her working life and accordingly that the one off investment being considered will not benefit from the ETP tax free threshold. The comparisons assume like balanced portfolios for the within and outside superannuation investments.

For periods of investment from 1 year up to 20 years, Chart 1 shows the comparative advantage of employer superannuation at various surcharge rates. Projected accumulation balances at retirement are compared for one-off investments made within and outside superannuation, using the same balanced portfolio for both investments. The chart shows the percentage advantage of the accumulation within superannuation compared to the outside alternative.

For both tax brackets there is a large improvement because of the surcharge rate changes, growing as the period of investment increases. The Chart also shows clearly that there is great advantage in voluntary employer superannuation even when there is only a short time to retirement. With the removal of the surcharge, for a person with a marginal tax rate of 48.5%, investing an additional sum only one year out from retirement yields an available sum after taxes over 40% greater than taking the equivalent sum as wages and investing outside superannuation. For a person with a marginal tax rate of 43.5% the advantage is around 28%. These advantages would be even higher if the sum were invested in a pension at retirement.

Chart 1

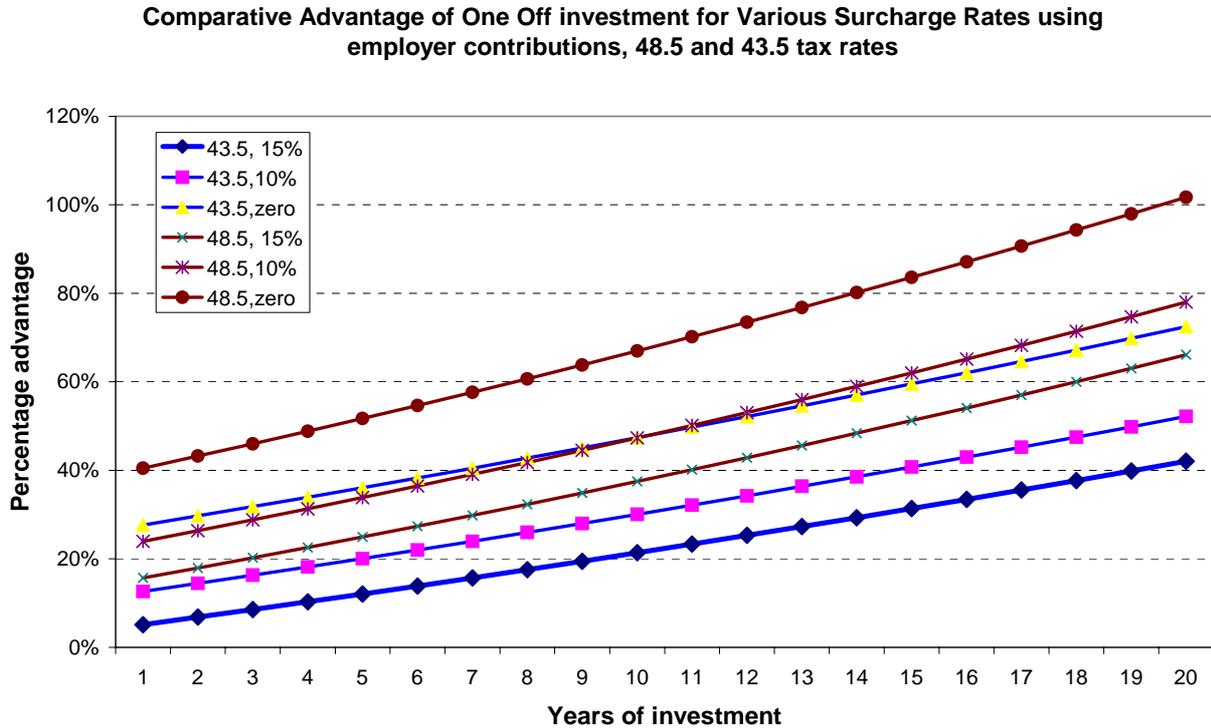
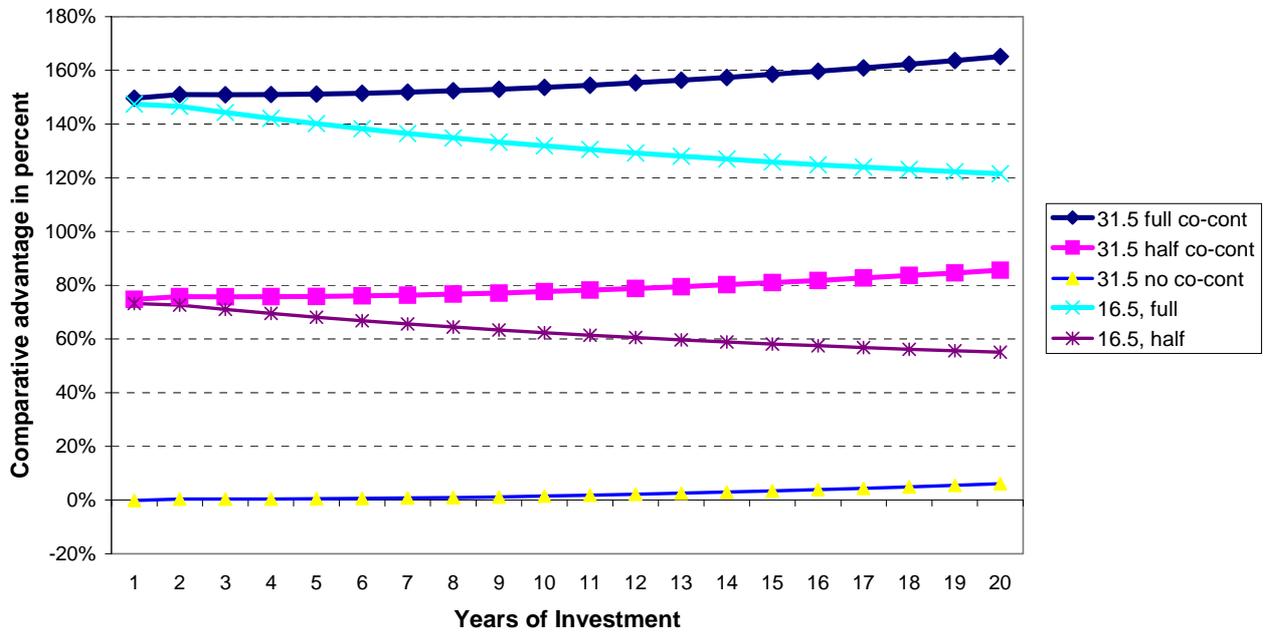


Chart 2 shows the dramatic potential impact of the Government's co-contribution policy which, adds up to a maximum of \$1500 (tax free) to the superannuation accounts of those eligible (see Attachment C for details). The examples shown should be taken as illustrative only: the exact extent of advantage will vary by the amount contributed. In the examples shown the cases marked 'full' contribute \$1000 of after tax money and receive the full \$1500 co-contribution, or a lesser amount which attracts the 150% government contribution in full. In the examples marked as 'half', half the amount contributed as a member contribution attracts the co-contribution. For comparison, a case where no co-contribution applies is also shown though in such a case using salary sacrifice would be more tax effective. The levels of comparative advantage in Chart 2 can clearly exceed those available in Chart 1 even after the surcharge has been abolished in full.

Chart 2

Comparative Advantage of Member Contributions attracting the Co-contribution, 31.5 and 16.5% tax rates



CONCESSIONALITY OF INVESTING IN SUPERANNUATION – WHOLE OF LIFE ANALYSIS

The framework for this analysis is similar to that applied to the accumulation phase, but uses the Treasury's RIMHYPO model to examine effects in the retirement phase. RIMHYPO is used to compare the amounts accumulated at retirement, average annual retirement expenditures and replacement rates (after all taxes) in three situations:

- the first where an amount equivalent to the SG is invested in the superannuation system;
- the second where an amount equivalent to SG plus an additional 3 per cent of pre tax salary is set aside to be invested into the superannuation system (with the additional saving assigned to the optimal strategy for the individual), and;
- the third where the same person invests equivalent additional monies (as available post income tax) outside of the superannuation system (while necessarily retaining the SG investment within superannuation), using the same investment portfolio as used for the superannuation investment.

As was the case when evaluating the accumulation phase, to make a sensible comparison we have to focus on pre tax money as the starting point. Again, all cases are assumed to be within age contribution and RBL limits and are also assumed to meet the eligibility tests for the Government co-contribution (see Appendix C for details).

We also take a simplified framework which assumes all benefits saved within superannuation are taken at age 65 as a complying age pension, and thus receive a 50% asset test exemption and, where income tax in retirement is payable, receive a tax rebate of 15% on pension income. The monies invested outside superannuation are assumed to remain outside the superannuation system in the retirement phase, but are drawn down upon evenly over retirement in a similar manner to the pension.

The benefit gained from investing equivalent monies outside the superannuation system could be improved by investing outside during the accumulation phase, and then placing all proceeds into superannuation as an undeducted contribution just before the point of retirement. The entire accumulation of savings could then be rolled over into a complying pension and be subject to the 50% asset test exemption, which may lead to an increase in age pension benefits over the course of retirement. Thus, the results presented may understate the benefit of investing outside superannuation where a wise investor chooses to utilise the superannuation system at the point of retirement, as described above.

In the analysis as before we consider investing funds additional to the SG in two broad situations specifically impacted by key recent policy changes:

- The abolition of the superannuation surcharge; and
- The expanded co-contribution introduced from July 2004.

Optimal Saving Decision

While the analysis of saving outside superannuation is fairly straightforward (assign 3% of pre tax salary to saving outside superannuation, pay the relevant income tax on those funds and invest the remainder in the assumed portfolio), the saving decision within superannuation can be more complex.

For the cases where the current income is \$60,000 or higher, an assumption is made that all saving within the superannuation system is made via salary sacrifice, so that the concessional nature of contributions tax can be utilised. However, for the \$20,000 and \$40,000 income cases, as indicated in Chart 2, the recently extended Government co-contribution provides a far superior net investment amount into superannuation than can be achieved via salary sacrifice. Thus, if these investors wish to maximise the benefits available from an extra 3% saving within superannuation, they will make

post-tax member contributions until such time as they can no longer receive any additional co-contribution, with any residual saving to make up the 3% being assigned to salary sacrifice.

For example, an eligible person with an income of \$40,000 can currently contribute \$600 to receive a maximum Government co-contribution of \$900. This member contribution represents 1.5% of salary, but as income tax must first be paid before this contribution can be made, 2.19% of salary is assigned to saving via this vehicle. Thus, the remaining 0.81% of salary is assumed to be saved via salary sacrifice. As there is no legislated indexation of the maximum amount of co-contribution that can be received, the level of saving necessary to receive the maximum co-contribution benefit is modelled as declining as a percentage of salary over time. To allow for this, it is assumed that the member reassesses the distribution of saving between post-tax member contributions and salary sacrifice every 5 years in order to achieve the optimal savings mix.

Results

Improvements in both savings at the point in retirement and average annual retirement expenditure are presented for a range of incomes in Chart 3 and 4 for both a 30 year working life starting in 2005-06 (retiring at age 65 in 2035-36) and for a person who is part of the way through their working life currently (assumed to have 15 years of working life left, retiring at age 65 in 2020-21, with an existing superannuation balance¹).

¹ The assumed current superannuation balance is broadly equivalent to the balance projected for SG contributions from 1992 to 2005.

Chart 3

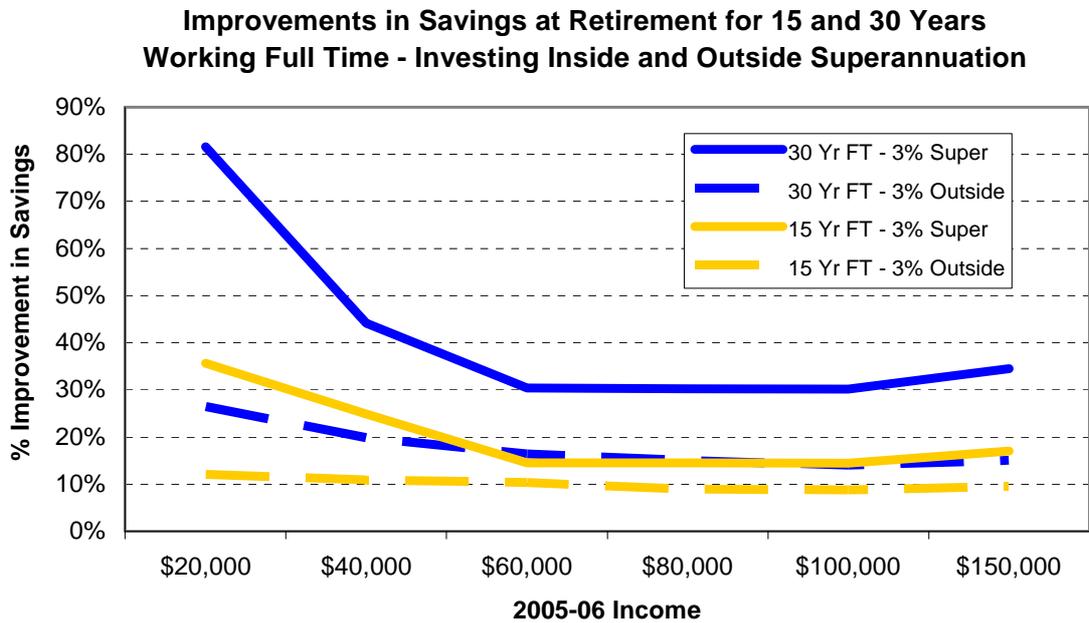
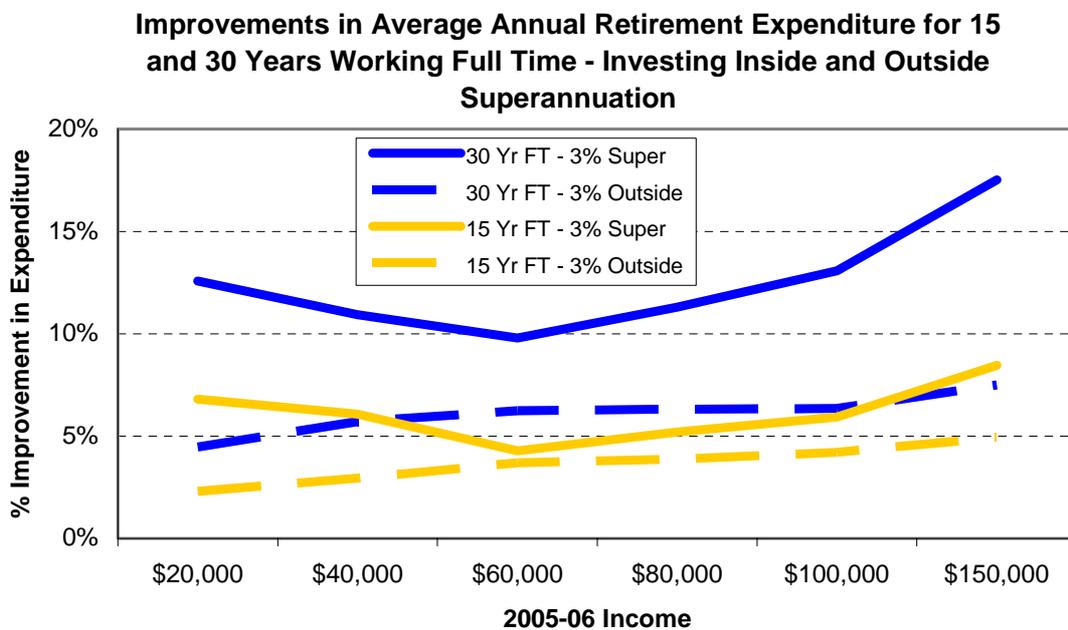


Chart 4



The results in Chart 3 and 4 highlight that at all income levels (and both ages) analysed, investing within superannuation provides a greater accumulation balance and greater annual retirement

expenditure than is achievable outside the superannuation system, where identical investment portfolios and investment returns are used for both cases.

For a person on \$40,000, around median earnings, 3% saving within superannuation over a 30 year working life, leads to 44% more private accumulation at retirement than achieved by the SG alone, with part of this coming from the co-contribution. By way of comparison, saving the same amount outside superannuation gives a 20% higher accumulation. Using the superannuation vehicle, the person's retirement spending, including a part age pension, rises by about 11%. The spending replacement rate in retirement rises significantly from 72% to 82% (see Appendix A for details).

The results show that with the utilisation of the co-contribution, the superannuation system provides incentives to save that are more favourable to lower income earners in the accumulation phase, while providing incentives that are reasonably even across income levels assessed in retirement expenditure terms. This is despite the fact that a significant proportion of retirement expenditure for lower income earners will be provided in the form of age pension outlays, which of course do not grow (and may fall) when a person increases the level of private saving.

The results also highlight that the projected improvements in retirement expenditure are significantly lower than the projected improvements in accumulated savings at the point of retirement. This result is due to the impact of the age pension and retirement taxation on the final retirement expenditure figures. As the age pension makes up a significant proportion of the total retirement expenditure for lower income earners, they have the biggest difference between percentage improvements in the accumulation and retirement phases. This difference is reduced as the proportion of retirement expenditure funded by private saving increases.

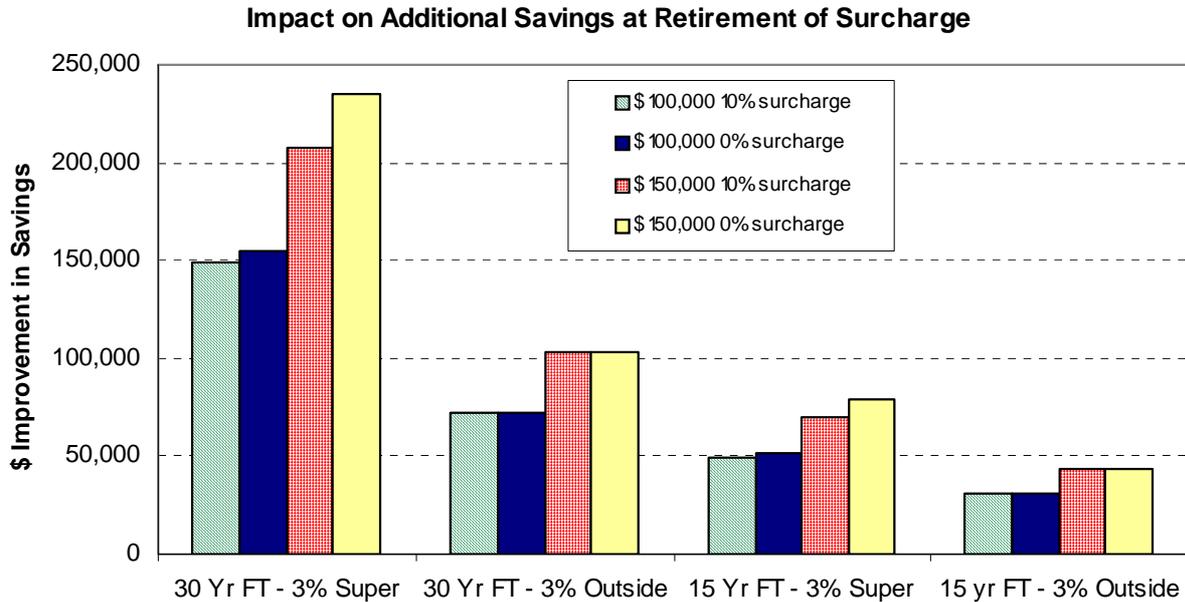
IMPACT OF ABOLISHING THE SURCHARGE

The recent government initiative to abolish the surcharge will impact on the relative incentives of saving within superannuation and outside superannuation. Essentially, the level of concessionality available to those who were previously liable for the surcharge will improve significantly, and therefore saving within superannuation will become more attractive, both in an absolute sense and in a relative sense when compared to investments outside superannuation. Charts 5 and 6 show the impact that removal of the surcharge is projected to have on improvements in the accumulated savings at retirement (in dollar terms and percentage terms), while Chart 7 shows the projected improvements in annual average retirement expenditure in percentage terms.

It may not be immediately apparent why the removal of the surcharge impacts upon the improvements available via saving outside the superannuation system. However, while the surcharge does not impact upon the additional dollar value of saving outside superannuation (as shown in Chart 5), it impacts upon the base level of saving within superannuation, as discussed above. Thus, the removal of the surcharge will lead to an increase in the SG accumulated benefit, and therefore any fixed dollar benefit of saving outside superannuation has a lower proportional impact.

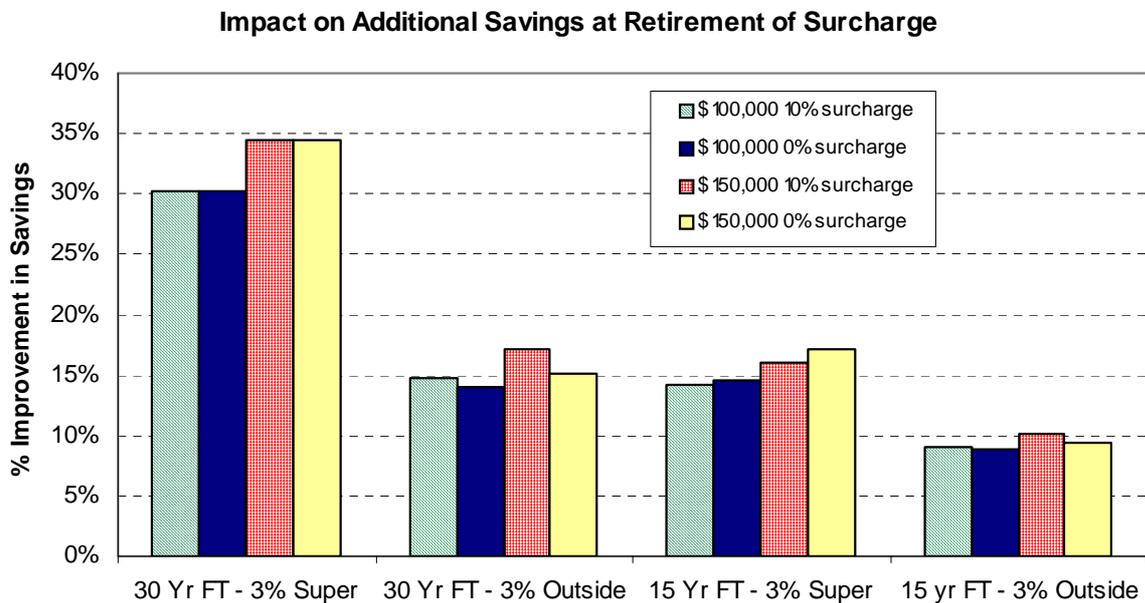
The implication of this result is that not only is the removal of the surcharge projected to improve the incentive to save within superannuation in absolute terms, but it is projected to increase the incentive to save within superannuation relative to saving outside superannuation. This result can also be seen for one-off rather than continuing investments in Chart 1.

Chart 5 : Dollar Improvements at Retirement, 3% extra saving



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Chart 6²: Percentage Improvements at Retirement, 3 % extra saving



² The incentive to save outside superannuation remains constant in dollar terms (as per Chart 5), but as the projected SG balance increases with the removal of the surcharge, the proportional increase derived from a fixed dollar benefit accumulated by saving outside superannuation is reduced.

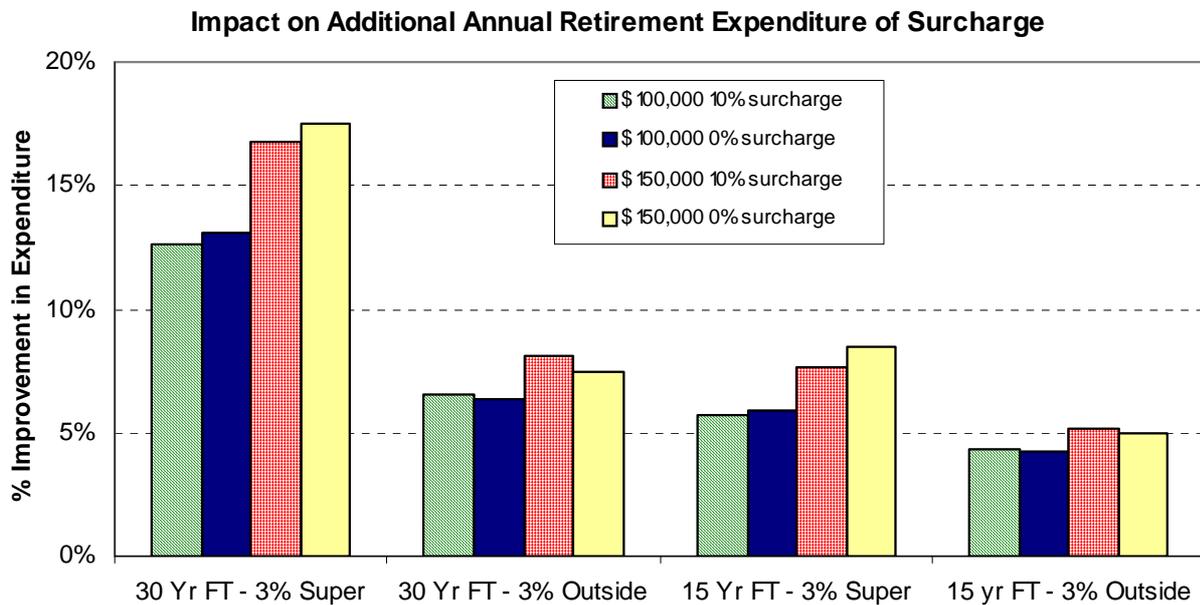
Chart 7: Percentage Improvements during Retirement, 3 % extra saving

Chart 5 and 6 highlight that the removal of the surcharge leads to a significant increase in the dollar incentive of saving an additional 3% of salary. The projected savings from the SG base have also increased by the same proportion for these people, such that they have the potential to benefit twice from the policy (once for their SG contributions and once in terms of improved incentives to save). As both of these potential benefits have grown by the same proportion (up to 13.3%³), the additional incentive does not change in percentage terms, despite both the base contribution and the additional saving growing in dollar terms.

As Chart 7 is also in percentage terms, it parallels the broad patterns of Chart 6 taken through to the retirement phase.

³ This is based on the previous legislated reduction of the surcharge rate to 10% in 2005-06 and beyond. For a gross contribution of \$1, the net contribution can increase from 75 cents up to 85 cents for a person paying the full surcharge rate. This represents an improvement of 13.3%.

SENSITIVITY OF THE RESULTS

The results presented in this paper are based on a number of assumptions about factors such as earnings rates, rates of wages growth, inflation, retirement age and life expectancy⁴.

A sensitivity analysis was performed to evaluate the impact of reducing the assumed pre-tax investment return by 1 percentage point (to a 6% per annum nominal return), while another was performed to evaluate the impact of a 0.5 percentage point increase in inflation (up to 3% per annum). These impacts were tested for the 30 years of full time work case, using current income levels of \$40,000 (capturing the impact of the government co-contribution) and \$150,000 (capturing the impact of abolishing the superannuation surcharge).

As this paper highlights proportional improvements against a base SG case, a reduction in the underlying investment earnings rate for both base and additional saving has little to no impact on the percentage improvements in savings at retirement that can be achieved (although this may vary a little depending on whether the reduction in investment returns is attributable to lower dividends, capital gains or fixed interest returns). The percentage improvements in annual retirement expenditure typically decline by around a half to one percentage point, reflecting the fact that a lower percentage of the retiree's expenditure is now being provided by their own saving and a greater percentage by the age pension, which of course does not grow (and may fall) in value when private saving increases.

Again, due to the percentage improvement nature of the analysis, adjustments to a parameter that affects both the base saving and any additional saving, such as inflation, will have minimal to no impact on the percentage improvements in savings at retirement that can be achieved (although this may vary a little if inflation were to fluctuate significantly over a member's working life). The percentage improvements in annual retirement expenditure are very similar for the \$40,000 income

⁴ All hypothetical cases presented assume a 7% per annum nominal rate of earnings (after fees but before tax), wage growth of 4% per annum and inflation of 2.5% per annum.

case, but can increase by over 1 percentage point for the \$150,000 case. The reason for this is that the thresholds for the means tests (both income and asset) for the aged pension are indexed by CPI, and therefore a greater rate of indexation increases the thresholds applicable during retirement. This leads to increased receipt of aged pension as the member draws down upon their superannuation assets. It does not have the same significant impact upon the \$40,000 income case, as with the utilisation of a 50% asset test exempt pension, this person is not projected to exceed the asset test threshold under either a 2.5% or a 3% inflation assumption.

Overall the results are quite robust to plausible changes in the parameters used.

HOW WILL AGGREGATE SUPERANNUATION FLOWS AND PRIVATE SAVING BE AFFECTED?

Other things being equal, the two key recent policies, when fully implemented, directly add around \$2 billion dollars of government money annually to the superannuation system, about \$1 billion for each policy. These additions to superannuation are fully preserved to the preservation age of the owners; accordingly the earnings on the funds will be also added on average for many years.

Perhaps the more interesting question is how much additional private savings will be generated.

Considering the surcharge first, the high income earners previously paying the surcharge are generally already undertaking some private saving. With the policy change, the relative concessionality of superannuation has been greatly increased at a time when it is generally expected that medium term capital gains in the residential housing market will be low to moderate, thus making negatively geared housing investment appear less attractive than previously. We expect a sharp increase in flows into superannuation of, say, \$1 billion or more annually, around a one percentage point increase in the average proportion of salary saved in superannuation by this group (which is currently around 11%). Previous analysis (Reserve Bank, 2004) indicates that the offset for voluntary saving is around 100 per cent which, on the face of it, implies minimal increase in private saving from the behaviour change. However, as noted above, superannuation contributions are preserved, while most alternative investments are not, so after a few years we would expect some net improvement in private saving. Further, the dramatic reduction in the rate to zero in the same year as significant income tax cuts may bring about some genuine additional voluntary saving.

The costing estimates for the co-contribution policy have assumed significant take-up from new persons previously not making member contributions; an IFSA survey of intentions also indicated very substantial behavioural change. As the base saving rate for those in the relevant low to middle income range is low and the incentive structure is so strong, the offset from other voluntary saving is expected to be quite low; perhaps 70% of the extra saving may be additional saving. The earlier

analysis in this paper demonstrates the excellent benefits available from taking up the co-contribution. This has been reflected in initial experience from the 2003-04 year, when the co-contribution was only dollar for dollar, which shows strong take-up, slightly greater than was assumed in the costing⁵. As a very broad estimate, additional private saving of about \$250 m a year may flow from this source.

Putting the components together, an initial estimate is that there is likely to be around \$3.5 billion additional flow into superannuation resulting from the policies. This compares with a base of about \$40 billion a year of superannuation contributions. While some reductions in other forms of private saving will occur, most of the additional flow will be a net addition to private saving. This increase in private saving will combine with the strong preservation imposed within superannuation, to bring about, over time, a significant growth in the wealth and spending power of retirees.

CONCLUSIONS

The analysis clearly shows that both consistent and one-off saving in superannuation is very worthwhile over a wide range of income levels. It also confirms that saving using the superannuation system remains very much better than saving outside superannuation⁶. Further, contrary to some claims, it shows (particularly through Charts 3 and 4) that the system is broadly equitable and treats low to middle income earners well.

For a person on \$40,000, around median earnings, 3% consistent (optimal) saving within superannuation over a 30 year working life, leads to 44% more private accumulation at retirement than achieved by the SG alone, with part of this coming from the co-contribution. By way of comparison, saving the same amount outside superannuation gives a 20% higher accumulation.

⁵ The Treasury costing estimated co-contribution payments of \$275m during 2004-05. For the period up to 31 March 2005, actual co-contribution payments of \$291m have been paid to over 540,000 recipients. The next quarter payments will be much less than pro-rata, as the vast majority of likely payments have already been processed.

⁶ While this paper only considers ungeared investments outside superannuation, previous papers by the authors eg Rothman, 2000, show that superannuation will often be the better investment even compared with geared investments.

Using superannuation, the person's retirement spending, including a part age pension, rises by about 11%. His spending replacement rate in retirement rises significantly from 72% to 82%.

For the high earnings \$150,000 case, the rise in accumulation at retirement is 35%, compared with 15% outside superannuation. Removal of the surcharge results in a 13% higher accumulation at retirement compared with the base 10% surcharge case. The 3% (pre tax) additional saving during working life flows through to a sizeable 18% increase in retirement income. After removal of the surcharge, the replacement rate for this case only rises from 38% to 46%. At this high income range more than 3% extra voluntary contribution may well be desirable.

Overall, the analysis demonstrates that the current system is effective and concessional, and is projected to deliver very good expected outcomes to those prepared to save even moderate amounts above SG. Moreover it does so across the range of income levels, delivering strong results for low and middle income earners as well as for high income earners.

These strong incentives to save more also have aggregate impacts. There is likely to be around \$3.5 billion additional flow into superannuation resulting from the policies, representing an additional flow of around 10% of base contributions. Most of this additional flow will be a net addition to private saving.

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APPENDIX A: REPLACEMENT RATE PROJECTIONS WHERE 3% OF SALARY IS ASSIGNED TO ADDITIONAL SAVING (INSIDE SUPERANNUATION AND OUTSIDE SUPERANNUATION)

Age	2005-06 Income	SG Superannuation Saving Only	SG Superannuation Saving plus 3% additional saving within superannuation	SG Superannuation Saving plus 3% additional saving outside superannuation
35	\$20,000	114%	132%	123%
	\$40,000	72%	82%	78%
	\$60,000	58%	65%	63%
	\$80,000	51%	58%	56%
	\$100,000	47%	54%	51%
	\$150,000	38%	46%	42%
50	\$20,000	108%	119%	114%
	\$40,000	70%	76%	74%
	\$60,000	55%	59%	58%
	\$80,000	48%	52%	51%
	\$100,000	44%	47%	47%
	\$150,000	35%	39%	38%

These replacement rate calculations have been based on the comparison of average real annual net retirement expenditure with the net expenditure in the final year of working life. This has historically been the preferred methodology of the Treasury. A comparison of the first 10 years of net expenditure during retirement to the last 10 years of net expenditure during working life was recommended by the authors in 2004 as the most robust when analysing a person who has worked part-time before retirement or has taken benefits as a lump sum. However, where a person is assumed to work on a full-time basis until the point of retirement and then takes a superannuation benefit as a complying pension, the results under both replacement rate formulas are very similar (see Rothman and Bingham, 2004).

APPENDIX B: HISTORY OF THE SURCHARGE

The Government introduced the superannuation contributions and termination payment surcharge in the 1996-97 Budget.

The superannuation contributions surcharge has been applied to surchargeable contributions (largely, deductible contributions to superannuation funds). The termination payments surcharge was introduced at the same time as the superannuation contributions surcharge to ensure that termination payments were not used as a means of avoiding the superannuation surcharge. The termination payments surcharge has been applied to employer termination payments that are retained as cash (that is, not rolled over into a superannuation fund).

The surcharge was not payable until an individual's adjusted taxable income exceeded the lower surcharge threshold. Prior to 1999-2000 the adjusted taxable income comprised of taxable income and surchargeable contributions. The maximum rate of the surcharge phased in between the surcharge thresholds of \$70,000 and \$85,000 (for the 1996-97 income year). Both thresholds have been indexed annually for movements in Average Weekly Ordinary Time Earnings. From 1999-2000 the grossed up taxable value of an employee's reportable fringe benefits were added to taxable income and surchargeable contributions to determine an individual's adjusted taxable income for surcharge purposes.

In the 2001-2002 Budget, the Government announced a number of enhancements to the surcharge arrangements. These included a change to the method used to determine a taxpayer's adjusted taxable income under the surcharge legislation. This meant that taxpayers who received modest termination payments and who otherwise do not have high incomes would have a reduced or no surcharge liability.

In the 2002-03 Budget, the Government announced that it would reduce the maximum surcharge rates to 10.5 per cent over three years commencing from 1 July 2002. However, in negotiations to

secure passage of the relevant legislation through the Senate, the Government could only obtain agreement to reduce the maximum surcharge rates to 14.5 per cent in 2003-04, 13.5 per cent in 2004-05 and 12.5 per cent in 2005-06 and succeeding years.

As part of the initiatives announced in the 2004-05 Budget to provide increased incentives for superannuation savings, the Government proposed to further reduce the maximum surcharge rates to 7.5 per cent from 1 July 2006. However, the Government could only obtain support in the Senate to reduce the rates to 12.5 per cent in 2004-05 and 10.0 per cent in 2005-06 and succeeding years.

In the 2005-06 Budget the Government announced that it will abolish the surcharge on superannuation contributions and relevant termination payments made or received in the 2005-06 and later financial years.

The abolition of the surcharge will boost the superannuation savings of affected individuals, provide incentives for individuals to make additional voluntary superannuation savings and simplify the operation of the superannuation system.

APPENDIX C: GOVERNMENT CO-CONTRIBUTION POLICY

The Government's expanded co-contribution policy offers a 1.5 for 1 co-contribution payment (maximum of \$1,500) to those who make post-tax personal contributions to superannuation and:

- are aged 70 or under at the end of the income year in which their personal contributions are made;
- receive at least 10 per cent of their income for co-contribution purposes as eligible employment income; and
- have an income for co-contribution purposes of under \$58,000 (income for co-contribution purposes is the total of assessable income plus reportable fringe benefits).

It is important to note that a member contribution of \$1,000 is not required to receive a co-contribution. As an example, any eligible person with an income for co-contribution purposes of less than \$52,000 can receive a co-contribution payment of \$300 by making post-tax contributions of \$200 in that year. Table C.1 below outlines the maximum co-contribution benefit available to eligible members with various incomes for co-contribution purposes, as well as the level of post-tax personal contributions required to receive this maximum benefit.

Table C.1: Maximum benefit available under the co-contribution for eligible members

Income for co-contribution purposes	Maximum co-contribution benefit available	Post-tax personal contribution required to receive maximum
up to \$28,000	\$1,500	\$1,000
\$31,000	\$1,350	\$900
\$34,000	\$1,200	\$800
\$37,000	\$1,050	\$700
\$40,000	\$900	\$600
\$43,000	\$750	\$500
\$46,000	\$600	\$400
\$49,000	\$450	\$300
\$52,000	\$300	\$200
\$55,000	\$150	\$100
\$58,000 and above	\$0	\$0