

TREASURY BRIEFING NOTE

Section 22

8 July 2014

Minister for Finance, Acting Assistant Treasurer

cc: Treasurer

AFSA REPORT ON THE EQUITY AND SUSTAINABILITY OF GOVERNMENT ASSISTANCE FOR RETIREMENT INCOMES IN AUSTRALIA**Timing:** At your convenience. The ASFA report was released in early July.**KEY POINTS**

- The Association of Superannuation Funds of Australia Ltd (AFSA) has released a report titled 'The equity and sustainability of government assistance for retirement income in Australia'. Your Office requested this brief in case you are asked about the issues raised in the report, especially given the Minerals Resource Rent Tax repeal debate.
- Overall, the ASFA report concludes the superannuation system is successfully delivering on the original objectives of the compulsory superannuation, claiming that retirement incomes and national savings have increased while Age Pension expenditures are lower than they otherwise would be. The report submits that over the coming years, the superannuation system will need to be adjusted to accommodate the demands posed by our aging population and reducing tax base.
- The report contains five specific conclusions and four key recommendations which are discussed below. Our detailed comments on ASFA claims regarding superannuation tax concessions are at Attachment A and an outline of recent measures affecting these concessions are at Attachment B.

Five ASFA conclusions

- The first conclusion is that superannuation is boosting retirement incomes and reducing reliance on the Age Pension. ASFA claim that superannuation reduces expenditure on the Age Pension by more than \$7 billion per annum.
 - While we have not undertaken a detailed analysis of this figure, our preliminary analysis suggests the \$7 billion estimate could be significantly overstated.
- The second conclusion is that reducing the concessional caps placed on superannuation has significantly reduced the tax concessions applying to high-income earners. We find evidence to support this claim, although 'significantly' may overstate the reduction.
- The third conclusion is that most of the tax concessions on concessional contributions flow to middle-income earners. However, this is based on income tax brackets rather than income deciles.
 - Income deciles are preferred because they contain equally sized groupings of taxpayers, thus giving a measure of concession per person. We estimate that the top income decile received 35.8 per cent of the tax concessions on concessional contributions in 2011-12. However, this estimate does not account for the reduction in tax concessions as a result of the Division 293 tax.
- The fourth and fifth conclusions are that the majority of tax concessions on superannuation earnings in the accumulation phase go to middle and high-income earners, while the majority of tax concessions on earnings in the pension phase go to low and middle-income earners.

- We agree that high income earners and balance holders receive a disproportionately high share of tax concessions on earnings in the accumulation phase. Data availability makes it more difficult to estimate the distribution of tax concessions in the pension phase. However, there is enough evidence to suggest that high balance holders have a disproportionately high share of superannuation assets.

ASFA recommendations

- The capping of the concessional tax treatment of superannuation, consistent with what might reasonably be expected for retirement income purposes, should be retained.
 - ASFA noted that concessional contributions caps were working so the current thresholds should not be lowered but indexing them is important.
- Lifetime caps for non-concessional contributions should be introduced.
 - The current annual and three year bring forward rule can allow individuals to accumulate very large balances. ASFA submits that an alternative is to introduce a lifetime cap for non-concessional contributions. This would allow individuals to accumulate sufficient funds for a dignified retirement while not providing tax concessions on very large superannuation balances.
- Superannuation tax concessions should not extend to very high account balances.
 - AFSA submitted that once superannuation account balances reach a very high level, possibly \$2.5 million per person, the same concessional tax treatment may not be required.
 - The ASFA proposal is similar in concept to the 2013-14 Budget measure ‘Superannuation reforms — reforming the tax exemption for earnings on superannuation assets supporting retirement income streams’, which the Government chose not to proceed with in the 2013-14 Mid-Year Economic and Fiscal Outlook.
- The low income superannuation contribution (LISC) should be retained.
 - The LISC is an equity measure that gives low income earners some superannuation tax concessions.
 - The LISC effectively refunds the 15 per cent contributions tax paid on concessional contributions, up to a maximum of \$500, for individuals with taxable incomes of \$37,000 or less.

Section 22

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Consultation: Tax Analysis Division (TAD)

TREASURY COMMENTS ON ASFA CONCLUSIONS

First conclusion: Age Pension

ASFA find clear evidence that superannuation is boosting retirement incomes and reducing reliance on the Age Pension. They claim that superannuation reduces expenditure on the Age Pension by more than \$7 billion per annum.

- While we have not undertaken a detailed analysis of this figure, our preliminary analysis suggests the \$7 billion estimate could be significantly overstated.
- Analysis undertaken by Treasury in 2012 showed that the proportion of people between age pension age and 70 not receiving a pension will typically exceed 40 per cent, which is in line with ASFA's finding. Further, the analysis found that the proportion of people of eligible age not receiving an age pension remains at around 20 per cent.
 - Notwithstanding a number of changes to the superannuation and age pension arrangements, the 2012 results were quite similar to those in Intergenerational Report (IGR) 2010 and previous IGR's. The basic picture had not changed, that successive cohorts of retirees will have higher levels of private wealth and income which will lead to fewer full-rate pensioners and more part-rate pensioners.
 - The 2012 analysis also found that the reduction in Age Pension outlays from an increase in the SG rate to 12 per cent is expected to be moderate with savings at around 2.6 per cent of pension costs. It was noted that the Treasury modelling was on the conservative side thus the real impact may be higher.
 - Although not yet fully costed and analysed it is expected that the change to the indexation of base pension rates to Consumer Price Index will have a larger downward impact on both pensioner numbers and outlays than that expected from the increase to the SG rate.

Superannuation tax concessions

For the majority of taxpayers, superannuation contributions and earnings receive concessional tax treatment, compared to taxation imposed at marginal tax rates within the personal income tax system.

By virtue of the 'flat tax' nature of contributions and earnings taxes compared to the progressivity of the personal income tax system, the greatest level of concessions per dollar of contribution made (or dollar of earnings incurred) flow to individuals with the highest marginal tax rates. Moreover, higher income individuals make, on average, greater dollar levels of superannuation contributions and have greater average superannuation balances (and generally greater average levels of superannuation earnings).

Second and third conclusions

ASFA claim that most of the tax concessions on concessional contributions flow to middle-income earners. However, this is based on an analysis of income tax brackets rather than income deciles. Income deciles are preferred because they contain equally sized groupings of taxpayers, thus giving a measure of concession per person.

- We find that individuals earning \$180,001 or more (i.e. the top marginal tax bracket in 2011-12) made up only around 2.6 per cent of all tax filers with deductible contributions in 2011-12 but received around 14.8 per cent of the dollar value of contributions tax.
- We estimate that the top taxable income decile received 35.8 per cent of the tax concessions for contributions in 2011-12 while the top percentile received 6.8 per cent of the tax concessions (see Table A1).
 - However, this estimate does not account for the reduction in tax concessions as a result of the Division 293 tax which commenced on 1 July 2012.
- Many tax filers with taxable incomes of less than \$37,000 in 2011-12 received either zero or negative tax concessions reflecting the relationship between the marginal tax rate (including offsets and Medicare Levy) and the 15 per cent contributions tax rate.
 - The LISC sought to refund the 15 per cent contributions tax paid on concessional contributions, up to a maximum of \$500, for individuals with taxable incomes of \$37,000 or less. The LISC was announced to be abolished as part of the 2013-14 Mid-Year Economic and Fiscal Outlook (see below).
- There is evidence to suggest that the reduction in concessional contributions caps in 2009-10 has reduced the share of tax concessions on contributions flowing to high-income individuals. This supports ASFA's second conclusion.
 - We estimate that the share of tax concessions on contributions for individuals in the top taxable income decile fell from 39.5 per cent in 2007-08 to 36.1 per cent in 2009-10 (see Figure A1).

Fourth and fifth conclusions

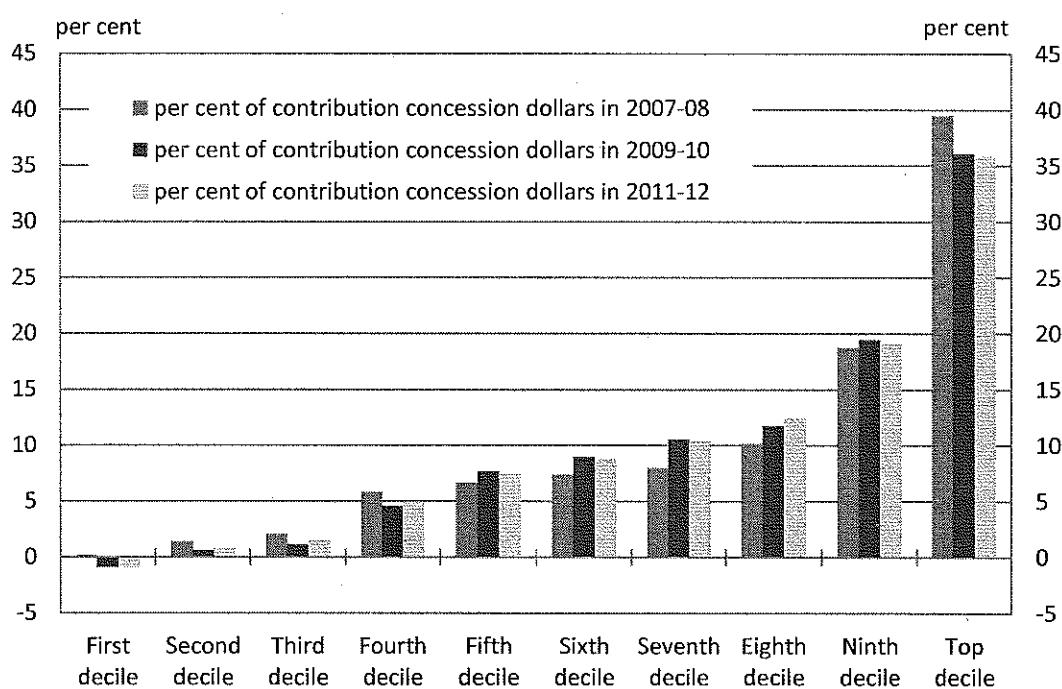
ASFA claim that the majority of tax concessions on superannuation earnings in the accumulation phase go to middle and high-income earners, while the majority of tax concessions on earnings in the pension phase go to low and middle-income earners.

- We find that high income earners and balance holders receive a disproportionately high share of tax concessions on earnings in the accumulation phase. We estimate that the top taxable income decile received 41.1 per cent of the tax concessions on superannuation earnings in the accumulation phase in 2011-12 while the top percentile received 11.4 per cent of the tax concessions on earnings (see Table A1).
- Data availability makes it more difficult to estimate the distribution of tax concessions in the pension phase. However, there is enough evidence to suggest that high balance holders have a disproportionately high share of superannuation assets.
 - For example, for individuals who contributed to super in 2011-12, we find that the top 2 per cent of superannuation accounts by asset size account for around 30 per cent of total superannuation assets. There is enough evidence to suggest that superannuation assets in the pension phase are similarly skewed.

Table A1: Superannuation tax concessions (for tax filers with concessional contributions) by taxable income deciles

2011-12 Taxable Income	Taxable income cuts in after: (\$)	Average net tax (\$)	Average contribution (\$)	Average superannuation balance (\$)	Mean contribution concession (\$)	Mean earnings concession (\$)	Share of contribution concessions (%)	Share of earnings concessions (%)	Share of total concessions (%)	Share of net tax (%)
First decile	0	-100	1,400	47,200	-100	-200	-0.9	-1.5	-1.2	-0.1
Second decile	15,100	400	2,500	39,100	100	100	0.7	1.4	1.0	0.3
Third decile	23,400	1,700	3,200	40,300	200	200	1.4	2.2	1.8	1.3
Fourth decile	31,500	3,100	4,300	49,100	700	500	5.0	5.0	5.0	2.5
Fifth decile	38,600	5,400	4,900	49,300	1,000	600	7.4	6.1	6.9	4.3
Sixth decile	45,800	8,200	5,800	56,900	1,200	700	8.7	7.1	8.0	6.5
Seventh decile	54,300	11,500	6,900	70,300	1,400	900	10.4	8.7	9.6	9.3
Eighth decile	64,800	15,500	8,600	94,000	1,700	1,100	12.4	11.2	11.9	12.5
Ninth decile	79,200	21,700	10,800	129,000	2,600	1,900	19.0	18.7	18.9	17.5
Top decile	105,100	56,100	17,700	238,100	4,900	4,200	35.8	41.1	38.1	45.8
Top five per cent	139,000	79,500	21,600	318,400	6,300	5,900	23.5	29.4	26.0	32.6
Top one per cent	266,900	187,400	30,000	588,000	9,100	11,500	6.8	11.4	8.7	15.4
All	-	12,500	6,600	81,800	1,400	1,000	100.0	100.0	100.0	100.0

Figure A1: Distribution of tax concessions on contributions dollars by taxable income deciles and year



ATTACHMENT B

RECENT MEASURES AFFECTING SUPERANNUATION TAX CONCESSIONS

Low Income Superannuation Contribution (LISC)

The LISC was designed to effectively refund the tax on concessional superannuation contributions (such as superannuation guarantee contributions) up to \$500 for low income earners on incomes of \$37,000 or less.

The LISC effectively refunds the tax on concessional contributions. Individuals on incomes of \$37,000 or less generally have no or little tax concession from superannuation compared to their marginal tax rate as they pay the flat 15 per cent contributions tax on their concessional superannuation contributions.

While there have been extensive calls from the superannuation stakeholders and the community to retain the LISC, the Government has committed to abolish this payment as part of the Minerals Resource Rent Tax repeal. The LISC as a spending measure was linked to the MRRT by the former government. Repealing the LISC will save \$3.8 billion in fiscal terms and \$2.7 billion in cash terms from the years 2013-14 to 2016-17.

Legislation to repeal the LISC is currently before Parliament. If repealed as proposed, no eligible contributions are to be matched by the LISC after 1 July 2013. Going forward, the Government has publicly committed to revisit incentives for low income earners once the Budget is back in a strong surplus.

Division 293 tax (an additional 15 per cent tax on contributions for high income earners)

The Division 293 tax ensures that the tax concession received by high income earners – broadly those with income and concessional contributions exceeding \$300,000 in an income year – is more closely aligned with the tax concession received by average income earners. The tax only applies to the extent that concessional contributions exceed the \$300,000 threshold.

The tax was introduced by the former government and applies from 1 July 2012 and is estimated to raise \$1.7 billion in fiscal terms in revenue from 2013-14 to 2016-17.

Proposal to tax retirement phase superannuation fund earnings on assets above \$100,000

On 5 April 2013, the former government announced a proposal to tax superannuation funds' retirement phase earnings (that is, investment earnings which are used to support income stream payments to retired individual members) above \$100,000 per individual (as part of a package of superannuation and Age Pension measures also announced on the same day). The threshold was proposed to be indexed to the Consumer Price Index. Grandfathering provisions were to be provided for capital gains on assets purchased before the announcement date.

It was estimated that around 16,000 individuals would be affected by the measure – around 0.4 per cent of projected 4.1 million retirees in that year. The measure was estimated to save around \$350 million over the forward estimates period.

On 14 December 2014, the Government announced that it will not proceed with the former government's proposal to tax retirement phase earnings above \$100,000 (along with other announced but unlegislated tax and superannuation measures). This was on the basis of superannuation industry feedback that the measure would be highly difficult to implement, and would significantly increase compliance costs. The announcement received strong support from the superannuation industry.

Reducing concessional contribution caps (primarily a 2009-10 budget decision)

In 2009-10, the former government legislated to reduce the general concessional contributions cap from \$50,000 per annum to \$25,000 per annum. Also the transitional concessional contributions cap of \$100,000 was reduced to \$50,000 per annum (this reduced cap was available to individuals aged 50 and over for the 2009-10 to 2011-12 financial years).

The purpose of these changes was to contribute to sustainable retirement income reform. This measure was estimated to have a gain to revenue of \$2.8 billion over the forward estimates period.

As part of the 2009-10 changes, the general cap of \$25,000 was indexed in increments of \$5,000. As a result, since 1 July 2014, the general concessional cap has increased from \$25,000 to \$30,000.

Also, in the 2013 Budget, the former government announced higher caps for senior Australians to make 'catch-up' contributions to superannuation. From 1 July 2013 the cap for individuals aged 60 and over was \$35,000 (not indexed). This cap has been extended to individuals aged 50 and over from 1 July 2014.

