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D.F: Taxing superannuation contributions at marginal rates minus a rebate

What problem(s) do these options address?

- The tax concession on contributions to superannuation are generally perceived to be inequitable, because the flat 15 per cent tax rate provides a much greater concession to high-income earners than low-income earners.

- These reform proposals potentially raise revenue that can partially fund other tax reforms, and could be seen as improving the fairness of the system. The lower the rate of the rebate, the higher the revenue gains.

DESCRIPTION OF OPTION	INDICATIVE GAIN IN 2017-18
1) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *refundable rebate*	**$1¼ billion**
2) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *non-refundable rebate*	**$1½ billion**
3) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 15% *refundable rebate*	**$5 billion**
4) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 15% *non-refundable rebate*	**$5½ billion**
5) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *non-refundable* rebate, but with floor of 15%	**$2 billion**
6) Replace flat 15% tax rate on concessional contributions with tax at marginal rates minus *refundable rebate* that varies with age as follows: 25% for those aged below 35 years, 20% for those between the age 35-50, and 15% for those aged 50 and over.	**$1¾ billion**
7) Replace flat 15% tax rate on concessional contributions with tax at marginal rates minus *non-refundable rebate* that varies with age as follows: 25% for those aged below 35 years, 20% for those between the age 35-50, and 15% for those aged 50 and over.	**$2 billion**
8) Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *refundable rebate* on all contributions (the proxy for the Australia's Future Tax System (AFTS) model)	**- $0.3 billion**

Summary of options

- Options 1 and 3 are preferred, as they are likely to be seen as the most equitable, relatively simple and generate revenue (especially Option 3 with the lower rebate). Option 8 has a similar characteristics but it has a negative fiscal impact as it extends eligibility for the concession.

- Options 2 and 4 do not provide the full benefit of the tax concession to very low income earners.

- Option 5 does not provide the full tax concession to individuals below $80,000.

- Options 6 and 7 are complex and difficult to understand and explain.

Revenue profile and uncertainty

- The estimated medium-term fiscal impacts of each of these options are sensitive to the final design of how the policy is to be implemented. Specifically, whether the taxing of contributions at marginal rates is to be paid by super funds out of contributions or by individuals out of disposable income will have a significant bearing on the medium-term profile of each proposal.
  - If super funds pay the tax on contributions and receive the rebate, the profile of estimated saves is projected to steadily increase in line with superannuation contributions and average marginal tax rates.
  - However, if contributions tax is abolished and individuals pay the tax on contributions out of disposable income and receive the rebate, preliminary estimates suggest that the profile of saves will be relatively flat. Under this model, there is a large (and growing) increase in superannuation funds under management and a consequent large reduction in funds held outside of the super system. As superannuation earnings are taxed at a concessional rate relative to investment earnings outside of the super system, there is a large (and growing) reduction in overall taxation of investment earnings. This largely offsets the growth in taxation of contributions at marginal rates over the medium term.
  - The above options have been costed on the basis that individuals receive the rebate and pay the tax on contributions out of disposable income. However, the difference in the costings between the two models is relatively small in the first year of implementation.
- The costings are indicative only and are before any estimated behavioural change. In particular, any behavioural response that increases superannuation contributions or contribution splitting between spouses will likely reduce the estimated value of the save.
- Further, the costings exclude interactions with other changes to the personal income tax, company tax, or superannuation tax systems. In particular, policies that lead to a general reduction in personal income taxes will reduce the estimated value of the save.
- Costings are on an economic transactions basis and abstract from timing impacts which typically have a greater impact on the first year of the policy.

OPTION 1

<table>
<tr><th colspan="2">DESCRIPTION</th></tr>
<tr><th>DESCRIPTION OF ELEMENTS</th><th>GAIN IN 2017-18</th></tr>
<tr><td>Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% refundable rebate</td><td>$1¼ billion</td></tr>
<tr><th colspan="2">RATIONALE</th></tr>
<tr><td colspan="2">To increase the fairness of superannuation tax concessions.</td></tr>
<tr><th colspan="2">IMPACTS</th></tr>
<tr><th>PROS</th><th>CONS</th></tr>
<tr><td>• Likely to be viewed as distributing the tax concessions for superannuation contributions more equitably across the income distribution, especially given the cessation of the low income superannuation contribution (LISC) and the Temporary Budget Repair Levy on 30 June 2017.
• The refundable rebate makes the LISC, Division 293 tax and the government co-contribution for low-income earners no longer necessary.
• Taxing superannuation contributions at a progressive but concessional rate is more closely aligned with taxation of ordinary income.
• Increases incentive for superannuation savings of low income earners and so may reduce pressure on the Age Pension.
• Raises revenue that can be used to fund other tax reforms.
• Simpler in design and implementation than other options except Options 3 and 8.</td><td>• Depending on the design of the changed contributions tax, there may be an impact on some employees' take home-pay.
• More complex than current arrangements if taxation is levied in the fund.</td></tr>
<tr><th colspan="2">EXPECTED DISTRIBUTIONAL IMPACTS</th></tr>
<tr><td colspan="2">• Most individuals with a taxable income below $37,000 are better off.
• Most individuals with a taxable income between $37,000 and $300,000 are worse off.
• Most individuals with combined taxable income and contributions above $300,000 are better off as they are no longer subject to the Division 293 tax.</td></tr>
<tr><th colspan="2">DEREGULATORY IMPACTS</th></tr>
<tr><td colspan="2">• Potentially adds compliance costs on funds and individuals, with the extent of the costs and the incidence depending on the detailed designed of implementation model for the option.
• Adds administration costs on the Australian Taxation Office (ATO).</td></tr>
<tr><th colspan="2">ISSUES AND SENSITIVITIES</th></tr>
<tr><td colspan="2">The Financial System Inquiry questioned whether the current superannuation policy settings are efficiently targeted by noting that the majority of the tax concessions accrue to the top 20% of income earners who would save for retirement anyway. The Australia's Future Tax System suggested that all superannuation contributions be taxed at the individual's marginal tax rate minus a rebate.
No transitional or grandfathering provisions are required. The contributions eligible for the rebate are only the concessional contributions. These contributions are subject the annual caps of $30,000</td></tr>
</table>

for individuals below 50 years of age, and $35,000 for those aged 50 and over. Special arrangements would need to apply to defined benefit and constitutionally protected funds due to their unique nature.
STAKEHOLDER VIEWS
Many commentators, community groups and academics argue that the current tax settings are unfair and unsustainable. Superannuation industry stakeholders are likely to oppose any increased tax on superannuation contributions, especially if it reduces the amount of money flowing into super.

OPTION 2

DESCRIPTION	
DESCRIPTION OF ELEMENTS	***GAIN IN 2017-18***
Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *non-refundable rebate*	**$1½ billion**

RATIONALE

To increase the fairness of superannuation tax concessions and to raise more revenue than under Option 1.
The fairness rationale is weaker than for Options 1, 3 and 8.

IMPACTS

PROS	***CONS***
• As in Option 1. • Raises more revenue than Option 1 by restricting the rebate only to the tax liability of an individual (so individuals below the tax free threshold would not benefit from the rebate).	• As in Option 1. • Low-income earners may miss out, fully or partly, on the tax concession due to not having any tax liability in a given year.

EXPECTED DISTRIBUTIONAL IMPACTS

- Most individuals with a taxable income below $37,000 are better off, but to a lesser extent than under Option 1.
- Most individuals with a taxable income between $37,000 and $300,000 are worse off.
- Most individuals with combined taxable income and contributions above $300,000 are better off as they are no longer subject to the Division 293 tax.

DEREGULATORY IMPACTS

- As in Option 1.

ISSUES AND SENSITIVITIES

As in Option 1.
Some may argue for making the rebate refundable or extending a period for claiming the rebate beyond one financial year to address the issue of some individuals not having tax liability in a given year to benefit from the concession.
Under this option, it would probably be necessary to leave the current co-contribution measure in place given individuals below the tax free threshold would not fully benefit. The Government has an election commitment to revisit incentives for low-income earners.

STAKEHOLDER VIEWS

As in Option 1 but criticisms will be stronger given the impact on low-income earners.

OPTION 3

<table>
<tr><th colspan="2">DESCRIPTION</th></tr>
<tr><th>DESCRIPTION OF ELEMENTS</th><th>GAIN IN 2017-18</th></tr>
<tr><td>Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 15% refundable rebate</td><td>$5 billion</td></tr>
<tr><th colspan="2">RATIONALE</th></tr>
<tr><td colspan="2">To increase the fairness of superannuation tax concessions and raise more revenue.</td></tr>
<tr><th colspan="2">IMPACTS</th></tr>
<tr><th>PROS</th><th>CONS</th></tr>
<tr><td>• As in Option 1.
• Raises more revenue than Option 1 given small rebate.</td><td>• As in Option 1
• Reduces the tax concession for superannuation contributions.
• Reduces superannuation savings.
• Increases pressure on the Aged Pension.</td></tr>
<tr><th colspan="2">EXPECTED DISTRIBUTIONAL IMPACTS</th></tr>
<tr><td colspan="2">• Most individuals with a taxable income below $37,000 are better off, although not to the same extent as under Option 1.
• Most individuals with a taxable income between $37,000 and $300,000 are worse off and by a greater extent than under Option 1.
• Most individuals with combined taxable income and contributions above $300,000 are worse off under this measure, as opposed to under Option 1 where they are better off.</td></tr>
<tr><th colspan="2">DEREGULATORY IMPACTS</th></tr>
<tr><td colspan="2">• As in Option 1.</td></tr>
<tr><th colspan="2">ISSUES AND SENSITIVITIES</th></tr>
<tr><td colspan="2">As in Option 1. In addition, it will be criticised for reducing the incentives to save in superannuation.</td></tr>
<tr><th colspan="2">STAKEHOLDER VIEWS</th></tr>
<tr><td colspan="2">As in Option 1. In addition, stakeholders will unlikely support a reduction in overall superannuation tax concessions.</td></tr>
</table>

OPTION 4

DESCRIPTION	
DESCRIPTION OF ELEMENTS	***GAIN IN 2017-18***
Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 15% *non-refundable rebate*	**$5½ billion**

RATIONALE
To increase the fairness of superannuation tax concessions and raise more revenue. The fairness rationale is weaker than for Options 1, 3 and 8.

IMPACTS	
PROS	***CONS***
• As in Option 3. • Raises more revenue than Option 3 by restricting the rebate only to the tax liability of an individual.	• As in Option 3. • Some individuals, typically low income earners, may miss out, fully or partly, on the tax concession due to not having any tax liability in a given year.

EXPECTED DISTRIBUTIONAL IMPACTS
• Most individuals with a taxable income below $37,000 are better off, although those with taxable income below the tax-free threshold do not benefit by as much as under Option 3. • Most individuals with a taxable income between $37,000 and $300,000 are worse off (as in Option 3). • Most individuals with combined taxable income and contributions above $300,000 are worse off under this measure (as in Option 3).

DEREGULATORY IMPACTS
• As in Option 1

ISSUES AND SENSITIVITIES
As in Option 3. Some may argue for making the rebate refundable or extending a period for claiming the rebate beyond one financial year to address the issue of some individuals not having tax liability in a given year to benefit from the concession. Under this option, it would probably be necessary to leave the current co-contribution measure in place. The Government has an election commitment to revisit incentives for low income earners.

STAKEHOLDER VIEWS
As in Option 3 but criticisms will be stronger given the impact on low-income earners.

OPTION 5

DESCRIPTION	
DESCRIPTION OF ELEMENTS	***GAIN IN 2017-18***
Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% non-refundable rebate, but with floor of 15%	**$2 billion**

RATIONALE
To increase the fairness of superannuation tax concessions and to raise more revenue than under Options 1 and 2. **The fairness rationale is weaker than for Options 1, 3 and 8.**

IMPACTS	
PROS	***CONS***
• Raises more revenue than Options 1 and 2 by ensuring that at least 15 cent tax is paid on superannuation contributions.	• As in Option 1. • Effectively denies a tax concession on their superannuation contributions to low-income earners. • Some individuals would pay a higher tax rate on their superannuation contributions than other income. • Reduces superannuation of savings of low income earners relative to the other options and as such not reducing pressure on the Age Pension in the long-run. • More complex than Options 1 and 2.

EXPECTED DISTRIBUTIONAL IMPACTS
• Most individuals with a taxable income below $37,000 are neither better off nor worse off under this option. Individuals below the tax-free threshold continue to receive a negative tax concession on their contributions, while individuals with taxable income between $18,200 and $37,000 receive very little tax concession on their contributions. • Most individuals with a taxable income between $80,000 and $300,000 are worse off under this option. • Almost all individuals with a taxable income above $300,000 are better off under this option as they are no longer subject to Division 293 tax.

DEREGULATORY IMPACTS
• Result in a greater burden on funds, individuals and the ATO than under Options 1 and 2.

ISSUES AND SENSITIVITIES
As in Option 2. Under this option, it would probably be necessary to leave the current co-contribution measure in place. In addition, this option will be criticised for not providing any tax concession to low-income earners, especially as the LISC is being discontinued from 1 July 2017.

STAKEHOLDER VIEWS
As in Option 2 but stronger criticisms given it is more complex, as well as the impact on low-income earners.

OPTION 6

DESCRIPTION	
DESCRIPTION OF ELEMENTS	*GAIN IN 2017-18*
Replace flat 15% tax rate on concessional contributions with tax at marginal rates minus *refundable rebate* that varies with age as follows: 25% for those aged below 35 years, 20% for those between the age 35-50, and 15% for those aged 50 and above.	**$1¾ billion**

RATIONALE
To provide a higher tax concession for individuals with a longer period until retirement and a lower tax incentive for older people.

IMPACTS	
PROS	*CONS*
• Likely to be viewed as distributing the tax concessions for superannuation contributions more equitably across the income distribution. • Provides a greater incentive for young people to save and engage in superannuation.	• Would be complex and hard to understand and explain. • Varying the rebate by age would be criticised as discriminating against older people, right at the time when they are trying to make extra contributions to their super. .

EXPECTED DISTRIBUTIONAL IMPACTS
• Individuals less than 35 years of age are better off while those aged 50 years and over are worse off compared to Option 1. • Overall, most individuals with a taxable income below $37,000 are better off. • Just over half the individuals with taxable income between $37,000 and $80,000 are worse off. • Most individuals with a taxable income above $80,000 are worse off.

DEREGULATORY IMPACTS
• Result in a greater burden on funds, individuals and the ATO than under Options 1 to 4.

ISSUES AND SENSITIVITIES
As in Option 1.

STAKEHOLDER VIEWS
As in Option 1. Stakeholders are unlikely to support differentiating rebate based on age.

OPTION 7

DESCRIPTION	
DESCRIPTION OF ELEMENTS	***GAIN IN 2017-18***
Replace flat 15% tax rate on concessional contributions with tax at marginal rates minus *non-refundable rebate* that varies with age as follows: 25% for those aged below 35 years, 20% for those between the age 35-50, and 15% for those aged 50 and over.	**$2 billion**
RATIONALE	
To provide a higher tax concession for individuals with a longer period until retirement and a lower tax incentive for older people and to raise more revenue than under Option 6.	
IMPACTS	
PROS	***CONS***
• As in Option 6 • Raises more revenue than Option 6.	• As in Option 6. • Compared to option 6, some individuals may miss out, fully or partly, on the tax concession due to not having any tax liability in a given year.
EXPECTED DISTRIBUTIONAL IMPACTS	
• Similar to Option 6, but individuals with a taxable income below the tax-free threshold are worse off compared to Option 6.	
DEREGULATORY IMPACTS	
• Result in a greater burden on funds, individuals and the ATO than under Options 1 to 4.	
ISSUES AND SENSITIVITIES	
As in Option 2.	
STAKEHOLDER VIEWS	
As in Option 2. Stakeholders are unlikely to support differentiating rebate based on age.	

OPTION 8

DESCRIPTION		
DESCRIPTION OF ELEMENTS		***GAIN IN 2017-18***
Replace flat 15% rate on concessional contributions with tax at marginal rates minus a 20% *refundable rebate* on *all* contributions (a proxy for the Australia's Future Tax System (AFTS) model)		**- $0.3 billion**
RATIONALE		
To increase the fairness of superannuation tax concessions.		
IMPACTS		
PROS	***CONS***	
• As in Option 1. • May be perceived to be more equitable than Option 1 as makes all superannuation contributions eligible for the tax concession. • Increases superannuation savings for more individuals.	• As in Option 1. • Has a negative fiscal impact so a lower rebate rate would likely to be required. • Unlikely to provide savings to fund other tax reforms.	
EXPECTED DISTRIBUTIONAL IMPACTS		
• Most individuals with a taxable income below $37,000 are better off. • Most individuals with a taxable income between $37,000 and $300,000 are worse off. • Most individuals with combined taxable income and contributions above $300,000 are better off as they are no longer subject to the Division 293 tax. • Most individuals who make non-concessional contributions would benefit compared to Option 1.		
DEREGULATORY IMPACTS		
• As in Option 1.		
ISSUES AND SENSITIVITIES		
As in Option 1. Australia's Future Tax System review recommended that all superannuation contributions be eligible for the rebate, especially as not all individuals have the same ability to make concessional contributions.		
STAKEHOLDER VIEWS		
As in Option 1. In addition, stakeholders will likely support the extension of the concession but not if associated with a lower rebate rate.		

D.G: Remove the tax exemption for superannuation earnings in the pension phase

What problem(s) do these options address?

- Pension phase earnings (i.e. earnings on the superannuation savings of individuals who have retired and are receiving superannuation income streams) are currently tax exempt.
- Removing this exemption (i.e. having a uniform tax rate across both accumulation and pension phases) could generate revenue that could partially fund other reforms, depending on the tax rate chosen.
- Applying a uniform tax rate across all earnings would greatly reduce the complexity of superannuation tax arrangements.

Summary of options to address the problem

DESCRIPTION OF OPTION	INDICATIVE FISCAL IMPACTS			
	2017-18 $b	2018-19 $b	2019-20 $b	2020-21 $b
1. Uniform earnings tax rate (immediate) – Maintain the accumulation phase earnings tax rate at 15 per cent; immediately increase the pension phase earnings tax rate to 15 per cent.	4	4	4½	4½
2. Uniform earnings tax rate (phased in over 15 years) – Maintain the accumulation phase earnings tax rate at 15 per cent; gradually increase the pension phase earnings tax rate to 15 per cent by 1 percentage point per year over 15 years.	0.3	0.6	0.9	1.3
3. Uniform earnings tax rate (phased in over 10 years) – Maintain the accumulation phase earnings tax rate at 15 per cent; gradually increase the pension phase earnings tax rate to 15 per cent by 5 percentage points every 5 years over 10 years (i.e. 5% from 2017-18, 10% from 2022-23, 15% from 2027-28).	1¼	1½	1½	1½

- The options involve trade-offs between revenue, perceived 'retrospectivity' and simplicity.
- Option 1 is preferred, as it would generate the most revenue and greatly reduce complexity.
- Options 2 and 3 could assist in managing sensitivities associated with the perceived 'retrospectivity' of an immediate increase of the earnings tax rate on individuals in or nearing retirement, by gradually increasing the tax rate. However, both would be more complex than Option 1, and would generate less revenue initially.
- Option 3 would be simpler than Option 2, as it involves fewer increments in increasing the earnings tax rate. It would also generate more revenue than Option 2 initially, as the uniform tax rate of 15 per cent would be applied after 10 years rather than 15.

Revenue profile and uncertainty

- The costings are of low reliability, indicative only, and may change in light of new data or modelling.

- The costings make some allowance for behavioural response. Specifically, it is assumed that most individuals will move funds outside of the super system to make use of any unused tax-free threshold when it is economically beneficial to do so.
- The costings exclude interactions with other changes to the personal income tax, company tax, or superannuation tax systems.
- The costings are on an economic transactions basis and abstract from timing impacts which typically have a greater impact on the first year of the policy.

COMPARISON OF OPTIONS

DESCRIPTION	
DESCRIPTION OF ELEMENTS	***GAIN IN 2017-18***
1) Maintain the accumulation phase earnings tax rate at 15 per cent; immediately increase the pension phase earnings tax rate to 15 per cent.	**$4 billion**
2) Maintain the accumulation phase earnings tax rate at 15 per cent; gradually increase the retirement phase earnings tax rate to 15 per cent by 1 percentage point per year over 15 years.	**$0.3 billion**
3) Uniform earnings tax rate (phased in over 10 years) – Maintain the accumulation phase earnings tax rate at 15 per cent; gradually increase the pension phase earnings tax rate to 15 per cent by 5 percentage points every 5 years over 10 years (i.e. 5% from 1 July 2017, 10% from 1 July 2022, 15% from 1 July 2027)	**$1¼ billion**

RATIONALE
To improve the simplicity and fiscal sustainability of superannuation earnings tax arrangements.

IMPACTS	
PROS	***CONS***
• Simplifies the taxation of earnings as a uniform earnings tax rate applies. • Regulations to protect the current exemption are impeding the development of longevity risk products. They would not be necessary if there were a uniform earnings tax rate. • A structural reform which improves fiscal sustainability, particularly as the proportion of superannuation assets in the pension phase will increase significantly in the coming decades. • Removes a tax concession that is no longer required, given that superannuation payouts are now tax exempt. • Reduces opportunities for tax planning. Current arrangements can be manipulated by funds (in particular self-managed superannuation funds) to reduce their overall tax liability (e.g. by waiting until the pension phase to realise capital gains). • Gradual increases in the tax rate (Options 2 and 3) may assist in managing likely sensitivities.	• Any increase in tax on superannuation savings will reduce the level of retirement incomes available. • May be perceived as unwinding the tax-free status of superannuation benefits. • Transitional arrangements (i.e. grandfathering or phase-ins) may be required, especially for individuals at or near retirement. However, some individuals could move their savings outside of the superannuation system and retain their tax-free status. • Weakens the incentive to transfer some assets into the retirement phase (where subject to minimum drawdown rules). • Would be criticised as 'retrospective', though it would not be. • Some individuals may reduce voluntary contributions. • Gradual increases in the tax rate (Options 2 and 3) could create more complexities than an immediate increase. Option 2 involves more incremental increases than Option 3, and therefore would be more complex. • Gradual increases in the tax rate (Options 2 and 3) would generate less revenue initially.

EXPECTED DISTRIBUTIONAL IMPACTS
• Individuals in the pension phase would be worse off because they currently pay no tax on earnings (although individuals with lower balances may move their savings outside the superannuation system on retirement and retain their tax-free status). Individuals in the accumulation phase (i.e. still working) will not be affected, although they would be highly sensitive to an earnings tax

rate change in the retirement phase if they are close to retirement. • Self-managed superannuation fund members are likely to be more adversely impacted than large funds given that they tend to be older (and therefore more likely to be in the pension phase).
DEREGULATORY IMPACTS
• There would be a substantial reduction in regulatory and compliance costs from simplifying the taxation of superannuation earnings.
ISSUES AND SENSITIVITIES
• A 15 per cent uniform earnings tax rate would increase the overall amount of taxation on earnings. Note – the "revenue neutral" uniform earnings tax rate is estimated to be around 10.5 per cent. • This increase could be phased in over a number of years, as per Options 2 and 3. • Transitional or grandfathering provisions may need to be considered for existing annuity contracts and defined benefit schemes.
STAKEHOLDER VIEWS
• Likely to be opposed by superannuation industry stakeholders, especially self-managed superannuation funds, given that the measure will lead to an increase in an overall amount of taxation on earnings.

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