SUBMISSION

Submission to the Senate Economics References Committee — inquiry into Australia's Taxation System

18 October 2024

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Via email: economics.sen@aph.gov.au

18 October 2024

Dear Sir/Madam

Inquiry into Australia's Taxation System

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to your inquiry into Australia's Taxation System.

ABOUT ASFA

ASFA, the voice of super, has been operating since 1962 and is the peak policy, research and advocacy body for Australia's superannuation industry. ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers.

We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

ASFA's strategic objectives include to develop public policy position and advocate for:

- **Equity** between members in regard to levels of government assistance and in regard to superannuation balances and retirement incomes received
- The **dignity** of individuals in retirement, through ensuring the adequacy of retirement incomes, relative to the needs and expectations of retirees, and achieving the right balance between self -reliance and receipt of government assistance
- **Member outcomes** that are appropriate, optimised and have no unintended consequences
- **Operational effectiveness**, to deliver, at a reasonable cost, services of a type and standard that meet the needs and expectations of fund members and help them develop confidence in the system
- **Sustainability**, a super system underpinned by the principle of preservation fiscally sustainable, robust to changing demographics and to shifts in the structure of the economy and the associated funding needs of business and government

SUMMARY

ASFA, the voice of super, notes that the Committee's terms of reference for this inquiry cover a broad range of taxation policy settings. The ASFA submission focuses on the appropriate taxation treatment of superannuation contributions, investment earnings and benefit payments.

RECOMMENDATIONS

ASFA recommends that the Committee:

- endorse the basic structure for the taxation of superannuation
- support measures which enhance the equity and efficiency of the taxation structure for superannuation
- support increasing the upper income threshold for the Low Income Superannuation Tax Offset (LISTO) from $37,000 a year to $45,000
- support the continuation of the discount for superannuation funds on taxation of capital gains for assets held for more than 12 months
- endorse the role of superannuation in providing both adequacy and sustainability of retirement incomes

If you have any queries or comments in relation to the content of our submission, please contact Ross Clare, Director of Research, on [redacted] or by emai[redacted].

Yours sincerely

James Koval

Head of Policy and Advocacy

Achieving equity in the tax treatment of superannuation

The tax treatment of superannuation retirement savings in Australia follows an approach which is not really followed in any other country. If Australia was starting from scratch with no superannuation contributions ever having been made and no superannuation assets in existence it would be reasonable to consider taxation approaches more in line with overseas practices. However, that is not the case in Australia and it is now not feasible or desirable to fundamentally change the basis of the taxation of superannuation given the past history of the taxation of contributions, investment earnings and benefit payments.

For a variety of reasons (including a desire to collect tax revenue upfront) when compulsory superannuation was introduced the reforms to the taxation of superannuation led to the adoption of a flat rate of taxation on superannuation contributions and investment returns, with concessional treatment of income in retirement on top of that. Subsequently, payments from superannuation became largely tax free when received at age 60 and over.

This differs from the personal income tax rates, which for 2024-25 onwards are set out in Table 1 below.

Table 1: Personal income tax rates, 2024-25 onwards

Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $45,000	18c for each $1 over $18,200
$45,001 – $135,000	$4,288 plus 32c for each $1 over $45,000
$135,001 – $190,000	$31,288 plus 39c for each $1 over $135,000
$190,001 and over	$51,638 plus 47c for each $1 over $190,000

Tax rates in the table include the 2% Medicare levy

When the flat rate of taxation on contributions at the rate of 15 per cent for concessional contributions was first introduced the rate of the tax concession increased with income, and at low income levels superannuation contributions were taxed more heavily than the marginal personal income tax rate. However, the introduction of the Low Income Superannuation Tax Offset and Division 293 higher taxation of superannuation contributions of certain higher income individuals have largely levelled out the tax concession delivered in terms of percentage of contributions made (Table 2).

Table 2: Tax concession on contributions, 2024-25 onwards

Taxable income	Tax concession on super contributions
0 – $18,200	Nil
$18,201 – $45,000	18% up to $37,000, 3% $37,001 to $45,000
$45,001 – $135,000	17%
$135,001 – $190,000	24%
$190,001 and over	32% until contributions and income reach $250,000, then 17%

There still are some gaps and inconsistencies in the pattern of tax concessions, with those on incomes between $37,000 and $45,000 receiving only a very small tax concession, and with some individuals on the top marginal tax rate receiving a relatively large tax concession. As will be discussed later in this submission, ASFA has recommended measures to redress these inequities.

The operation of the LISTO means that those with taxable incomes of less than $18,200 are not disadvantaged by the taxation of superannuation contributions relative to personal income. As well, many such individuals receive benefits from having a lower reported income for social security and like purposes. In any event, only around one per cent of total employer superannuation contributions are made in regard to individuals with taxable income under $18,200 a year.

Those with relatively large superannuation balances also receive tax concessions through investment earnings being taxed at the rate of 15 per cent during the accumulation phase and at a zero rate in the pension phase. Measures put in place to limit the tax concession for those with high balances have included the introduction of the Transfer Balance Cap, which limits the amount of superannuation in regard to which an individual can have investment returns taxed at a zero tax rate, and limits on contributions which can be made by those with high account balances. There also are measures which allow individuals with low account balances to make contributions in excess of the usual annual caps.

There is a strong case for both further limiting the superannuation tax concessions for those with high balances and/or high incomes and assisting further those on low incomes with generally low balances. ASFA has consistently advocated for such measures.

The following sections of this paper examine how various current and proposed provisions work and how they would impact on various groups.

The proposed Division 296 taxation of individuals with very high superannuation balances

The legislation currently before the Parliament proposes that from the 2025-26 income year onwards, the headline concessional tax rates applying to superannuation earnings would be:

- up to 15 per cent on earnings on superannuation balances $3 million and below; and
- up to 30 per cent overall on a percentage of investment earnings equal to the percentage of the individual’s Total Superannuation Balance above $3 million.

The effective tax rate will be reduced by the proportion of the superannuation balance that is in pension phase.

The legislation has progressed through the House of Representatives but is still to be considered by the Senate.

It is important to note that only the part of total assessed investment earnings that is applicable to the superannuation balance over $3 million is subject to the additional tax rather than all investment earnings being subject to the proposed tax once an account balance exceeds $3 million. This approach is in contrast to Division 293, where all the superannuation contributions are subject to the additional tax once a threshold is reached.

A worked example follows:

> In the 2025–26 income year Mary received benefit payments of $250,000 combined from her two pension accounts and made a $300,000 downsizer contribution. On 30 June 2025 Mary's Total Superannuation Balance (TSB) was $3.7m and $4.1m on 30 June 2026.
>
> Mary's adjusted TSB at the end of the year is calculated to be $4.05m by adding her total withdrawals of $250,000 and deducting her total contributions of $300,000 from her 2025-26 TSB of $4.1m. Her superannuation earnings for the year are $350,000, the difference between $4.05 million and $3.7 million.
>
> The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $4.1 million and then dividing it by $4.1 million, resulting in a percentage of earnings attributable to the balance over $3 million of 26.83 per cent.
>
> The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $350,000 by 26.83 per cent, which is $93,905. That amount is then multiplied by the 15 per cent tax rate, leading to a Division 296 tax amount of $14,085.75. This is a relatively small proportion of the overall superannuation earnings of $350,000.

The calculation could not be regarded as being intuitive but it is reasonably easy to calculate on an automated basis making use of a few data items for each individual.

What would be involved in assessing taxable superannuation investment income (excluding unrealised gains) at the individual level

A number of commentators have suggested that unrealised capital gains be excluded from the calculation of the Division 296 tax liability. However, such an approach would involve substantial challenges in being implemented and would lead to high administration and compliance costs that would be disproportionate to the revenue collected from the tax.

APRA regulated funds have clear records for each member on the quantum, type and timing of contributions. However, in regard to investment returns, taxation occurs at the fund level and there are no records at the individual level of the detailed tax components applying to investment returns as delivered by unit pricing or crediting rates.

Superannuation taxes can be easily applied to contributions at an individual level but the taxation of investment earnings is done at the fund level. There also are issues relating to the treatment of defined benefit superannuation interests with a capital value in excess of $3 million where investment earnings are not directly linked to an account and/or the superannuation interest is unfunded and paid out of consolidated revenue.

If detailed tax information were required for each of the 24.4 million superannuation accounts in the Australian system this would involve very considerable compliance costs. Some APRA regulated funds might only have a few members potentially affected by the tax, with the great bulk of those likely to be affected in SMSFs, followed by a small minority in defined benefit funds, and then by those with an account in an APRA regulated fund.

It is for this reason the legislation proposes use of a proxy for investment earnings making use of currently reported or easily collected data, including opening and closing account balance and amounts either contributed or taken as a benefit.

Including unrealised capital gains in the calculation of the tax

ASFA in its past submissions on the proposed Division 296 tax has stated that this is an unorthodox approach in the context of Australian taxation arrangements, and one that should not set a precedent for the taxation of superannuation or personal income tax more broadly.

However, the submission also indicated that ASFA accepts the rationale for use of this simplified, proxy calculation in this context to minimise the compliance burden and cost that might be incurred – and passed through to individual fund members – if all funds were required to determine, attribute and report, at the individual level, a more precise calculation of ‘earnings’ for Division 296 purposes.

While taking into account unrealised capital gains in a taxation or retirement income context is not common, there are a number of cases where this occurs in the Australian system. Examples include:

- The asset test for the Age Pension uses current market value for assessing assets, including unrealised capital gains.
- Land tax uses a market value linked measure for assessing land tax liability.
- Council rates use a market value linked measure rather than purchase price.
- The Transfer Balance Cap used for a variety of superannuation purposes makes use of market value of assets, including unrealised capital gains.
- Supervisory and other levies linked to assets of an entity are based on market value, including unrealised capital gains.
- Family Law splits of superannuation are based on market value of superannuation assets and do not exclude unrealised capital gains.

Taxation of unrealised capital gains is not common in other countries but there are some examples in operation. There also is a proposal in the US Budget for fiscal year 2025 to impose a tax on unrealised capital gains in relation to asset holdings of high net worth individuals[1]. Lengthy deferral of payment of tax by the very wealthy on capital gains clearly is a public policy issue that at least one other jurisdiction is addressing.

The Supreme Court of the US recently upheld the constitutional validity of a tax related to unrealised capital gains associated with investments by US residents in foreign corporations[2].

The operation of the Low Income Superannuation Tax Offset and other measures available to low income earners

The Low Income Superannuation Tax Offset (LISTO) came into effect on 1 July 2017 as a renamed version of the Low Income Superannuation Contribution (LISC). LISTO payments are capped at $500 per year.

The LISC policy initiative was a response to the Henry Review into Australia's tax system. The Henry Review argued that low-income taxpayers should not be paying more tax on their concessional superannuation contributions (employer contributions and contributions an individual has claimed a tax deduction) than on their wage and salary income.

While the then Government in the main did not take up the Henry Review recommendations, it did develop an alternative mechanism for delivering a superannuation contribution tax concession for lower income individuals.

The upper threshold when introduced aligned with the then second lowest personal income tax band with the capped amount of $500 equivalent to 9 per cent of $37,000. There has been no indexation or discretionary adjustment of the measure since its introduction despite changes to the upper threshold of the second lowest tax band and increases in the rate of the Superannuation Guarantee from 9 per cent of wages to the current 11.5 per cent (reaching 12 per cent next year).

When initially introduced in 2012-13 the measure benefitted around 3.6 million individuals.

In 2018-19 expenditure on this measure was $650 million, growing only marginally to $673 million in 2022-23 when around 2.7 million individuals benefitted. Nominal wages growth since 2012-13 has led to fewer employees having incomes under $37,000 a year but it has resulted in higher average payments (up to the cap) being made.

Who would benefit from an increase in the upper threshold for LISTO

Increasing the upper threshold to $45,000 and increasing the maximum amount payable to $700 as advocated by ASFA in its Pre-Budget Submission for the 2024-25 Budget would lead to an additional 1.2 million additional individuals receiving LISTO with a substantial number of those already receiving LISTO receiving a greater payment. The additional cost to the Budget would be

[1] Biden proposes 25% tax on unrealized gains for high-net-worth individuals (finbold.com)
[2] 22-800 Moore v. United States (06/20/2024) (supremecourt.gov)

around $750 million a year. It would lead to the number of beneficiaries being in line with the number benefitting when the measure was first introduced.

For a person aged 35 and retiring at age 67 who is on a wage of $44,000 a year, receiving a LISTO payment to their superannuation account of $700 a year would lift their superannuation balance at retirement in today’s dollars from around $293,000 to $336,000, a substantial increase.

ATO taxpayer sample data provide an indication of those who would benefit from the proposed enhanced LISTO. Nearly 60 per cent would be female. Around 55 per cent are aged under 40. Typically those who would be benefit are in blue collar, clerical and retail occupations rather than professional or managerial roles. Around 10 per cent benefitting would be technicians and trade workers, around 20 per cent community and personal services workers, around 15 per cent clerical and administration, and around 10 per cent sales workers. In many cases those benefitting would be individuals working part-time or full-time workers who have worked for only part of a financial year.

Those aged under 40 would particularly benefit from increased access to LISTO given that they would have some decades for superannuation to compound before they retire from the paid labour force. The average superannuation balance in 2022 for those aged under 40 and receiving income in the range $37,000 to $45,000 was only $21,330 with the median balance even lower at around $17,000. It can be argued that such individuals are much more deserving of government assistance for their superannuation than individuals with more than $3 million in superannuation and/or with taxable income and superannuation contributions exceeding $200,000 a year.

The sustainability of tax arrangements for superannuation

The increase in average superannuation balances at the time of retirement as the superannuation system has matured has assisted in keeping Age Pension expenditures in check or even falling as a percentage of GDP despite the ageing of the Australian population structure (while at the same time boosting retirement incomes of the recently retired). The Retirement Income Review (RIR) indicated that Age Pension expenditure as a percentage of GDP is expected to fall moderately over the next 40 years, from 2.5 per cent today to 2.3 per cent in 2060. More recently the OECD has forecast that Age Pension expenditure will be only 2.0 per cent of GDP in 2060.

Of course expenditure on the Age Pension is only part of the story. The cost of tax concessions for superannuation contributions and investment earnings are relevant. The cost of contributions tax concessions has grown more slowly than contributions, reflecting the tightening of policy settings, such as lower contributions caps and a reduced Division 293 tax threshold.

The introduction of the transfer balance cap, which restricts the amount that can be taken into the retirement phase where earnings are tax free, has partly restrained growth in earnings tax concessions. As the superannuation system grows, the cost of contributions tax concessions as a percentage of GDP is projected to remain stable, while earnings tax concessions as a percentage of GDP are projected to grow slightly.

Contributions are closely related to growth in GDP (especially after the SG reaches 12 per cent). The earnings tax concession tends to grow with the increase in average superannuation balances, but mechanisms such as the Transfer Balance Cap applying to the amount an individual can place in the retirement phase, limit the tax concession on account investment earnings.

Contribution caps, the Balance Transfer Cap applying to the opening of income stream accounts, and the Division 293 taxation of contributions in regard to higher income earners are all playing a role in containing tax expenditures on superannuation.

The total cost of Age Pension and superannuation tax concessions was projected by the RIR to be around 5.0 per cent of GDP by the year 2060, a very modest amount in international terms. The average public expenditure on pensions of OECD countries is forecast to be 10.3 per cent of GDP in 2060 with a number of countries (including Canada) having significant tax expenditures on top of that. All other developed countries are forecast to have expenditures on public pensions alone in excess of 5 per cent of GDP in 2060, with forecast figures for France of 13.4 per cent and for Italy of 14.1 per cent of GDP.

The calculation for Australia also predates the announcement of the proposed additional tax on investment earnings on balances over $3 million.

As well, the means test for the Age Pension is containing Age Pension expenditures as superannuation balances grow in the runup to retirement. Over time there have been numerous changes to superannuation tax settings, generally leading to a more restrictive approach to taxation concessions.

Superannuation tax settings, including superannuation benefit payments generally being tax free after age 60, have played an important role in assisting individuals with living expenses in retirement, including when their income is less than their required expenditure for living expenses, requiring a drawdown on capital.

The concessional taxation of capital gains for assets held more than 12 months

In jurisdictions around the world the general approach is to tax capital gains on assets held for more than 12 months at rates lower than those that apply to other income.

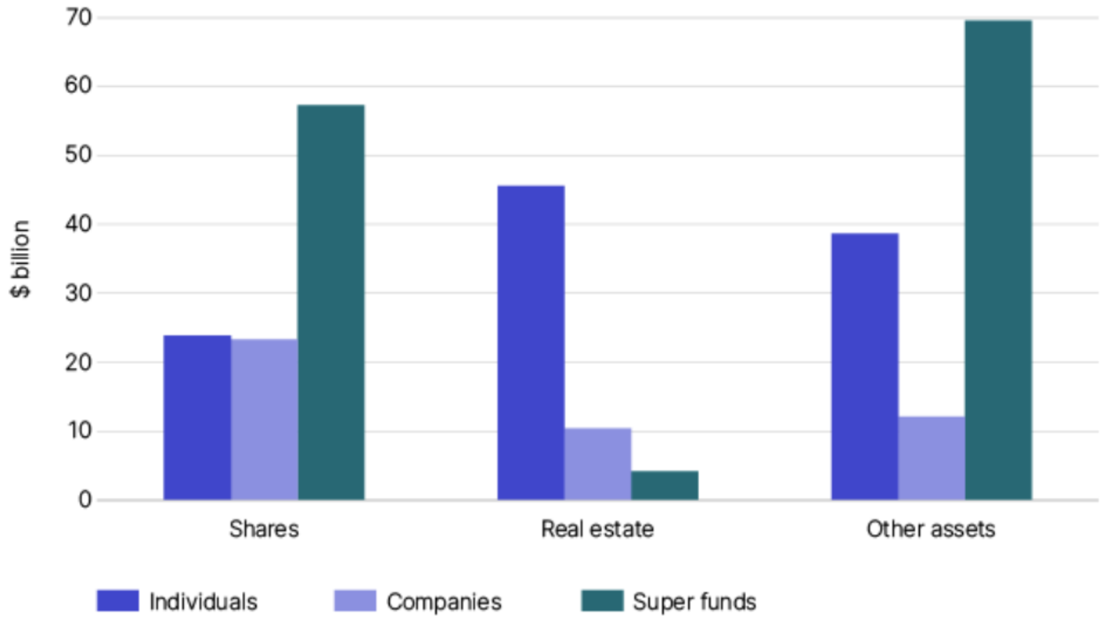
Capital gains tax (CGT) has been a feature of the Australian tax system since 1985 when capital gains for assets held for more than 12 months began to be taxed at the usual marginal rates but with nominal gains deflated by the change in the CPI over the period the asset were held.

The reforms instituted by the Ralph Business Taxation Review in 1999 were based on the argument that an improved capital gains tax regime was needed to stimulate saving, investment and economic growth. Rather than capital gains tax applying to the CPI deflated increase in value, marginal tax rates were applied to a discounted portion of the capital gain. For individuals the discount is 50 per cent.

Australian trusts can discount a capital gain by 50 per cent, complying super funds can discount a capital gain by 33.33%. Companies cannot use the CGT discount.

The following Chart, reproduced from the ATO website[3], indicates that the great bulk of capital gains realised by superannuation funds relate to active investments in companies and other business related activities rather than passive holdings of real estate.

Chart 17: Source of current year CGT, by entity type, 2021–22 income year



ASFA recommends that the Committee support continuation of the current discount applied to capital gains realised by superannuation funds on assets held for more than 12 months.

[3] Capital gains tax statistics | Australian Taxation Office (ato.gov.au)