CHAPTER 5:

TAX AND SUPER

With a high income comes a tax problem and the Government reaches out to help. More thought needs to be put into what is a good incentive for women who tend not to have tax problems ... and what would help them make retirement plans.[1]

Super is concessionally taxed *for some*

5.1 Super is a concessionally taxed savings vehicle.

5.2 Whilst the current superannuation system has greatly improved the potential retirement incomes of women, it must be conceded that the historical development of the system has meant that what currently exists is a superannuation system based upon a regular, reasonably high income working life. It is a system that has focused on male working patterns. Consideration has only just begun on how to accommodate those who have intermittent workforce participation and those on low incomes.

5.3 Given that superannuation is a concessionally taxed vehicle and that it has grown out of a system based on full time paid employment, the tax advantages fall disproportionately to higher income earners.[2]

5.4 Lower income workers pay a higher overall rate of tax than they would have paid had they not received superannuation.[3] Whereas, the tax rate of higher income earners is lowered by the superannuation tax structure.

5.5 Taxation incentives have played a central role in Government policies to encourage saving for retirement through superannuation. Albeit there is now a degree of compulsion in superannuation through the Superannuation Guarantee Charge (SGC), taxation legislation continues to offer concessions for superannuation funds, contributions and benefits.

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1 Women's Legal Resource Centre, SW Sub No 58

2 Office of the Status of Women, New Zealand, SW Sub No 7

3 Playgroup Council of Australia, SW Sub No 13

5.6 The Committee considered whether existing taxation incentives were equitably and sufficiently targeted to provide assistance to women, and to others whose working lives do not fit the traditional model.

Why taxation has been used as an incentive for superannuation

5.7 Because the Commonwealth has no express power under the Constitution to make laws on superannuation, it has relied almost exclusively on its taxation power, especially through provisions in the *Income Tax Assessment Act 1936*, to provide incentives for superannuation. The 1992 SGC legislation is an example of use of the tax power. It imposes a tax on employers who fail to make the minimum Superannuation Guarantee contributions, rather than require compulsory contributions to be made.

5.8 With the advent of award superannuation and the SGC the government needed to increase its level of supervision and regulation of superannuation funds. Accordingly it used a combination of its powers in respect of both corporations and old age pensions to enact the *Superannuation Industry (Supervision) Act 1993* (SIS).

5.9 The Government continues to rely on its taxation powers for the purpose of conferring tax advantages on those funds which comply with the requirements of SIS.

Superannuation taxes and incentives

5.10 Superannuation is taxed at three points:

- on entry to the fund - a contributions tax of 15 per cent;
- whilst in the fund - an earnings tax of 15 per cent, which may be reduced by dividend imputation credits, etc; and
- on receipt of benefits - a benefits tax at 0, 15 or 30 per cent, depending upon the tax that has been previously paid and the amount of the benefit. Benefits over the Reasonable Benefit Limit are taxed at a member's marginal rate.

5.11 Employer contributions are deductable for the employer (subject to upper limits) and are taxed at 15 per cent upon receipt by the fund.

5.12 The end benefit, when paid on or after age 55, is subject to a further tax on that benefit above $83,168 (indexed to average weekly earnings each 1 July).

5.13 Generally, member employee contributions are not taxed, and for persons on assessable incomes of less than $31 000, a rebate of 10 cents in the dollar up to $1 000 per year of contributions is payable, providing a maximum rebate of $100 per year. The rebateable contribution is $1 000 for incomes of $27 000 or less, declining to nil for incomes $31 000 and above.

5.14 Persons self-employed enjoy full deductibility on the first $3 000 of contributions, plus 75 per cent of any excess over $3 000, at their marginal rate of tax. Contributions for which a deduction is claimed are taxed at 15 per cent on receipt by the fund.[4]

5.15 The taxation arrangements for superannuation disadvantage those on low incomes who are most likely to be female, and either part-time or casual employees. Persons on incomes in the range $5 401 to $20 700 per annum pay personal income tax at 21.4 per cent while those below $5 401 pay no tax. Therefore, taxing employer contributions at 15 per cent provides little or no advantage from superannuation for this group.[5] In fact, given the tax on benefits above $83 168 should such people be able to achieve that amount, there is a tax disincentive to participate in superannuation.[6]

Recommendation 5.1:

The Committee recommends that measures be taken to redress the tax imbalance experienced by low income earners.

Capital Gains Tax

5.16 The Committee is aware of concern in some quarters that pressure for increased efficiency may induce some funds to merge and to risk suffering a capital gains tax impost. At the time of writing, the Senate was due to consider a Bill passed by the House that will ameliorate some of these concerns for a

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4 Jacques Martin Industry, SW Sub No 17

5 Delphin K, SW Sub No 76

6 SW Sub No 17

limited period. If enacted, the change to the *Income Tax Assessment Act 1936* will allow certain superannuation funds that merge before 1 July 1997 to effectively roll-over any accrued capital gains or losses that would have been realised by the merger.

The taxation of superannuation lump sum benefits

5.17 Prior to 1 July 1983, only five per cent of a superannuation lump sum was taxed (at the taxpayer's marginal rate). This contrasts to pensions and annuities which were fully assessable, subject to a deduction for the undeducted purchase price (if any) provided by the taxpayer. The very generous tax treatment afforded to lump sums meant any taxpayer with a choice of benefit would inevitably choose a lump sum.

5.18 From 1 July 1983, superannuation lump sums were taxed by considering the benefit in two parts. The pre-July 1983 component continued to be taxed at 5 per cent, while the post-30 June 1983 component was fully assessable, though subject to a rebate that effectively capped the percentage tax liability. (In addition, the tax-free threshold of $83 168 is applied to the post-30 June 1983 component.)

5.19 The rebate was designed to encourage people to defer receiving a lump sum benefit until they were at least age 55. Amounts received by a person on or after their 55th birthday are subject to a maximum rate of tax of 15 per cent on the first $50 000 (indexed annually), and a maximum of 30 per cent on the balance. Benefits paid to individuals prior to their 55th birthday are taxed at a uniform rate not exceeding 30 per cent.

Reasonable Benefit Limits (RBLs)

5.20 The purpose of the RBLs is to limit the amount of concessionally taxed benefits which a taxpayer can receive. Funds are not permitted to accept tax deductible contributions in excess of the maximum funding limits. However, the amount by which a total benefit paid exceeds the RBL is taxed at the highest marginal rate.

5.21 In a submission calling for the simplification of the tax of superannuation, Mr Phillip Ho submitted that the RBL system should be abolished on the basis that '95 per cent of Australian tax payers are funding the RBL system to ensure the other five per cent would not be significantly better off in their old age'. Mr Ho proposed that if the RBL remain, the following fixed dollar RBL should apply:

- lump sum RBL: zero, or at most twice AWOTE
- pension RBL: unlimited.[7]

5.22 Currently, in accordance with the policy of encouraging retirement income streams rather than the taking of lump sums, two different reasonable benefit limits apply. The RBL set in July 1 1994 was $400 000 for beneficiaries who elect to take their benefit as a lump sum, while an RBL of $800 000 applies to benefits taken as an income stream, even if up to half the total benefit was taken in the form of a lump sum. These amounts are adjusted for inflation each year and the current 1995-96 RBLs are $418 000 and $836 000 respectively. The Committee considered these levels and some members were of the view that the removal of the indexation of the flat dollar amounts may go some way to alleviating the inequitable distribution of tax concessions between high and low income earners.

Comment

5.23 The Committee concurs with Mr Tony Cole of LIFA, that while there is an obvious incentive for people with a total retirement benefit of more than $400 000 to take at least some income stream, it really 'does not impact on the vast majority of the population'.[8] The amounts are simply beyond the likely benefits of most superannuants.

The impact of taxation concessions

5.24 One argument put to the Committee was that the current arrangements do not make superannuation attractive for low income people. The Australian Council of Social Services (ACOSS) considered:

> the tax subsidies for superannuation should be restructured to increase the effective subsidy for low income earners and reduce that for high income earners.[9]

ACOSS also considered that the 'excessive' tax concessions for high income people were wasteful, as:

> high income earners are likely to save in the absence of tax concessions for superannuation.[10]

7 SW Sub No 45

8 Evidence, p 264

9 SW Sub No 62

5.25 This latter view accords with accepted economic theory which asserts there is a greater ability to save among high income earners than low, and with common sense which suggests if you haven't got it you can't save it. Another aspect of the relative greater advantage afforded higher income earners is they have a greater capacity to forgo current income in favour of superannuation.

5.26 Mr David Vernon of Jacques Martin Pty Ltd, discussed the rebate on member contributions which cuts out at income level $31 000. He believed the rebate 'should be looked at to encourage people to make voluntary contributions'.[11] On the other hand, Mr Donald Blyth from the Trustee Corporations Association of Australia, advocated tax deductibility. He believed tax incentives were necessary as people would not voluntarily contribute.[12]

5.27 Perhaps the position of lower income people was made most clear in the submission of the Victorian Minister for Women's Affairs quoting ABS Statistics:

> For those on a high marginal tax rate, the key incentive to make superannuation contributions is the 15 per cent tax rate applying to scheme earnings in salary sacrifice arrangements. However, 52 per cent of women earn less than $400 per week. At an income lower than $400 per week the marginal tax rate is 20 per cent, accordingly the overall rate is 15 per cent. Therefore, for many women who forgo some part of a small income for membership in a superannuation scheme, there is no tax advantage whatsoever.[13]

Other parts of retirement incomes policy

5.28 Taxation concessions are part of retirement incomes policy. It was pointed out that the welfare and age pension system is 'highly progressive in its design and should be seen as offsetting, to some extent, the regressive feature of the tax deduction arrangements'.[14] The Committee considers this fair comment.

10 ibid

11 Evidence, p 55

12 Evidence, p 100

13 SW Sub No 66

14 Smith G, Evidence, p 600

Incentive proposals for lower income earners

5.29 The proposed use of rebates was a common theme. For example, Mr David Vernon of Jacques Martin Pty Ltd, advocated a tax rebate for the first $500 a person contributes to a superannuation fund on their own behalf when they commence employment.[15] The Institute of Actuaries of Australia also favoured the use of a rebate on contributions and indicated a complex of features that such a rebate could have.[16]

5.30 The Association of Superannuation Funds of Australia (ASFA) listed a number of options relating to tax incentives which have been 'put forward by various organisations and individuals in the community as a means of increasing superannuation coverage of the population or of improving equity in the tax system'.[17] Among these options were:

- a universal rebate for everyone (employed or not) on all personal contributions up to the RBL limit;
- removal of the 15 per cent tax on member balances up to $500; and
- the issue of tax credits to people out of work, who have a nil marginal tax rate, which could be credited to their superannuation fund.

5.31 The Committee is aware that in many, and probably most, cases people on low incomes would prefer cash in hand rather than see their superannuation grow.[18] Also, in relation to tax incentives, the Women's Legal Resources Centre said:

> More thought needs to put into what is a good incentive for women who tend not to have tax problems.[19]

5.32 ACOSS suggested reform of the tax concessions by:

- taxing both employer contributions and fund earnings at the individual member's marginal rate;

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15 Evidence, p 55

16 SW Sub No 61

17 SW Sub No 43

18 Australian Women in Agriculture, SW Sub No 44

19 SW Sub No 58

- partly offsetting these taxes with a rebate to members, calculated on an annual or lifetime basis and paid annually into the fund; and
- removing taxes on benefits, except for large lump sums and pre-retirement payments.

Finally, as a package option, ACOSS proposed 'at the least':

> replacing the 15 per cent tax on employer contributions and present concessions for employee contributions by a flat tax rebate, substantially reducing the present reasonable benefit limits, and increasing the tax applied on large lump sums.[20]

5.33 The proposals for rebate arrangements were varied and sometimes complicated in concept, quite apart from the administrative detail. ACOSS did not accept it was reasonable to apply a rebate system that included individual marginal tax rates. It was a matter which had been 'looked at very thoroughly a few years ago' and 'to run a system that requires taking into account individual members' marginal tax rates is generally regarded as not workable'.[21] Also, Treasury commented specifically on employer based schemes:

> [w]e have noted that with an employer based scheme and with a scheme that includes promised benefits in the design, it is technically quite difficult, if not impossible, to design a rebate structure that would be equitable, effective and administratively workable.[22]

5.34 Ms Anna Adams, of Olsberg Adams and Associates, offered some positive anecdotal support for current arrangements. Ms Adams advised she was a registered nurse, working as a palliative care nurse in the community and in contact with carers of the terminally ill. As a home educator too, she encountered many women opting to take longer periods out of the workforce.

5.35 Ms Adams had conducted interviews in research with 'women and focus groups about their working patterns'. That was probably her 'main area of interest'.[23] In response to questioning about positive incentives she said:

> A lot of the women that I interviewed, even with their very small incomes, are very appreciative of having superannuation. They say,

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20 SW Sub No 62

21 Maroney T, Evidence, p 198

22 Smith G, Evidence, p 600

23 Evidence, p 217

> and I have heard it repeatedly, that it is good that somebody actually saves money for them ... When they have extra I think that giving them an incentive means that they do put in money. That would encourage them a lot to think that it was possible to make it. Their own perception is that they waste money.[24]

Other forms of tax assisted savings

5.36 During the course of the Committee's inquiry, and generally from time to time, various alternatives to superannuation sponsorship have been proposed as appropriate action for the Government.

5.37 A suggestion from Ms Eva Cox, Co-Convener of the Women's Economic Think Tank, was for a 'drawing account' which could be drawn upon for certain costs such as those relating to disability or child rearing, with what is left over going to superannuation. Ms Cox said such an arrangement:

> would at least prove a reasonable savings option for a lot of people because it had flexibility.[25]

5.38 Ms Cox did not think the current arrangements for taxation concessions for superannuation helped women. She said:

> Having something which is entirely based on retirement, given actuarial details, given women's work pattern problems and so on, it is neither going to provide them with a decent retirement income nor is it going to deal with a whole lot of other issues that need to be dealt with - financial demand points - at other points in their lives. Because we are the child bearers and withdraw from the workforce to take care of ageing parents.[26]

5.39 An option considered by the Committee was a tax assisted, long-term, savings vehicle as an alternative to superannuation. This would be available to individuals only (not partnerships or trusts), with easy access along the lines of the account proposed by Ms Cox. Such vehicles would be less concessionally taxed than the current superannuation arrangements in recognition of the preserved status of superannuation monies. There would be no tax payable for low income earners. The Committee commends this concept for further consideration.

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24 Evidence, p 227

25 Evidence, p 305

26 ibid

Conclusion

5.40 The Committee is not persuaded that major reform of the system of taxation incentives is warranted, but considers some form of additional taxation incentive for those on low incomes to save is justified, both within and outside the superannuation arena.