Information paper: Changes to superannuation

November 2016

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committee for economic development of australia

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Introduction

Treasurer the Hon. Scott Morrison introduced his superannuation package to the House of Representatives on 9 November 2016, during the noise of the US presidential election. The measures were first announced as part of the 2016–17 Federal Budget, released on 3 May 2016. On 23 November 2016 the measures were finally approved, and most changes will take effect on 1 July 2017.

The changes include legislation that defines the primary objective of the superannuation system as "providing income in retirement to substitute or supplement the Age Pension". All other reforms are in-line with this primary objective.

Creating a fairer system

The Treasury has stated the superannuation changes will create a more equitable system.

Superannuation has been designed to create incentive for Australians to save for their retirement, which is why it is taxed at a lower rate than income (superannuation contributions you make before tax are taxed at 15 per cent). The changes seek to address the fact that taxation incentives offered, mostly benefit the rich, with the top 20 per cent of income earners accounting for 58 per cent of superannuation tax concessions.

For those with substantial earnings, concessional contributions offer a way for individuals to avoid paying the tax usually associated with their income bracket. For example, an individual on $250,000 per annum would ordinarily pay a 47 per cent marginal tax rate. However, they can currently make concessional contributions of $30,000 into super, wherein they only pay 15 per cent tax on their contribution.

Additionally, non-concessional contributions (such as personal contributions made by the member that incurs standard income taxes) are a way to make a significant investment in which they pay a very low rate of tax on their

investment income stream. For example, an individual with $2 million invested in superannuation would receive investment income off their superannuation account, in which they only pay a concessional amount of tax.

Better targeted tax concessions are intended to make the superannuation system more sustainable as the population ages and fiscal pressures increase.

Why put assets into superannuation over other investments?

As outlined by Trish Power on SuperGuide.com.au, superannuation is taxed at lower rates "to encourage people to lock their money away for retirement". She outlines the four different stages tax incentives are offered at:

1. Concessional (before-tax) contributions: This type of contribution is when you, or your employer, make concessional contributions. This is taxed at 15 per cent, which is (in most instances) lower than the tax bracket your income would normally be taxed at.

2. Non-concessional (after-tax) contributions and co-contribution: This is a contribution you make to your super after you have paid your standard tax on it. While you do not receive any direct tax incentive as you are paying your normal income tax, the investment earnings on this contribution is taxed at a concessional rate (point 3);

3. Investment income on super fund investments: This is the income generated from your super investment. The income you earn off your super is taxed at the rate of your employer contributions (15 per cent); and

4. Superannuation benefit payments: When you receive your superannuation benefit. You do not pay any tax on your super when you receive it.

Read the full article by Trish here.

Proposed changes

Balance cap on total superannuation

As stated in the May release by the Treasurer, the super retargeting includes introducing a $1.6 million balance cap on the total amount of superannuation that could be transferred into the tax-free retirement phase.

According to the fact sheet released by the Treasury, the rationale for this change is that "superannuation tax concessions are not intended to provide people with the opportunity for tax minimisation or for estate planning. As the earnings from retirement phase superannuation accounts are tax-free they are a very desirable investment choice for individuals. Superannuation savings accumulated in excess of the cap can remain in an accumulation superannuation account, where the earnings will be taxed at 15 per cent."

The Treasury states that this measure will not affect the vast majority of Australians, stating that it will, in fact, affect less than one per cent of fund members. Presently, the average superannuation balance for a 60-year-old Australian nearing retirement is $240,000 – a far cry from the new $1.6 million cap.

Additionally, the transfer balance cap will be indexed and will grow in-line with the consumer price index (CPI), meaning the cap will be around $1.7 million in 2020–21.

The full government fact sheet on this proposed change can be accessed here.

Concessional contributions cap

The annual concessional contributions cap will be reduced to $25,000. This means members can only contribute up to $25,000 to their super per annum through their employer's Superannuation Guarantee contribution or a salary sacrificed super contribution (or for the self-employed or not employed, a tax-deductible super contribution) and receive the 15 per cent concessional tax rate. Any amount contributed over $25,000 will be taxed at 30 per cent.

These caps are currently $30,000 for those under age 50; $35,000 for those aged 50 and over.

To be liable for the 30 per cent tax rate, an individual would need to have at least $250,000 in combined income and concessional superannuation contributions.

The median Australian worker currently makes annual concessional contributions to their superannuation of around $4200 per year, and those who are affected in 2017–18 will have average incomes of around $200,000 and average superannuation balances of around $760,000.

The full fact sheet can be accessed here.

Lowering the annual non-concessional contributions cap

This measure has seen some adjustment. The 3 May 2016 package included

a $500,000 lifetime non-concessional cap. Due to internal pressure, the measure was scrapped in exchange for an annual cap on non-concessional contributions of $100,000 from 1 July 2017 (the current annual cap is $180,000).

This measure is expected to affect less than one per cent of fund members, i.e., those who can afford to make an additional contribution of $100,000 to their superannuation after paying standard income tax on it.

Low Income Superannuation Tax Offset

The package includes introducing the Low Income Superannuation Tax Offset (LISTO) to replace the Low Income Superannuation Contribution, which expires on 30 June 2017. The measure is intended to support low income earners to save for their retirement. As mentioned, superannuation should create incentive for Australians to save for their retirement by being taxed at a lower rate than income. However, for low income earners, the 15 per cent tax on superannuation contributions means they pay more tax on their superannuation contributions than on their other income.

The LISTO effectively refunds the tax paid on concessional contributions by individuals with a taxable income of up to $37,000 – up to a rebate cap of $500.

The full fact sheet can be accessed here.

Access to concessional contributions

All individuals under 65, as well as individuals aged 65 to 74 who meet the work test, can claim a tax deduction for personal contributions up to the concessional contributions cap.

This reform is intended to benefit the self-employed, those who are partially self-employed, and those whose employers do not offer salary sacrifice arrangements.

The full fact sheet can be accessed here.

Catch-up concessional contributions

Individuals with a super balance of less than $500,000 will be helped by the Government if they have been in-and-out of work. Such individuals can carry forward any unused concessional cap space for up to five years.

Extending the spouse offset

Under current law, individuals who choose to contribute to their spouse's superannuation fund can access a rebate of $540 if their spouse earns $10,800 per annum or less. In the new reforms package this has been extended up to $40,000 per annum.

This is to cater to the fact that many Australians, especially women, take time off work to raise children.

The full fact sheet can be accessed here.

Innovation in retirement income streams

The Government's reform package extends the tax exemption on a wider range of earnings in the retirement phase, such as income from deferred lifetime annuities and group self-annuitisation products. This is a measure intended to avoid people outliving their savings.

The full fact sheet can be accessed here.

Anti-detriment rule

The anti-detriment provision allows superannuation funds to claim a tax deduction for a portion of the death benefit paid as a lump sum to eligible dependents. This will be abolished in order for all superannuation funds to be consistent in their treatment of death benefits.

Outcomes

Who will benefit?

The Treasurer has stated, "The majority of Australians – 96 per cent of individuals with superannuation – will either be better off or unaffected as a result of these changes." Adding that roughly a quarter of fund members – particularly low income earners – would benefit from the super changes.

People who stand to benefit from the changes include:

- Those earning up to $37,000 per annum will be entitled to receive an annual rebate capped at $500. This is predicted to affect 3.1 million Australians, including 1.9 million women.
- Those with less than $500,000 in super will be allowed to access their unused concessional cap space to make additional concessional contributions can make catch-up concessional contributions.
- Those whose partners earned less than $40,000 can gain tax offsets by contributing to their spouse or defacto partner's super. This is an increase

from the current income threshold of $10,800.

Who will lose?

People who stand to lose out from the changes include:

- Those who make before-tax contributions of more than $25,000;
- Those who have more than $1.6 million in their superannuation account;
- Those who plan to make more than $300,000 of after-tax contributions over three years; and
- Those who make over $100,000 in non-concessional contributions per annum.

Criticism of the reform package

The Australian's Contributing Economics Editor Judith Sloan has stated the specific criticism of the report include that "it's over-engineered, unworkable, unfair and the figures are wrong".

Additionally, Ms Sloan points out that, because housing isn't taken into account when looking at pension eligibility, Australians can still estate plan by funding their money into more and better properties.

A recently released report by the Grattan Institute, titled *Age of entitlement: age-based tax breaks*, highlights additional issues that the current superannuation changes are either failing to address, or they believe are being addressed incorrectly.

The report questions why older Australians pay less tax than younger ones with identical incomes, highlighting the faults with the Low Income Ages Persons Rebate and the Senior Australians Tax offset.

John Daley, Brendan Coates and William Young from the Grattan Institute have also written that the Government shouldn't use super to help low income earners save, and that "super top ups are a costly way to ensure that every Australian enjoys an adequate retirement."

They state that the LISTO (which has a budgetary cost of $160 million a year) would be better funded into a $500 rent assistance boost for eligible seniors, at a cost of $200 million a year. Adding that: "Super top ups should not be expanded. It is too hard to target them tightly at those most in need, and super fees can eat up their value."

An underlying criticism of superannuation changes in general is centred on the fact the superannuation system undergoes so many repeated changes that it is difficult for long-term planning as a member of a super fund. As stated in Dr Diana Warren's Chapter in CEDA's *The super challenge of retirement income policy*, "Since the 1992 introduction of compulsory superannuation, almost every subsequent Federal Budget has announced changes to the retirement system. Most of the changes have added to its complexity. Several of the more recent changes may not actually produce their intended effects."

Speaking on the issue, Mercer Senior Partner, Dr David Knox said, "Superannuation represents the most important financial asset for most Australian households. It is money that is being set aside for the future so that all Australians may have a dignified retirement. After all, we are all living longer and many of us will live into our 90s, if not beyond.

"With an ageing population, it is inevitable that Government support for the aged will be cut back over time. Australians will save for the future if they have confidence in the system and trust that their money will be invested well and be there when they need it.

"However, it seems that superannuation is reviewed by governments on an ongoing basis. This does not encourage the long-term confidence within the community that is needed. Instead it encourages decisions based on the short-term.

"Ideally, we would have a bipartisan approach to superannuation with any review limited to the year following the publication of the Intergenerational Report every five years. Such an approach would provide stability while also ensuring that any necessary changes are developed in the context of the latest demographic and financial data."

Changes to superannuation since the 1970s

1973	Means tests abolished for persons aged over 75.
1975	Means tests abolished for persons aged 70 to 74. Pensions linked to 25 per cent of average weekly earnings, to be indexed annually.
1976	Assets test abolished for all persons. Only income test applied.
1978	Re-introduction of the assets test for persons over 70.
1983	Special income test applied to Age Pension for individuals aged 70 and over.
1985	Age Pension assets test re-introduced for all persons.

1989	Special income test for Age Pensioners 70 years and over removed.
1990	Age Pension means tests liberalised for pensions and annuities. Income test deeming rules introduced to simplify the income test for financial assets.
1992	Allocated pensions become subject to both the income and assets test.
1993	World Bank endorses Australia's three-pillar retirement system as world's best practice.
1995	Phase-in of increase to women's Age Pension eligibility age commences.
1996	Extended deeming applied to financial investments under the Age Pension income test.
1997	Age Pension to be formally maintained at 25 per cent of average male weekly ordinary time earnings.
1998	Deferred Pension Bonus Scheme introduced. Complying annuities 100 per cent exempt from assets test.
2000	Income test taper rate reduced from 50 cents to 40 cents in the dollar. Four per cent GST supplement added to Age Pension. Senior Australian Tax Offset introduced.
2004	Assets test exemption applied to complying annuities reduced from 100 per cent to 50 per cent. Work test removed for those under the age of 65.
2005	Work test for those aged between 65 and 74 simplified to require only that a person had worked 40 hours within a 30-day period of the financial year in which contributions were paid.
2007	Age Pension assets test threshold raised and taper rate reduced from $3 to $1.50 per $1000. Complying annuities no longer exempt from the assets test.
2009	One-off increase in Age Pension rates in response to Harmer Review. Deferred Pension Bonus Scheme replaced by Work Bonus Scheme. Age Pension Supplement replaces GST Supplement, Telephone Allowance, Pharmaceutical. Allowance and Utilities Allowance. Income test taper rate increased from 40 cents to 50 cents in the dollar. Age Pension eligibility age to be gradually increased to 67 for men and women from 2017.
2013	Eligibility age for women reaches 65.

Source: Abridged table from Dr Diana Warrren's chapter in *The super challenge of retirement income policy*, September 2015.

What's next from here

Given the legislation has now passed, most measures will take effect on 1 July 2017.

CEDA's review of the incoming changes

In September 2015 CEDA released the publication *The super challenge of retirement income policy* (the full report can be accessed here), which proposed a series on recommendations on reforming the retirement system. Outlined below are the issues addressed by CEDA in the publication, and the recommendations suggested to overcome them. Alongside this is a review of how well the Turnbull Government's superannuation reforms address these issues and take on board these recommendations.

CEDA's recommendations

Recommendation I: Adopt clear and consistent objectives

This recommendation was put forward due to the disconnect and confusion among the public, industry and the Government regarding the objectives of the retirement income system. Some members of the public see the Age Pension as an entitlement; the finance industry is more concerned about the superannuation aspect of the system; and the Government's focus is on the associated expenditure and perceived fairness.

To help Australians confidently plan their retirement, CEDA suggested that the Government should confirm and communicate clear and consistent retirement income system objectives. Moreover, CEDA suggested that while fiscal sustainability is important, it should not be the primary or only focus of the retirement income system.

CEDA stated that the primary objective should be to ensure that all Australians retire with dignity and decent living standards.

Within the system, the objectives should be to:

- Provide a social safety net for those Australians who cannot afford to save enough (or at all) for retirement; and
- Help people save for retirement and manage the associated financial and longevity risks.

Outcome

This recommendation has been fulfilled, to some extent, by the Government legislating that the primary objective of the superannuation system is "to provide income in retirement to substitute or supplement the Age Pension". The objective chosen was put forward by the 2014 Financial System Inquiry which stated: "Government should seek broad agreement on the following primary objective for the superannuation system: To provide income in retirement to substitute or supplement the Age Pension."

According to the Treasury, the objective will "ensure that all proposed changes to superannuation in the future are better aligned with the objective of the superannuation system", while the "subsidiary objectives provide a framework for assessing the compatibility of a Bill or regulation with the objective of the superannuation system."

Recommendation II: Recognise housing as the fourth pillar of the system

CEDA posited that owner-occupied housing (also known as the family home) is a key component of the third pillar of the retirement income system (voluntary private savings). However, the system should better recognise the extent to which owner-occupied housing contributes to household wealth and retirement liveability. People who do not own homes are exposed to the high-cost rental market and risk poverty in retirement. Home ownership continues to decline among young Australians, more of whom are expected to retire without owning a home. The government should recognise the role of housing in poverty alleviation and in contributing to the objectives of providing for a decent retirement.

Outcome

There is no mention of housing in the new package of reforms.

Recommendation III: Address superannuation taxation inequity

The CEDA report highlighted that taxation incentives mostly benefit the rich, with the top 20 per cent of income earners accounting for 58 per cent of superannuation tax concessions (including concessions on earnings). With superannuation contributions already compulsory, taxation incentives are not needed.

The difference between taxation approaches for superannuation and income (which is then saved, including for retirement) has sparked equity concerns. There have been calls to increase superannuation taxes usually by making them more progressive.

CEDA suggested the Government should reconsider providing taxation incentives for superannuation whereby contributions up to a certain amount attract a concessional tax rate.

It should:

- Mandate that superannuation contributions be made from after-tax (net) income; and
- Include the family home in the assets test for the Age Pension as part of the same reform. This reform would address equity concerns around taxation incentives, and would align the treatment of superannuation and housing – both critical determinants of a comfortable retirement.

Given the importance of housing for retirement, CEDA suggested another option would be to allow mortgage payments to be made pre-income tax. This would allow two important components of retirement savings – superannuation and the family home – to be treated the same.

Outcome

The reforms address the fact that tax concessions largely weigh in favour of higher earners and includes measures to address this. There have been measures to address this, such as the $1.6 million concessional cap, and taxing concessional payments for earners over $250,000 at a rate of 30 per cent rather than the standard 15 per cent. While the reforms do not make all contributions from after tax income, there has been an added measure to increase Low Income Superannuation Tax Offset so that more Australians on low incomes can access rebates, bringing more equality to the superannuation system. Again, the reforms did not touch on housing as a point in the reform equation.

Recommendation IV: Provide innovative post-retirement products

CEDA's report stated that there is evidence that retirees are not confident managing their finances in retirement – they are prone to under-consume and save, and that superannuation funds could provide products that offer longevity protection to help retirees better manage their funds and reduce under-consumption.

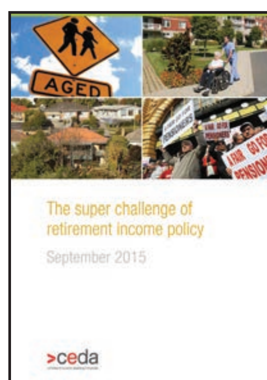
Examples include:

- Income stream products, particularly, deferred lifetime annuities whereby income payments are delayed until a certain age is reached, that are innovative by, for example, being customised to a particular type of profession; or
- Group self-annuitisation schemes, whereby funds are pooled and paid to survivors – either once they reach a certain age (potentially as income streams), or as a regular payment.

Outcome

This change has been embraced in the reforms proposed by Government, with the Government specifically highlighting the avenues of deferred lifetime annuities and group self-annuities.

CEDA research on this topic:



About this publication
Information paper 96: Changes to superannuation
CEDA 2016
ISSN: 1832 8814

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