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Does compulsory superannuation disadvantage middle income earners?

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ABSTRACT

This article provides a simulation analysis of the effect of key elements of the superannuation tax regime on the working lifetime financial assets and consumption profile for low, medium and high income workers. The analysis is motivated by ongoing proposals by various stakeholder groups for changes to the taxation of superannuation contributions and superannuation fund income. A whole of working life approach is important because workers are affected to different degrees by the taxation of superannuation as their income changes over their working lives. The key result is that medium earners gain least from the compulsory Superannuation Guarantee Levy compared with low and higher earners, and this applies also under a number of proposed changes to the taxation of contributions and superannuation fund income. The gains are measured in terms of retirement assets for given levels of consumption and saving, and in working life consumption possibilities for a given level of retirement assets.

1. Introduction

This article discusses simulations of the effects of changes to key tax parameters in the Australian compulsory superannuation scheme.[1] Effects are calculated on financial assets at retirement and working life consumption possibilities, for representative medium, high and low income workers. This is motivated by the ongoing debate about further changes to the tax regime for superannuation. This would follow a history of numerous superannuation regime changes as described in Guest (2013), updated and illustrated in Fig. 1. It is widely recognised (ASFA, 2018) that continuous change in retirement income policy makes retirement planning very difficult and undermines public confidence in the system, which may lead to poor retirement planning decisions. In a recent survey (Gill et al., 2018) for example, only 33 per cent of Australians aged 25–34 thought it was at least 'quite likely' that the age pension would remain in its current form. Although this survey result refers to the age pension, there are implications for attitudes to superannuation given that the age pension and superannuation policies are closely connected.

Further policy changes to superannuation have been recommended in other quarters, for example the Australian Labor Party (Carroll, 2018),[2] the superannuation industry (ASFA, 2018), the Henry Tax Review (Henry et al., 2009), the Australia Institute (Ingles, 2015), the Australian Council of Social Services (ACOSS, 2013), the Australian Council of Trade Unions (ACTU,

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[1] Details of this scheme can be found at http://workplaceinfo.com.au/payroll/superannuation/superannuation-guarantee.

[2] These proposals which have been in place since 2016 include: (i) reducing the Higher Income Superannuation Charge (HISC) threshold from $300,000 to $250,000, at which the current additional 15 per cent tax surcharge on income streams will apply (i.e. a total 30 per cent tax rate on the income stream); (ii) applying a tax of 15 per cent on superannuation income streams greater than $75,000 per year (the effect of this will be very similar to the current policy of applying a 15 per cent tax on any superannuation income earned on balances greater than $1.6 million).

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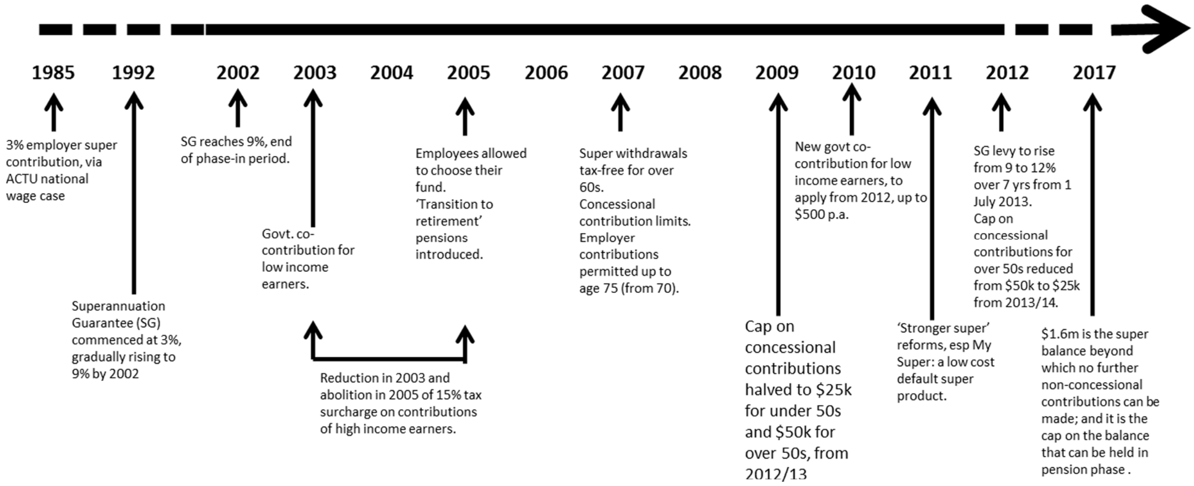

Fig. 1. Key superannuation policy developments in Australia. *Source:* Guest (2013) Comparison of the New Zealand and Australian Retirement Income Systems. Background paper prepared for the Commission for Financial Literacy and Retirement Income. Updated by author.

2018) and key consulting firms (Deloitte, 2015). These represent myriad recommendations, however one common theme relates to the mix of taxes on contributions and earnings of superannuation funds, which is taken up in the simulations reported here. For example, the Henry Review recommended that superannuation contributions be taxed at marginal rates minus a flat offset. The Review recommended that the offset be determined so that the net tax rate for the average taxpayer would be the same 15 per cent contributions tax that exists now. The Review also recommended that the rate of tax on superannuation fund earnings be halved to 7.5 per cent. This model of higher tax on contributions and lower tax on earnings is supported by a range of stakeholders. Deloitte (2015) for example recommended tax at marginal rates with a sliding discount and lower tax on superannuation earnings. Similarly, the Australia Institute (Ingles, 2015) has recommended a contributions tax rate of at least 30 per cent irrespective of income. The Australian Council of Social Services has gone somewhat further in recommending that all contributions be taxed at full marginal tax rates with a rebate only for low earners (ACOSS, 2013). This approach has been partly adopted in legislation but only for high income earners. That is, from 1 July 2017 the 30 per cent rate on contributions has applied as an additional 15 per cent surcharge only to those with taxable incomes in excess of $250,000.

There does not appear to have been much if any analysis of the distributional impacts of changes to key tax parameters underpinning the Superannuation Guarantee Levy (SGL) in terms of the effects on accumulated financial assets at retirement or on the consumption possibilities over a working lifetime . This is the main aim in the simulations discussed in this paper. A parsimonious approach is taken to the simulations, keeping the analysis simple enough to elicit the main differences among low, medium and high income earners. A working lifetime perspective is taken since workers can be at different income categories over their working life.

2. Simulation method

The key aspects of the superannuation legislation, as at March 2018, that are modelled in the simulations are as follows. The minimum percentage SGL is 9.5 per cent until 30 June 2018 and will increase by 0.5 per cent each year until it reaches 12 per cent from 1 July 2022. These contributions are taxable, up to a maximum contribution cap of $25000 per year, at flat 15 per cent or 30 per cent for those earning an adjusted taxable income of more than $250,000. Contributions beyond $25000 per year are taxed at marginal tax rates. The earnings on a superannuation balance in a fund are taxed at a notional 15 per cent, although the actual rate is usually less due to imputation credits and capital gains. Other aspects of the superannuation regime are not modelled; for example the tax parameters that apply after retirement, such as the tax rate on super earnings or distributions, are ignored because this would require assumptions about the amount of withdrawals from the fund during the pension phase. The focus here is on the level of retirement assets and the consumption possibilities during working life implied by the given level of retirement assets.

There are three representative workers: medium income, low income and high income. Their working life income patterns are illustrated in Fig. 2. Each worker enters the workforce today aged 20 and their employer contributes the SGL from age 20 until retirement at age 65. The age-earnings data by income level is chosen to approximately match the age-earnings distribution of cash earnings of all employees at May 2016 (ABS Cat. 63060DO003_201605 Employee Earnings and Hours,