AUSTRALIAN TAXPAYERS' ALLIANCE

# TAXED TO DEATH

**How superannuation taxes stop Australians from retiring comfortably**

ATA

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# Introduction

The Keating government introduced superannuation to help Australians retire comfortably without relying on taxpayer-funded pensions, support lower-income demographics, and increase the savings rate, so the Australian economy did not rely so heavily on foreign debt.

Instead, 68 per cent of retirement age Australians depend on the means-tested age pension.[1] Additionally, during the COVID-19 pandemic the government spent billions of dollars on subsidies to prompt Australians to spend instead of save.

Some policymakers believe they have discovered the solution. On July 1, 2021 the government will increase the compulsory superannuation guarantee requirement from 9.5 percent of a worker's wages to 10 per cent according to the schedule to reach 12 percent by 2025.[2]

Additionally, during the COVID-19 pandemic, the government spent billions of dollars on subsidies to prompt Australians to spend instead of saving.

Some policymakers believe they have discovered the solution. On July 1, 2021, the government will increase the compulsory superannuation guarantee requirement from 9.5 per cent of a worker's wages to 10 per cent, according to the schedule to reach 12 per cent by 2025.

While this would increase Australians' annual retirement incomes and help people off the pension, that money comes directly from workers' salaries. Every percentage increase in superannuation is a percentage decrease in take-home earnings. As a result, the spending rate the government has worked so hard to foster during the pandemic will drop.

If the government instead chose to cut taxes on superannuation, retirees would have more money on which to retire than the increase in the SG will provide — all without the short term cost.

The government uses superannuation as yet another revenue source, with super taxed on the original contributions and the realised earnings. As a result, Australians who would otherwise have enough to retire become dependent on the taxpayer-funded pension.

Meanwhile, the federal government spends upwards of $50 billion per year on means-tested aged care payments. Nevertheless, the ATO only collects $12 billion from all the taxes on

[1] "Retirement Income Review," Australian Department of Treasury, Consultation Paper November 2019, https://treasury.gov.au/sites/default/files/2019-11/c2019-36292-v2.pdf.
[2] Australian Taxation Office, *Super guarantee percentage,* last modified 31 March 21, https://www.ato.gov.au/rates/key-superannuation-rates-and-thresholds/?anchor=Superguaranteepercentage

superannuation. For the average person, the amount they are allowed to collect from the means-tested age pensions is less than they would have been able to save had the government not taxed their superannuation.

Most importantly, the compulsory superannuation guarantee removes individuals' autonomy over their own financial decisions. By making superannuation compulsory, the government indicates that the Australian citizenry cannot manage their own money. This assumption is untrue.

Individuals have more information on their financial situations, which the government has neither the time nor the capacity to collect. Australians need the flexibility to make the best possible decisions instead of being entrapped in a rigid government system.

*To ensure superannuation achieves its original goals, the government should stop double taxing superannuation. They should also replace compulsory superannuation guarantee payments with a voluntary opt-out retirement program.*

Making superannuation voluntary would allow individuals to choose their own savings vehicles and determine where they would like to invest their money. These alternatives could include saving for a home, which often serves people well in retirement or investing in their own small business. Making the system opt-out retains the behavioural incentives to save instead of spend. Tax incentives increase people's propensity to save with positive reinforcement as opposed to fee-driven enforcement.

Superannuation should support Australians instead of burdening them.
Superannuation is taxed in three primary ways: on contributions, on investment earnings, and withdrawals. The superannuation funds also have very high fees, which cut into profits. Table 1 shows the annual tax on superannuation averaged throughout a person's lifetime. It assumes individuals save merely the 9.5 per cent superannuation guarantee of a set income for 40 years at a 6.5 per cent interest rate.

| Table 1 - Taxes on Savings for Specific Incomes | | | |
|---|---|---|---|
| | **Minimum Wage** *($36,182)* | **Average Wage (Vic)** *($63,442)* | **High Wage** *($110,000)* |
| Tax on Superannuation Contributions | $546 | $904 | $1,567 |
| Tax on Super Investment Earnings (6.5% Interest for 40 yrs) | $880 | $1,457 | $2,527 |
| Tax on Superannuation Withdrawals | — | — | — |
| **Total** | **$1,426** | **$2,361** | **$4,094** |

# Compulsory Super

## IMPACT ON SALARY

Employers, not employees, pay the 9.5 per cent compulsory superannuation guarantee, so most view it as an addition to wages. However, the least elastic party, that is, the group least sensitive to changes in the price, tends to bear the brunt of costs, whether it is a tax or, in this case, a forced savings program. In this case, workers are the least elastic party. While employers must make SG contributions, workers bear the cost of these contributions through lower wage growth.[3]

Wages-superannuation tends to have a statistically significant elasticity of 1.03[4] (nearly unit elasticity). Elasticity is "a measure of a variable's sensitivity to a change in another variable; most commonly, this sensitivity is the change in price relative to changes in other factors."[5] It can be measured as the percentage change in wages over the percentage change in the compulsory SG equals 1.03. Note that elasticity is written as an absolute value (the negative is dropped), so wages-superannuation is inversely proportional. This relationship indicates an increase in the SG of 2.5 per cent from 9.5 per cent to 12 per cent would lead to an estimated drop in wages by 2.5 per cent.

Applying this logic, it follows that a worker currently earning the minimum wage would have an annual wage of $41,938 instead of $38,300. The average worker in Victoria making $63,442 would have a salary of $69,469, and a high wage worker earning $110,000 would have $120,450.

With additional money would come additional income taxes. However, because workers cannot access that money immediately, there is a high opportunity cost. The value of money in the future is highly discounted.

## OPPORTUNITY COSTS

"The present value is the concept that states an amount of money today is worth more than the same amount in the future."[6] Consequently, the money saved in superannuation funds is worth less to the person earning it than if it were paid as salary today. We can calculate the present value of a superannuation contribution by dividing the future value by one plus the inflation rate to the

[3] Henry, K., Harmer, J., Piggott, J., Ridout, H., & Smith, G. (2009). A2-2 Taxing Retirement Incomes. In Australia's future tax system: report to the treasurer.Canberra: Commonwealth of Australia.
[4] Taylor, Kyle. "Does higher superannuation reduce workers' wages." McKell Institute (2019).
[5] Adam Hayes, "Elasticity," Investopedia, accessed 14 Novemeber 2020, https://www.investopedia.com/terms/e/elasticity.asp.
[6] Chris B Murphey, "Present Value (PV)," *Investopedia,* updated 19 August 2020, https://www.investopedia.com/terms/p/presentvalue.asp.

power of years to retirement. This paper uses the same equation to calculate the real value of retirement incomes in the figures above instead of merely using nominal values.

$$PV = \frac{A}{(1+\pi)^n}$$

$PV = PresentValue$
$A = Amount$
$\pi = InflationRate$
$n = NumberofYearsUntilRetirement$

The younger the employee the greater the lost value. A 20 year old losses 59 per cent of the value of their superannuation because they cannot access it and use it as they so choose. When combined with tax that amounts to a 74 per cent loss to the worker.

This is not an argument against saving in general, which allows people to smooth consumption over their lifetimes, prepare for crises, and build wealth. It's a reason not to force people into a single savings vehicle.

Superannuation funds accrue interest which can be said to account for some of the loss from inflation, but not the opportunity cost of workers unable to access or choose how their money is used. However, “about 1.7 million member accounts and $62 billion in assets are in MySuper products that underperform”.[7] All highly managed retail funds underperform basic index funds.[8]As a result of high fees most super holders would be better off with their money in a simple index fund.

The Reserve Bank of Australia estimates that around 38 cents of each dollar of superannuation contributions is offset, that is Australians save 38 cents less elsewhere. This money could go to investing in higher returning stocks and bonds, saving for a deposit on a home, hedging against a personal emergency, building that nestegg to start a business, funding the children’s education, or any number of valuable savings and investment options.

[7] Barr, Nicholas, and Peter Diamond. "Response to superannuation: assessing efficiency and competitiveness: productivity commission draft report." (2018).
[8] Niblock, Scott, Elisabeth Sinnewe, and Panha Heng. "A review of superannuation fund performance studies." Accounting Research Journal (2017).

Restricting how Australians are allowed to save for retirement leaves many worse off when they reach retirement age. Policy makers should allow Australians to make their own financial decisions while not punishing them for making good choices. Australia does not need a compulsory superannuation to retain its higher savings rate.

## OPT-OUT SYSTEM

By replacing compulsory superannuation with an opt-out system, Australia could likely retain much of the increased savings rate while giving Australians the flexibility to save elsewhere if they so choose.[9] Behavioural economists in the United States found that when employers automatically enrolled their employees into a 401(k) retirement savings plan, 86 per cent of employees stayed in the plan. For lower income employees, those making less than $30,000 a year, when they were switched from an opt-in retirement plan to an opt-out situation, participation in the 401(k) savings plan tripled.[10] The authors recommend increasing retirement savings when an employee receives a raise. Many US employers have switched to this program with favourable results.[11] By switching to an opt-out system with automatic increases tied to raises, Australia could retain much of its higher savings rate while giving Australians the flexibility to save as they choose.

[9] Madrian, Brigitte C., and Dennis F. Shea. "The power of suggestion: Inertia in 401 (k) participation and savings behavior." The Quarterly journal of economics 116, no. 4 (2001): 1149-1187.
[10] Nesmith, Utkus, and Young, "Effectiveness of Automatic Enrollment," p. 8.
[11] Richard H. Thaler and Shlomo Benartzi, "Save More Tomorrow": Using Behavioral Economics to Increase Employee Saving," Journal of Political Economy, vol. 112, no. 1 (2004), pp. 164–187.

# Super Taxes

For many, their superannuation account holds the vast majority of their savings. Unfortunately, superannuation, unlike many international retirement funds, is taxed on both contributions and on investment earnings. It also has additional fines and taxes associated with withdrawals. While the taxes on superannuation are less than the income tax or the capital gains taxes, they impact Australians' ability to retire comfortably.

Superannuation contributions are taxed according to the size of the fund, annual income, whether or not contributions were made before or after annual income tax and whether or not you have supplied your Tax File Number (TFN).

The tax on the interest accrued and realised at retirement is a simple 15 per cent but does not take into account inflation which has a heavy impact on these earnings. Retirement savings, unlike most investments falling under capital gains taxes, are held for a much longer period (often over forty years) and, as a result, are heavily impacted by the inevitable decrease in the value of the Australian dollar.

The ATO determines the tax on withdrawals based on the age at which a retiree withdraws their money, the amount of money they withdraw, whether they make the withdrawal as a lump sum or an income stream, whether they worked in the private or public sector, and various other factors.

When making these forecasts, we assumed the individual was 25 years old and planned on retiring at 65 years of age. That allows them to save for 40 years. Additionally, we assumed an interest rate of 6.5 per cent before retirement and an interest rate of 5 per cent during a 15-year retirement, as well as an inflation rate of 2 per cent. We then calculated all the taxes on superannuation and found their impact on total compensation.

## TAX ON CONTRIBUTIONS

Superannuation 'before-tax' contributions are taxed at 15 per cent, with an annual contributions cap of $25,000.[12] This includes the superannuation guarantee placed in a worker's superannuation fund by their employer. Beyond this limit, additional contributions are taxed according to an individual's marginal tax rate.[13] If an individual earns more than $250,000 per annum, their contributions up to a $25,000 threshold are taxed at 30 per cent and according to the individual's

[12] AustralianSuper. (2020). *Tax on Super* [fact sheet], https://www.australiansuper.com/tools-and-advice/forms-and-fact-sheets
[13] Ibid.

marginal rate thereafter. This tax is generally paid by the super fund provider, further separating the individuals from what happens to their retirement savings.

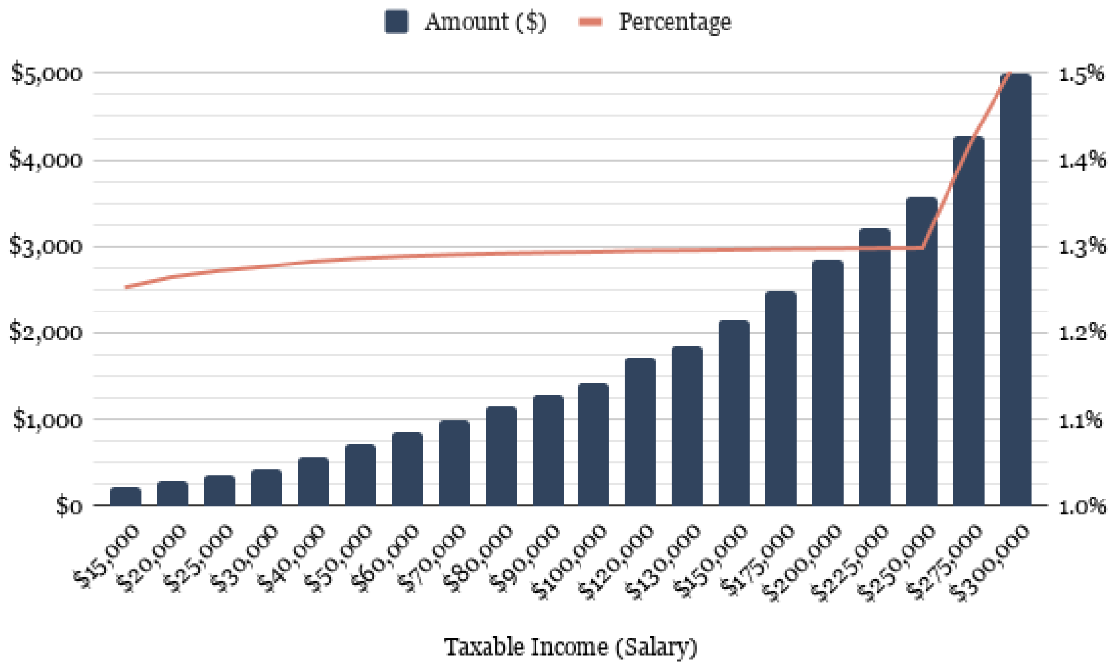
The tax on contributions severely impacts a person's ability to retire comfortably. Without the tax on contributions, a worker would be able to retire on 63.4 per cent of their working income as opposed to 54.1 per cent. The closer an individual's retirement income is to their working income, the easier it will be for them to retire without needing to make dramatic changes in lifestyle to match their reduced financial situation.

Figure 1 shows the direct tax on contributions as well as the percentage of total compensation. Unlike consumption taxes, the tax on contributions is a relatively flat tax. The figure does not show the cost to retirement saved, merely the initial tax paid.

Lastly, if no TFN is supplied, 'before-tax' contributions are taxed at 47 per cent[14], irrelevant of whether or not one's income is more than or less than $250,000 per annum. As mentioned above, the tax on contribution affects one's ability to retire comfortably. The 47 per cent tax further exacerbates the effects of the tax.

[14] AustralianSuper. *How super is taxed,* https://www.australiansuper.com/superannuation/how-your-super-is-taxed#:~:text=in%20superannuation%20are%20generally%20taxed,through%20a%20Choice%20Income%20account.

**Figure 1 - Tax On Super Contributions Amount Paid and Percentage Tax Compared**




## TAX ON INVESTMENT EARNINGS

Investment earnings within a super fund are taxed at 15 per cent before determining the consumer's crediting rate. As such, this specific tax is paid by the super fund, and investors are credited an amount that takes this into account.

Even though Australians do not have to pay the full capital gains taxes on their superannuation funds, the 15 per cent tax on interest adds up as a result of high returning superfunds, compound interest, and the fact that retirements, unlike most investment savings, are held for longer and accrue larger sums of money.

To calculate the tax on the investment earnings, we found the compounding interest during an individual's working life and the taxes on that interest. Using future value calculations, we found what that money is worth in real terms. This subtracts the impact of inflation and so allows us to use the figures in terms of real dollar terms today. We then repeated this for an individual's earnings for the course of their retirement. Adding these figures together, we found the total earnings on the assumed superannuation fund and what those taxes will be. We then found the average across those fifty-five years and applied it to our annual figures on total taxation.

Without the tax on earnings, a worker would be able to retire on 61.9 per cent of their working income as opposed to 54.1 per cent. By cutting either the tax on contributions or the tax on earrings, a retiree would have a more comfortable retirement with a smaller shock transitioning from working life to retired life.

## TAX ON WITHDRAWALS

A retiree can easily incur additional taxes depending on how they chose to withdraw their superannuation fund. Australians must take into account their preservation age (for those born after 1964 that is 60 years)[15] and the age at which they wish to withdraw their superannuation; whether they wish to withdraw their superannuation as a lump sum or as an income stream and what type of retirement income stream they receive; whether their superannuation is made up of 'tax-free' or 'taxable' components and of the 'taxable' components how much of it is the 'taxed element' and how much is the 'untaxed element'.

If 60 and over, an individual pays no tax on retirement income payments or lump sum withdrawals. Individuals under 60 have their withdrawals taxed according to their specific "Preservation Age": the age at which an individual can access their super without incurring higher taxes. Individuals are taxed 22 per cent on contributions withdrawn under their preservation age. Between the age of 59 and their preservation age, $215,000 may be withdrawn tax-free, after which the balance is taxed at 17 per cent. This additional cost aims to disincentivise early withdrawal, which leaves retirees living on fewer earnings compounded over their working life during a longer retirement period.

Many Australians take a hands-off approach to their superannuation savings, assuming the superannuation guarantee will provide them enough in retirement.

Let us assume a retiree aged 65 withdraws their superannuation as an income stream with superannuation made up solely of the taxable superannuation guarantee and no additional voluntary contributions.

Using these assumptions, the withdrawals tax only applies to an income stream of over $100,000. For every dollar over $100,000 withdrawn within the course of a year, Australians must pay tax on half the amount at their marginal tax rate. For example, if a retiree has an annual retirement income of $150,000, they must pay tax on $25,000 at the marginal tax rate of 19 per cent. However, if this

[15] "When you can access your super," *Australian Government Australian Taxation Office,* last modified 11 November 2020, https://www.ato.gov.au/individuals/super/in-detail/withdrawing-and-using-your-super/withdrawing-your-super-and-paying-tax/?anchor=Preservationage#Preservationage.

retiree has other sources of income, such as a rental property, they could pay tax in a higher income tax bracket.

Because the tax on Superannuation applies at such a high rate, if an individual does not add any voluntary contributions to their super fund, they will only have to pay the tax if they have an annual income over $250,000.

## FINES AND FEES

The superannuation scheme has a myriad of fees and penalties, which eat into individuals' superannuation funds. These levies include administration fees, investment management fees, performance fees, advice fees, investment switching fees, and the buy/sell spread fees.[16]

The administration fee takes into account the general cost of managing super funds, and can be a fixed fee, a percentage of total funds, or both. The investment fee covers the cost of hiring investment managers and brokers. It is typically imposed on a percentage of one's super funds and can include performance fees, of which is a fee on the percentage of returns that exceed expectations.

Contributions, withdrawals, or switching investment plans are considered buying or selling investment units. Hence, there is a fee to cover the difference between the price for buying and selling.

Fines are imposed on late or unpaid super contributions at a 10 per cent interest rate. The penalty for false or misleading information can come up to 75 per cent of the unpaid super.[17] On top of that, a 200 per cent fine is charged on employers for failure to provide required information and documents.[18]

Australians could avoid these additional costs in an ordinary investment situation by managing their own savings. However, the superannuation system does not allow Australians select their investments on their own without a financial advisor and even higher fees associated with Self

[16] "What fees do Australian super funds charge?", *Canstar*, last modified February 5, 2021, https://www.canstar.com.au/superannuation/fees-explained/
[17] "The Superannuation Guarantee Amnesty has finished. What now?", last modified October 21, 2020, https://atticusaccountants.com.au/the-superannuation-guarantee-amnesty-has-finished-what-now/#:~:text=The%20ATO%20apply%20a%2010,(currently%208.54%25%20per%20annum)
[18] "Module 7: Reducing the risk of penalties,"last modified April 7, 2021, https://www.ato.gov.au/Business/Super-for-employers/In-detail/SG-employer-obligations-course/?page=7#:~:text=Additional%20super%20guarantee%20charge%20(known%20as%20Part%207%20Penalty)&text=a%20Superannuation%20guarantee%20charge%20statement%20for%20a%20quarter%20by%20the,being%20requested%20to%20do%20so.

Managed Super Funds. While in theory this sounds like best practice, many Australians would be better off simply putting their money in index funds and avoiding expensive super funds.

## IMPACT ON RETIREMENT

Taxes on superannuation severely impact an individual's ability to have a livable retirement income. Consequently, 68 per cent of Australians over the age of 65 depend on the means-tested age pension. This costs current taxpayers more and robs retirees of financial independence.

Table 2 shows a retired person's annual pension as a percentage of their current taxable income. The closer a retiree's pension is to their working salary, the less of a financial shock they must face at retirement. Without tax on superannuation, Australians would take home close to 73 per cent of their working income, merely saving the current superannuation guarantee. However, as a result of taxes and multiple levels of superannuation, individuals must instead live on 54 per cent of their working income.

| Table 2 - Percentage of Retirement Income to Working Income | |
|---|---|
| Under Current System | 54.1% |
| Without Tax On Contributions | 63.6% |
| Without Tax On Interest Earned | 61.9% |
| Without Either Tax | 72.8% |

Figure 2 charts the amount individuals lose as a result of taxes on retirement savings. For simplicity, the figure assumes the same salary throughout a person's lifetime. This loss takes into account both the initial tax and the lost interest on that money, so it is greater than merely the direct cost of the tax. The figure demonstrates how much better off a worker would be each year without the tax, not the amount the government collects from the tax. In reality, the government only collects a small fraction of what the individual loses, making this an incredibly inefficient tax.

**Figure 2 - Annual Amount Lost In Retirement From Superannuation Taxes**


The government collects only a fraction of what an individual loses on their retirement as a result of superannuation tax. This makes all taxes on superannuation incredibly inefficient. On average, the federal government only collects $12 billion off of superannuation while spending $50 billion on the means-tested age pension. Merely removing the taxes on superannuation would leave many Australians so much better off in retirement than they would not qualify for the means-tested age pension. This would save the government money and give Australians greater financial independence in retirement.

# Conclusion

Superannuation is a program aimed at helping Australians to save money, so they have financial independence upon retirement. However, more money locked up in the savings account means less present financial capability.

The government claims to want to help its people, but continues to enforce taxes on mandated contributions and investment earnings. It even takes away the people's freedom to make withdrawals by levying fines for doing so. Superannuation is a compulsory program from which the government collects additional revenue.

When the government does not give its people the right to opt out of superannuation, they are also forcing the people to pay administrative fees and performance fees for a service they may not necessarily want.

To help superannuation to provide Australians financial independence in retirement, the government does not need to increase the superannuation guarantee. The SG has a high opportunity cost taking choice from Australians. Instead, the government needs to reduce the tax burden on superannuation. The taxes on superannuation bring in only a small fraction of the expenditure on the age-pension. By ensuring Australians have enough on which to retire the government could save billion in pension payments.

Additionally, the COVID-19 crisis has shown us how often Australians need access to their savings. Allowing individuals to save or spend their earnings as they chose will yield the most efficient allocation of resources. Individuals, not governments, know how to best use their wages to maximise their own personal welfare. By restricting choice, the government stops many Australians from purchasing goods and services that would provide long term benefits such as housing, education, or business investments.

However, most people discount the value of goods in the future and as a result do have enough on which to retire. The Australian government can provide Australians with flexibility while still prompting the majority of Australians to save responsibly through an opt-out system. Most Australians automatically enrolled in superannuation will remain enrolled and not opt-out. Those who need the money or have a better way of preparing for their retirements can withdraw and use their money accordingly.

The Australian Taxpayers' Alliance recommends removing the tax on super contributions, or the tax on super earnings, or both to ensure Australians have enough to retire comfortably without reducing current wages. We also recommend and opt-out superannuation system to give Australians the flexibility they need to most efficiently use their money while still incentivising saving. These changes will make a significant improvement on the lives of Australians and help them retire comfortably without having to depend on taxpayer-funded age pension.

**Recommendations**

1. **Remove tax on superannuation contributions**
2. **Remove tax on superannuation earnings**
3. **Replace the compulsory superannuation guarantee with an opt-out system**

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The Australian Taxpayers' Alliance is the nation's largest grassroots advocacy group representing the everyday Australian taxpayer. Through our campaigns, we fight to oppose over-regulation, wasteful spending, and burdensome taxes. Our mission is to give a voice to the millions of Australians quietly going about their lives and paying their taxes. It is our job to stand between the greedy hands of government and the money Australians work hard to earn.

We oppose high taxes, wasteful spending, and excessive regulation, we aim to foster a more prosperous Australia that champions the rights of individuals, and we work every day to empower people - not the state.
Each year the Australian government collects billions in tax wasting a large portion of that nannying individuals instead of freeing them to pursue their dreams. Dreams which will better not only themselves but their families, their communities, and Australia as a whole. We cannot count the businesses that failed to make it past conception because of over-taxation and over-regulation. They died quietly as potential entrepreneurs were forced to face the reality of our burdensome system. Government does not know best when it comes to your money.

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