

Reports of Treasury Figures on Super Costs are Flawed

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SMSFOA today called into question the figure of \$30bn in total tax concessions that has been reported by Treasury in relation to the tax treatment of superannuation and relied on to justify higher taxation of super funds.

The \$30bn figure double counts the two main tax concessions on contributions and fund earnings when in fact the figures are mutually exclusive calculations and cannot be added together.

Treasury's full report mentions under a heading "interpretation" that their "estimates are not strictly additive" but then, immediately below this statement provides a table which adds together all the concessions that relate to superannuation. It is this flawed aggregate number, which has now been widely reported, and we believe that Treasury should issue a statement explaining that this is substantially misleading.

Treasury estimates tax concessions by calculating the tax a taxpayer would have paid if he or she did not have the benefit of the tax concession. The reason their total is a flawed figure is because if the contribution tax concession was not there and taxpayers paid full tax on their contributions, the net amount then invested would be dramatically reduced. Compounding over time then causes accumulated earnings on such reduced net contribution to be substantially lower than if the concessional tax rate had applied to the contribution.

However, in making estimates of the cost of the tax concession on superannuation fund earnings Treasury does not use this reduced amount but assume that the same amount of investment is made as if the contribution continued to be taxed concessional. This is why you cannot then add these two figures together.

While Treasury do the actual calculation in a different way (using the actual total of all super contributions and earnings for a particular year) nevertheless a simple example can explain the effect of what Treasury has done:

Let's take an example of a taxpayer putting \$100 into super now and earning income on this investment over 35 years at 7%. The figures are:

1. \$100.00 taxed at 15% = \$15.00 tax paid and \$85.00 invested
2. 7% interest compounded over 35 years = total \$656.00 return on just this one contribution
3. 15% tax on \$656.00 earnings = \$98.40 tax paid over time
4. Total tax paid = \$15.00 + \$98.40 = \$113.40

Treasury's calculation of tax concession on contributions

Treasury would say that if the contribution were taxed as income for this taxpayer and his or her marginal tax rate were 46.5% (top rate plus Medicare levy), instead of the 15% concessional rate, the tax on the \$100 contribution would then be \$46.50 not \$15.00 and so a tax concession of \$31.50 has been received by the taxpayer. So far so good.

Treasury's calculation of tax concession on superannuation earnings

The effect of how Treasury calculates the tax concession on the **earnings** of the investment and then adds this to the contribution concession is where the problem lies.

Taking the above simple example to explain. The earnings in our example (at a 15% contributions tax rate) on the investment of \$85.00 over 35 years compound to a total of \$656.00. Treasury effectively takes this total earnings amount and calculates the tax concession as being the difference between 15% tax on this (i.e. \$98.40) and tax on this figure the taxpayer would have paid if there was no concession. At 46.5% of \$656 this is equal to \$305.13, which when compared with \$98.4 at the 15% concession rate would give a tax concession on these earnings of \$206.64.

Then Treasury would add this \$206.64 tax concession on the earnings to the \$31.50 tax concession on the contribution to come up with a total superannuation tax concession of **\$238.23**.

This is in effect the methodology behind the \$30bn "Total Superannuation Tax Concession" figure.

BUT – you cannot add these figures to show the overall tax concession due to a lower tax rate on contributions and superannuation earnings because the second figure **assumes** a return of \$656.00, which assumes an investment of \$85.00 invested at 7% over years etc.

However, if the contribution were taxed at the marginal rate of 46.5% instead of the concessional rate of 15%, then the amount of investment left from the \$100.00 would be only \$53.50 which invested at 7% for 35 years would give a cumulative return of only \$262.12 (i.e. 60% lower). The tax on **this** at a 46.5% marginal rate would be \$121.89, which when compared with \$98.4 at the 15% concession rate would give a tax concession on these earnings of only \$23.49.

Adding this tax concession to the \$31.5 tax concession on the contribution gives a total tax concession of **\$54.99 NOT \$238.23** as Treasury would say.

This suggests that the actual total tax concession may be about a third of the total reported by Treasury by simply adding the two numbers together.

Other misleading features in using Treasury's annual figures as a measure of the cost to the government of the superannuation tax concessions are:

1. Taking the actual earnings and contribution in one year ignores the compounding effect over time of superannuation funds accumulating earnings at a lower tax rate;
2. The correct tax concession does not vary as much with income as implied by Treasury's figures;
3. It ignores and has not costed the increased risk and projected substantial cost of a taxpayer drawing the Age Pension and other Government benefits, if there were no tax concessions; and
4. Uses the wrong benchmark and ignores tax concessions on income tax. Treasury say that this is because the income tax rate concessions are an "*integral design feature*" of the tax system but somehow believes that superannuation and other concessions such as tax-free capital gain on ones main residence are not an *integral design feature*!

These points are the subject of separate analyses using SMSF Owner's Alliance modelling.

Treasury's calculations can be found at:

<http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/TES-2012>