FINANCIAL REVIEW

'Unfair' super tax breaks back on agenda to save budget

PRINT EDITION: 23 Feb 2015

Jennifer Hewett

Here we go again … Superannuation tax concessions are back as the favourite target for a budget in trouble. In a rancorous political climate, this seems to be the one area of furious agreement – that such tax breaks are inherently "unfair".

There is a stream of economists complaining aboutthe advantages to high-income earners. David Murray, head of the inquiry into the financial system, says lower-income earners miss out on benefits and subsidise higher-income earners. The Australian Council of Social Services is always happy to cite super "loopholes" as evidence the most vulnerable are being disadvantaged – yet again. Stories are recycled about self-managed super funds that have tens of millions of dollars salted away and yet can still rort the system through concessional rates. Now there are calls for tax breaks to be curbed once super balances hit a certain amount – despite the obvious cost and administrative complexity of doing so.

Yet there's a good reason for Joe Hockey's silence on this supposedly sound budget logic. The catch in trying to find easy money in super tax breaks goes well beyond the obvious politics. Any move on super ahead of the election would clearly be another large broken promise that would infuriate many – especially the diminishing number of Coalition voters.

But in policy terms, the problem is, if anything, even bigger. The neat figures on the cost of concessions don't add up in the way Treasury implies – a fact acknowledged by Treasury in the fine print.

Exhibit A in the unfairness case is the Treasury Department's estimate of super tax concessions costing about $30 billion a year, for example – compared with pension payments of about $40 billion a year. Then there's the estimate that about 80 per cent of people will continue to rely on a pension or part pension despite the tax breaks on super.

Actually, a large-scale move to a part pension from a full pension is a very significant budget saving over time – but the statistic is still used to undercut the rationale for tax concessions.

Treasury also points out, however, that its estimates are pretty ropey. Australians pay a 15 per cent tax rate on contributions super up to a cap of $30,000, and $35,000 if they are over 50. If they earn over $300,000, the tax rate goes up to 30 per cent.

Treasury admits its estimate of $16 billion of "revenue foregone" last financial year from the concessional rate on contributions only has "medium" reliability. It also says estimates of another $16 billion in "revenue foregone" from the 15 per cent tax on investment earnings within super has only "low" reliability.

That's partly because these estimates don't model changes in behaviour if people lost super tax concessions. Instead, they assume people would just be content to be taxed at their marginal tax rates rather than trying to reduce tax via different investments – such as negatively geared housing, for example. Or putting less money into super and spending the balance more quickly. Or thinking of other novel ways to lessen high tax.

Yet Treasury's alternative attempts to model the impact of potential changes in behaviour are privately conceded as even less reliable, despite the political pressure to produce the figures. Treasury estimates ending all concessions on contributions would have meant an additional $13.5 billion in the budget last year, for example, and $14.1 billion in tax on investment earnings inside super.

But the department concedes all this depends on assumptions whose impact could vary wildly given the huge sums involved and the effect of even small variations in predicted behaviour – which are certain. So the talk of the $30 billion "cost" to the budget is anything but precise or accurate.

Then there's the issue of any government making more changes to an already complicated super system and discouraging voluntary contributions after years of broken promises from all parties that "tinkering" would end.

Not that the current arrangements make much sense – for either individuals or the government. Australia is unusual in taxing super on contributions and investment earnings rather than on withdrawals. Not taxing money going into super and in the accumulation phase would obviously add up to a much larger (taxable) amount at the end. But altering a back-to-front system now would require a massive restructuring and pain to go with it, especially if the objective is to save money.

Another option would be to modestly tax withdrawals as well – which would make Australia unique in taxing super at all three stages. How sensible is that for a country trying to reduce reliance on the aged pension and to encourage more private savings in retirement? And despite the examples cited of multimillion-dollar pension funds benefiting unfairly from tax breaks, the numbers don't add up there either.

On the figures for the 2011-12 financial year, 1.5 per cent of self-managed super funds had assets of between $5 million and $ 10 million. Even on the generous assumption this percentage has doubled since, it's still a tiny minority. And they certainly didn't make that amount of money by putting in $35,000 a year on concessional rates.

About 9 per cent of self-managed funds had assets of between $1 million and $2 million, biased heavily towards the lower end. Now that sounds a lot. But that amount is usually shared between a couple –and even a $1million balance adds up to an annual income of $50,000 at a 5 per cent return. Hold the champagne.

The Australian Financial Review

BY Jennifer Hewett

Jennifer is a senior national affairs columnist based in our Sydney newsroom.

@jennifer_hewett