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Media Release

Finally it's official - focus on $32 billion cost of superannuation is misleading

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Over two years ago we questioned the publication by Treasury of figures which were interpreted, wrongly, as meaning superannuation tax concessions were a $32 billion cost to the Federal Budget. We have since consistently said **it is not valid to use the aggregate figure of $32 billion in tax concessions as an estimate of the amount of tax the government would save if there were no tax concessions (on superannuation).**

We have also suggested repeatedly that the persistent misuse of this figure by various commentators was distorting a rational debate about superannuation and that Treasury should issue a statement explaining that such use of the figure is misleading.

So we are delighted to hear that a senior Treasury official has now made a clear and unequivocal statement that: ***"When people report things that say this ($32 billion) is a measure of tax expenditure and therefore that's the amount the Government could save if they did something about it, that is untrue." ****

Rob Heferen, Executive Director of Treasury's Revenue Group is reported to have told an SMSF conference this week the annual Tax Expenditure Statement is not a document with a policy message. *"When it is reported in the press...there seems to be an inference that simply because there is a large measured tax expenditure, the Government should do something about it. That is not the case. There is no policy message in the Tax Expenditure Statement."*

He went on: *"We are asked to do an audit, so we do. But be wary on the revenue gain estimates. Don't use them, they are too unreliable. On the revenue foregone (estimates), done according to international best practice, that is not a measure of what is saved. Anyone who says this is not reading the fine print - it's not even in fine print, it's in bold print. Every year when we put it out, we get criticism so I wanted to make it clear." **

With this clarification Treasury has made it possible to have a more objective and rational discussion about the purpose, effectiveness and benefits of superannuation and how Australia's retirement savings system can be improved, without undue focus on a large but artificial number.

However, the Tax Expenditure Statement (TES) still does not, for example, explain what savings in Age Pension flow from the existence of the superannuation tax concessions and ignores the reporting of some very large tax concessions such as the income tax concessions for those on lower incomes. A full disclosure of such figures could assist a thorough and objective review of taxation.

That there are tax concessions with regard to superannuation is not in doubt. However, some reported suggestions that superannuation tax concessions may not be of benefit ignores the importance of national savings for the ongoing health of the Australian economy. In his context Dr Ken Henry's comments in his 2009 Report on Australia's future tax system should be noted. He clearly stated that "*income taxation creates a bias against savings*" and "*discriminates against taxpayers who choose to defer consumption and save*" with the result that "*individuals* (savers) *pay a higher lifetime tax bill than people with similar earnings who choose to save less*". In particular he reported that the bias against long-term savings was evident" *for lifetime savings such as superannuation*" and that "*superannuation should receive preferential income tax treatment compared to other savings*".

Like Rob Heferen, Dr Henry also questioned the validity of over-reliance on the reported tax expenditures due, in part, to differences of opinion as to what benchmark should be used. The reported figures depend upon the benchmark used. The Henry Tax Review raised questions about the benchmark used in the Tax Expenditure Statement, by reporting that *"most countries' retirement income systems use an expenditure tax benchmark."* The TES in contrast uses the "income tax benchmark".

To give Treasury due credit, and to illustrate the problematic nature of this exercise, in last year's report on superannuation tax expenditures they also reported on superannuation tax expenditures using the "expenditure tax benchmark". This resulted in the tax expenditure with regard to the concessional taxation of super earnings swinging from the $16.1 billion it usually reports to <u>minus</u> $5.8 billion (i.e a tax <u>penalty</u> rather than tax <u>concession</u>). Unfortunately, they did not repeat the exercise this year. Despite the problems with the tax expenditure report, Rob Heferen explains that they are obliged to report some of these figures in order to comply with a recommendation in 2007-08 by the National Audit Office.

Treasury have also been consistent in warning that the two superannuation components - tax concessions on contributions and tax concessions on fund earnings - are not additive. (i.e the $32 billion number is definitely wrong) Treasury also notes that *"Readers (of the TES) should exercise care when comparing tax expenditure estimates with direct expenditure estimates."*

The overall point is not that one method is right and another wrong, but that the whole process is inexact and will produce different numbers according to the benchmarks used.

In this context, it is of concern to see the head of Treasury, John Fraser, describe superannuation tax concessions as *"middle class welfare"* and should be debated as part of the Government's attempt to fix the budget.

Mr Fraser rightly points out that *"Australia has spent its way to a structural budget problem. Government payments are growing faster than government revenues and without action this trend will continue."*

We have been making exactly this point to the previous and present Governments in our past three pre-Budget submissions.

The deficit and debt problem needs to be fixed by reining in current Government spending, not by more taxation on the retirement savings of Australians. When people make savings for their future, they need to be confident that their savings are secure and not available to Governments that have a problem because they can't properly manage their budget. The Government should heed Dr Henry's warning about the problems of the over-taxation of savings.

The Henry Report also emphasised how the *"compounding effect of interest* (income) *has a significant influence on how much superannuation a person can accumulate"* and that "*the taxation of earnings reduces this compounding effect."* A reduction in the tax rates on superannuation fund earnings from 15% would improve the effectiveness of superannuation.

A comment often made in the context of superannuation taxation concessions - repeated in the media this weekend - is that the top 20% of income earners get more than half of the benefit of the concessions. It is rarely mentioned that the same top 20% of income earners also pay 65% of income tax. A comprehensive analysis of who pays tax in Australia and how much they pay, net of welfare and other benefits, would be useful background information and provide an objective reference point for submissions on the Taxation White Paper and in the debate over the fairness of superannuation tax concessions.

We commend the recent observation by the Assistant Treasurer, Josh Frydenberg, that the growth of SMSFs is a good thing and that they are a key source of competition in the superannuation system. He said how keen he was to see Australia have the most efficient, transparent and competitive superannuation system.

In this regard, we agree that an over-arching and, ideally, bipartisan statement of superannuation objectives, as recommended by David Murray's recent Financial System Inquiry, is a sensible step. Such a formal statement of the purpose and objectives of superannuation will make it harder for governments to tinker with the system and will help to engender confidence in what is a lifetime investment for Australians.

We have taken the statements made in the Henry Review, the Cooper Report and other overseas reports as being reasonable objectives for the Government to adopt. i.e.

> By compulsion and tax incentives, support a privately-funded superannuation system that delivers a pension to most Australians that bears a reasonable relationship to each Australian's pre-retirement income; with the Age Pension only being a safety net for a minority of Australians.

We therefore believe that the focus of any review of superannuation, either in the context of the Taxation White Paper or otherwise, should be :

1. Adequacy - setting an appropriate measure for retirement income in relation to pre-retirement income and making it possible for most Australians to achieve this level of financial independence in their increasingly longer period in retirement;
2. Fairness – what this means, how to measure it and how each alternative system addresses this;
3. Efficiency – as acknowledged by the Financial System Inquiry, improving the competitiveness and efficiency of superannuation investments leads to an improved system for everyone; and
4. Reducing red-tape – such as removing features of the system that have been added in an ad-hoc fashion by various Governments over time and which do not appear to directly help in achieving the principle objective of super but rather increase its complexity.

We will be addressing these issues in our response to the Taxation White Paper process following the release of the Intergenerational Report which will set the scene for shaping the best retirement savings system in the long-term interests of all Australians.

* As quoted in the weekly online newsletter *Cuffelinks*.

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