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Super taxation as a cash grab won't work

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Scott Morrison and Revenue and Financial Services Minister Kelly O'Dwyer may well regret ever hearing the word superannuation. Having experienced a rush of blood to their heads and working on the basis of misleading and deceptive advice given to them by activist bureaucrats, they now find themselves in a right royal pickle.

The ill-considered and over-engineered package of superannuation changes announced in the budget — out-Laboring Labor — has produced a monumental headache for the dynamic duo.

Their problems started from the decision to opt for the faulty definition of the purpose of superannuation offered in the Murray report into the financial system. (At a general level, it has to be said that the Murray report was much weaker on superannuation than on other aspects of the financial system.)

David Murray's suggestion is that the purpose of superannuation is "to provide income in retirement to substitute or supplement the age pension". The weaknesses of this definition are obvious. A supplement of $1 over the age pension would meet the test; so would a supplement of $100,000. The definition also makes the age pension the mainstay of retirement incomes, with superannuation a worthy addition. Rather than providing a useful guide to policy, this definition is actually retrograde.

The alternative is simply to state that the purpose of superannuation is to reduce the dependence on the age pension. If this criterion is not being met, then the purpose of super is not being met. The corollary is that the incentives for people to self-provide in retirement have to be targeted at those with the best chances of achieving this outcome — that is, at those in the top half of the income distribution.

The present Treasury projections point to a fall in the dependence on the full age pension across time, but the proportion of those who will be self-reliant budges little during the next 25 years or so.

One policy alternative raised in the context of this debate is making the age pension universal and cutting out any special concessions for savings for the purposes of retirement.

There is a certain elegance to this solution and a number of countries run this model. New Zealand provides universal access to the age pension, for example, although more latterly it also has introduced retirement savings incentives as well.

This approach cuts out the huge compliance costs associated with assessing people's incomes and assets used to determine eligibility for the age pension.

And the gaming of the system that now goes on would be largely eliminated. It also could lead to a more rational taxation of savings, in general.

Rather than have several different modes — the interest on term deposits is taxed at full marginal income tax rates whereas superannuation savings are taxed at lower rates — we could have one consistent rule. The Henry tax review, for instance, recommended a 40 per cent discount on income from all savings for the purposes of taxation.

But there is no way that the government would consider a universal age pension at this stage — it would be just too expensive in the short term — and so it has to work with the dog's breakfast of arrangements that exist. Something that is not widely recognised is the extent to which the present superannuation tax concessions are driven by the income tax scales and bracket creep. In point of fact, the taxation of superannuation has been reasonably settled for some time — the Division 293 30 per cent contributions tax for high-income earners is an exception — but the cost of the concessions estimated by the Treasury has exploded.

There are three principal reasons for this: the higher proportion of workers being pushed into the next tax bracket; the recent rise in the top marginal tax rate; and the increase in the superannuation guarantee charge, until its recent pause.

Want to reduce the cost of the concessions? Then lower the income tax scales and maintain the pause, and that is what will be achieved.

The government also has fallen into the trap of thinking that these tax concessions are somehow paid for by low-income earners, who subsidise higher-income earners to build up substantial superannuation balances. Nothing could be further than the truth. After all, most low-income earners (earning under $37,000 a year, say) pay very little tax or no tax at all. The amount of tax they pay on their compulsory superannuation contribution is also very small.

Let us not forget that the top 10 per cent of income earners pay close to two-thirds of income tax revenue and that income tax revenue is by far the largest single source of revenue for the federal government, making up more than 50 per cent of general government receipts.

More generally, we need to dispel the myth that low-income earners somehow subsidise high-income earners, be it in respect of superannuation, negative gearing or other particular tax treatments.

The reality is that low-income people would be better off if they could escape the net of compulsory superannuation altogether. Most people on $37,000 a year could use that $3500 in superannuation contribution now, rather than have it put into a superannuation account where the balance is whittled away by fees, charges and unwanted insurance.

And while those few extra dollars could be helpful when they retire, they still will retire on the full age pension and the taxpayer will have saved nothing.

That is why the low-income superannuation tax offset is such a dumb idea. If we are going to hand over several hundred dollars to low-income earners each year, we shouldn't be putting it into their superannuation accounts, which they cannot access for many years.

The only ones likely to be excited by LISTO are the union-controlled industry super funds, which can get their hands on more funds courtesy of the taxpayer.

The worst aspect of this sorry saga is that the advice Treasury should have given to the Treasurer and O'Dwyer is that the design of the taxation of superannuation should never be driven by a revenue grab — as a means of repairing the budget.

In any case, the estimates of the extra revenue and/or savings from most of the individual measures announced in the budget are not to be believed.

Treasury and the Parliamentary Budget Office are players in this game, not impartial advisers. The only firm figure is the extra spending that will be associated with LISTO; the other revenue gains/savings simply will fail to materialise as people change their behaviour.

The end result is a purposeless up-ending of the stability of the taxation and regulation of superannuation, which is an enforced long-term savings product.

Confidence in the system already has been undermined — witness the drying up of voluntary contributions. It is the antithesis of good public policy.

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