Actuaries Institute.

Discussion Paper

Superannuation Tax Reform

Sensible Changes for a Fairer System

December 2024

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The Actuaries Institute acknowledges the traditional custodians of the lands and waters where we live and work, travel and trade. We pay our respect to the members of those communities, Elders past and present, and recognise and celebrate their continuing custodianship and culture.

About this Discussion Paper

This Discussion Paper was commissioned by the Actuaries Institute as part of its Public Policy Thought Leadership program. Enquiries should be directed to the Institute's Public Policy Team at public_policy@actuaries.asn.au.

The Discussion Paper was authored by actuarial consultants Richard Dunn FIAA, Michael Rice AO FIAA, Jennifer Shaw FIAA, and Alun Stevens FIAA, who were engaged by the Institute. Deloitte Actuaries & Consultants were commissioned by the Institute to provide the modelled impacts of the proposed reform to implement a uniform tax rate on earnings.

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Actuaries Institute Foreword

Central to the design of a robust and effective retirement income system are superannuation tax arrangements that provide for an appropriate set of incentives and supports for system participants. To engender trust and confidence in the system, tax settings should remain stable over the short and medium term and must also consider longer-term economic, societal and demographic trends.

It is now widely acknowledged that those longer-term trends are causing broader budgetary pressures and, understandably, there is discussion around current tax concessions, including for superannuation. Noting also that meaningful superannuation tax reform was last made many years ago, it is therefore timely to ask whether current arrangements remain appropriate and, if not, what might meaningful tax reform that is fit for the future look like.

It is in that spirit that the Institute commissioned this multi-generational author team of wide experience to prepare this Discussion Paper laying out their vision of what such reform could look like and the key considerations. To model the impact of the authors' proposed reforms, the Institute commissioned modelling from Deloitte Actuaries & Consultants.

Acknowledging that we do not start with a blank slate, the Institute requested that the authors consider reform within the current broad structure of the superannuation system. The Institute acknowledges the substantial efforts by the author team to develop a balanced, well thought through package. It is designed to deliver stronger outcomes for more generations of retiring Australians.

The Institute also acknowledges there are many alternative views on superannuation tax reform, including within the actuarial profession, that the Institute could also consider. The diversity of views is wide, and often around individual aspects of the system. This paper is deliberately intended to stimulate and facilitate debate. Wider debate is an essential part of developing the case for, and path to, meaningful tax reform being achieved.

We welcome feedback. The Institute's current public policy position statement on the retirement income system, which is in the process of being updated, is notably silent on tax settings. Feedback will help inform any extension of that statement to tax.

1. Executive Summary

1.1. Case for Tax Reform

The Australian superannuation system delivers considerable benefits, including a financially secure retirement for an increasing number of retirees. However, a range of taxes on contributions, earnings and benefits make the system complex in a variety of areas. Many Australians find the system to be incomprehensible and many experts struggle to keep up with legislative change. The system has also been challenged on whether it provides equitable outcomes across the population, and across generations.

From a fiscal perspective, the retirement system is supported by generous tax concessions on superannuation, as well as additional expenditure on Age Pensions and other social security outlays for older Australians.[1] Some of this cost (for current and future taxpayers) could be better targeted to improve system equity and deliver better economic value.

Through this Discussion Paper we propose several changes to improve the ***Simplicity, Efficiency, Equity, Adequacy*** and ***Sustainability*** of the system by seeking to address the realities that:

- the complexity of Australia's superannuation system is a barrier to understanding the system, and it adds cost. Implementing reform to simplify the tax structure for contributions, earnings, and benefits would improve the viability of the overall system and save costs;
- inequality exists within the system. This is most evident across wealth cohorts of the population. Any reform should ensure that the system is structured to provide better targeted superannuation tax concessions; and
- anomalies exist within the system which are inconsistent with the objective of superannuation.

1.2. Key Reforms

Proposed reforms that target each of the areas where tax is collected within the superannuation system would include contributions, earnings and benefits. Proposed reforms would:

- apply a uniform tax on fund earnings in the accumulation and retirement phases;
- reform the tax payable on benefits; and
- simplify the treatment of superannuation contributions.

1.2.1. Proposed Tax Reform — Earnings

Earnings on superannuation assets are taxed at a rate of 15% in the accumulation phase and are tax-free in the retirement phase of superannuation. The current rules create complexity and cost by necessitating separate accumulation and retirement accounts, convoluted rules and processes for moving money between them, and contribute to inequity by providing larger tax concessions to wealthy members.

1 Our Discussion Paper considers the current superannuation taxation system as the baseline for comparison, a summary of which can be found here: Budget Explainer - How is super taxed? (pbo.gov.au).
https://www.pbo.gov.au/about-budgets/budget-insights/budget-explainers/how-super-taxed

Reform 1 – Earnings

Apply a single rate of tax on earnings across all accumulation and retirement accounts to improve the simplicity, sustainability and equity of the system.

Many commentators, including Henry (2009 Tax Review), the Grattan Institute and Rice Warner, have suggested having a uniform rate across all accounts. The Retirement Income Review also noted:

> *Changes to earnings tax concessions would increase the system's cost-effectiveness and directly contribute to improving its sustainability by reducing the growth in costs relative to growth in GDP. In particular, the cost of the earnings tax exemption in the retirement phase is likely to grow as the superannuation system matures. Extending earnings tax to the retirement phase could also simplify the system by enabling people to have a single superannuation account for life and would improve the sustainability of the system. Changes to superannuation earnings tax concessions would improve equity, and in turn boost public support for the system.*

A single rate of tax on earnings (including realised capital gains) would greatly improve equity across the system. Retirees would pay higher taxes, but those not yet retired would enter retirement with higher balances from which to fund this extra tax. The new tax on earnings for those who have already retired, and how to deal with this change, are discussed in Sections 4.2.2 and 5.2.

Implementing a uniform tax rate across accumulation and retirement would also mean that all members could have a single account. Retirees would not need to juggle two accounts with different rules and the significant complexities (and costs) of Transfer Balance Caps would be removed. A single combined account would make it easier for members, funds and advisers. Further details on these proposed changes are set out and discussed in Section 4.2. At a high level, the proposed reforms would have the following impacts on:

- **members** — There would be simplification as most members would hold a single account for all their superannuation investments. We note that existing retirees would pay more tax; however, the dollar value would be low for those with low- to medium-sized balances and compensation could be provided by, for example, adjusting the Age Pension thresholds and means tests. The cost of these adjustments would be more than offset by the additional tax revenue collected in retirement;
- **Government** — Our modelling indicates that a rate of 11% across all accounts would be revenue-neutral for a decade, if changed in the next few years. As superannuation assets grow, the tax from earnings will also grow. Consequently, the rate would need to be reduced periodically to provide revenue neutrality if that is an objective; and
- **superannuation funds** — The key benefit for superannuation funds would be a simplified product structure which should lead to a reduction in operating costs over time.

1.2.2. Proposed Tax Reform — Benefits

Relative to other international retirement systems, the current tax regime is generous for retired members who can draw out unlimited benefits tax-free at any time. This was not always the case and emerged from a range of changes from 2007 which saw the removal of Reasonable Benefit Limits. We consider there to be scope to impose a tax on very high benefits to improve equity and align the taxation of benefits with the objective of superannuation.

Reform 2 – Benefits

Impose a tax on very high benefits drawn in retirement and on death benefits, beyond the levels expected to be required to provide a suitable retirement income.

We acknowledge that there are many ways to implement this reform. One potential approach to implementing this would be to apply (for individuals):

- no tax on retirement income benefits under (say) an amount in the range of $150,000 to $190,000 a year, or the highest marginal tax bracket;
- no tax on lump sum payments in aggregate over the period from age 60 to age 70, up to (say) an amount in the range of $250,000 to the Age Pension Asset Test lower limit for single persons;
- the excess of payments above these thresholds would be added to personal assessable income; and
- tax at 17% on all death benefits, after age 67, above a threshold of (say) $500,000, paid to any beneficiary who is not a spouse or other dependant. A higher tax-free threshold of (say) $2,000,000 could be applied to benefits paid to a spouse or other dependants.

Implementation of these changes to tax on benefits would leave the system unchanged for the bulk of retirees and still allow members to make large withdrawals at retirement for the purpose of immediate needs (such as paying off a mortgage, home renovations, or replacing the family car). Further details on these proposed changes are set out and discussed in Section 4.3. At a high level, the proposed reforms would have the following impacts on:

- **members** — The high thresholds would ensure that the system will remain unchanged for most Australians. The thresholds would also ensure that reasonable lump sum withdrawals at retirement for the purpose of capital payments to fund immediate needs remain untaxed;
- **Government** — This approach provides the facility to increase taxes should the Government need funds to improve equity in other parts of the superannuation system; and
- **superannuation funds** — Systems and processes would need to be changed to allow for the taxation of benefits. This will incur development costs and will need time for implementation, but over the longer term would reduce administrative complexity and operating costs.

1.2.3. Proposed Tax Reform — Superannuation Contributions

Under current policy settings, contributions are broken into concessional (tax deductible) and non-concessional (after-tax) contributions. Both types are subject to annual limits and are treated differently once made to a fund. This separation of contributions adds unnecessary complexity to the system and encourages perverse strategies that do not improve system outcomes.

Reform 3 – Contributions	Remove the distinction between concessional and non-concessional superannuation contributions once they have been made to the fund. Concessional contributions would remain assessable income to the fund in the year they are received.

Implementation of this change to contributions tax is expected to drive efficiency by simplifying administration processes. This should reduce costs for funds which can be passed on to members via reduced fees. Further details on these proposed changes are set out and discussed in Section 4.4. At a high level, the proposed reforms would have the following impacts on:

- **members** — There would be a single record of all contributions made into the fund by a member or their employer, removing a level of complexity and some jargon;
- **Government** — The proposed changes to the treatment of contributions would have a small budgetary impact due to the removal of the non-concessional tax component of benefit payments. The details are discussed in Section 4.3; and
- **superannuation funds** — It would no longer be necessary to separate contributions into different types within fund accounts and to track them over time. The ATO would track the deductibility of contributions through data-tracking (as they do now). This would simplify systems and administration processes. The separate treatment of concessional and non-concessional contributions when determining the tax on benefits would be removed, further simplifying the system.

1.3. Impact of Reforms

1.3.1. Impact of Reform on Member (and System) Outcomes

Implementation of the proposals would improve member outcomes at a system level by:

- **improving adequacy and equity** through levying taxes that more fairly treat cohorts of the population that receive considerable tax concessions despite having access to income beyond that required to provide a dignified retirement; and
- **improving simplicity and efficiency** of the system by altering settings which add complexity and cost, or which encourage perverse outcomes with no benefit to members or the Government.

Beyond direct impacts, simplification of the system should reduce the operational costs incurred by funds which could be passed on to members and improve net returns. While this is difficult to quantify, we estimate that operational costs savings could be in the range of $850 million to $1.5 billion per year.

1.3.2. Impact of Reform on the Fiscal Position

The proposed reforms are fiscally sustainable. The levels and thresholds can be set to provide fiscal neutrality while improving equity and maintaining member outcomes. Across our reforms, the key fiscal driver we have selected is the level for a ‘uniform’ tax on earnings. There is no single uniform rate that would provide revenue neutrality at implementation and over time. A uniform rate of 11% would provide approximate neutrality for 10 years but would then generate an increase in tax revenue compared to the current regime. This would provide future scope for lowering the rate, reducing taxes elsewhere or increasing the Age Pension.

Equally, setting a slightly higher rate now for earnings (such as 12%) would be revenue-positive for longer, and setting a slightly lower rate (such as 10%) would be slightly revenue-negative immediately before becoming revenue-positive and be a simple “round” number.

Taxing retirement income benefits above $150,000 per year would yield tax revenue of approximately $200 million per year and a tax on all large death benefits would remove the attraction of superannuation as a mechanism for accumulating tax-free bequests. Our proposed changes to the treatment of contributions do not have a significant fiscal impact.

1.4. Implementation Considerations

All tax reforms produce winners (who will pay less tax) and losers (who will pay more tax). This is particularly true of proposals such as these, which aim to improve equity and sustainability. Dealing with this is critical as the historical experience is that debate tends to focus on cost 'paid' by the losers to the exclusion of both the direct benefits gained by the winners and the overall equity and sustainability of the system. Consequently, changes should be announced and implemented sensitively with sufficient transition.

Adoption of a uniform rate of tax on all superannuation earnings would be the most significant in this regard, with working-age members paying less tax and those in the retirement phase paying more. A potential concern for those with small and moderate retirement balances is reduced fund earnings because of the increased tax. While this is small in absolute terms, it would have an impact on their modest incomes. However, we note that most of these members will be eligible for full and partial Age Pensions, and this means these members can be shielded from the increased earnings tax via an increase in the Age Pension and adjustments to the Income and Asset means tests.

Over time, the impact on those in retirement phase will disappear because those moving into the retirement phase will increasingly have higher balances due to having paid lower taxes in the accumulation phase. The proposal could, therefore, be implemented with little impact on the incomes of most retired members and could be modified over time to provide an equitable, sustainable system.

We further note that the imposition of tax on retirement phase earnings might also prompt those in the retirement phase to consider withdrawing their assets from superannuation to avoid the tax. This would not be a major concern as it would only be relevant to assets sufficient to generate an income below the tax-free threshold.

Changes to taxation will also require changes to administration systems and processes. The changes proposed will reduce the complexity and cost of these systems and processes over time, but there will be a cost of implementation, and the implementation will take time. The timetable for implementation will therefore need to allow enough time for funds to do what is necessary and to, wherever possible, include upgrades to systems, products, marketing material and other processes into their regular annual cycles.

Finally, there is scope to improve equity by considering changes to the Age Pension terms. Some suggestions are set out in Section 5.3. Many of these could be funded from taxes raised by the proposed changes we have set out in this Discussion Paper.

Figure 1: How super could be taxed[2]

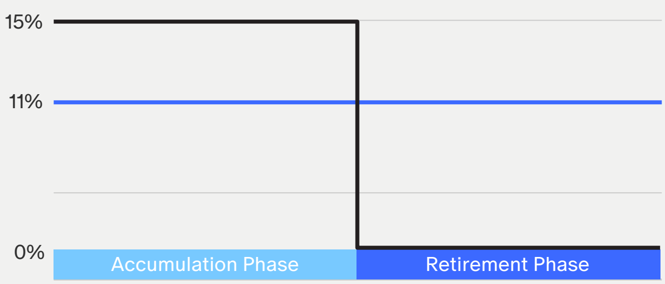
Proposal 1 Uniform low tax rate on lifetime earnings in super

Problem: Separate rates under current rules create complexity, cost and multiple accounts

Current Rules

- **15% tax in Accumulation Phase**
- **No tax in Retirement Phase** Subject to moving super into a retirement account and the Transfer Balance Cap ($1.9m as of 1 July 2024)

Figure A: Headline Tax Rate on Earnings in Super



Note: Government has proposed an additional 15% tax on earnings from superannuation balances exceeding $3 million.

Proposed Rules

A uniform rate on earnings

- **For example, a uniform rate of ~11%** would be revenue-neutral for one decade

Proposal 2 Retirement benefits remain tax exempt except for large withdrawals All smaller super bequests become tax exempt

Problem: Retired members are not encouraged to steadily spend their super during retirement

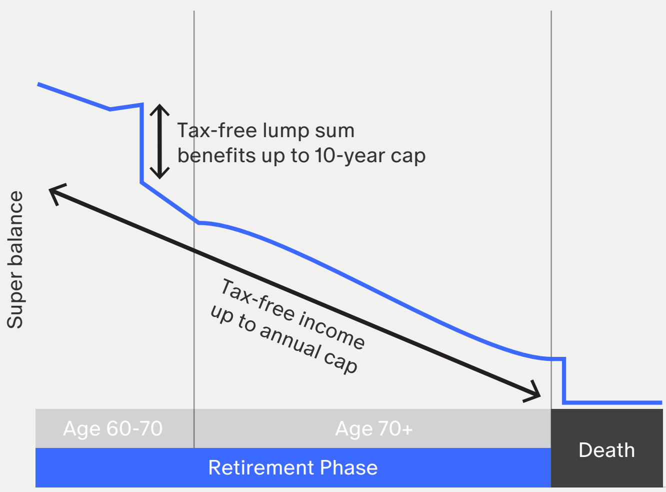
Current Rules

Tax-free retirement benefits from age 60 for both income and lump sum withdrawals (no upper cap)

Bequests for age 60+

- 17% tax on bequests to a non-dependent beneficiary
- No tax on bequests to a dependent beneficiary

Figure B: Taxation of retirement benefits (illustrative scenario)



Proposed Rules

- **Tax-free lump sum benefits from Age 60-70** Up to ~$250,000 - $566,000 in total
- **Tax-free retirement income benefits** Up to ~$150,000 - $190,000 each year
- **Excess withdrawals taxed** added to personal income and taxed

Bequests for age 67+

- 17% tax on any part of a bequest that exceeds ~$500,000
- A higher tax-free threshold of ~$2m could apply for dependent beneficiaries

Proposal 3 Treat all contributions into super the same once made

Problem: Treating concessional and non-concessional contributions differently once in super creates complexities

[2] The Actuaries Institute is canvasing proposals for discussion that aim to make super simpler to invest, easier to spend and fairer with bequests.

2. Overview

2.1. Contextualising Superannuation

The Australian superannuation system is unique. It has:

- mandatory employer contributions which have grown from 3% in 1992 to 11.5% today and are legislated to rise to 12% from July 2025. All contributions fully vest to members immediately;
- acted as the largest provider of life insurance for Australian workers;
- many funds which have delivered high real rates of return over periods up to 40 years, leading to strong retirement benefits for many members;
- been accompanied by a targeted state Age Pension, which is means-tested unlike State supported pensions in most countries; and
- taxes applied on contributions and fund earnings (up to retirement) and provides tax-free benefits.

Australia's superannuation system has grown over 40 years with annual legislative changes to refine it.[3] The rapid growth and increased complexity have made the system difficult to understand and this has contributed to ongoing administrative difficulties.

Change has also occurred in the absence of a specific overall objective. Rectifying this was a recommendation of the Financial System Inquiry in 2014, and this has led to multiple consultations and parliamentary debate on the specific wording. The wording that has recently passed Parliament is as follows:

The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.

Formulation of this objective has led to debate on the value of superannuation concessions, and equity between members now and intergenerationally. The tax incentives, which are a core facilitator of the system, are often viewed as being too generous for wealthier Australians because they are higher in dollar amounts for earnings on larger account balances and for those making large concessional contributions. There have been calls to scale back and better target concessions on the grounds that excessive savings provide far more than a dignified retirement, including accumulation of estates.

In response, changes have been made. These include the introduction of the Transfer Balance Cap from July 2017 which aimed to cap the concessions from tax-free earnings in retirement. Further reductions in tax concessions (such as the proposed Division 296 Tax on large total superannuation balances) are being considered. The superannuation system also does not operate in isolation. Modelling indicates that the total annual cost of Australia's retirement income system is approximately 4.0% of GDP.[4] This means it is a key fiscal policy and determinant of the budget position in a period when:

- the COVID-19 pandemic resulted in a large Federal Government debt which could take decades to pay off (notwithstanding ongoing surpluses generated from mining profits over recent years); and
- state governments are also running historically high levels of debt without any budgetary goal of reductions for many years.

In this environment, there will be pressure to raise taxes, and superannuation is a potential target. **Any change to the tax structure should not be made if it runs contrary to the objective of superannuation**. Consequently, there is even more reason to ensure the structure of taxation is sound, and to highlight where tax reform should be targeted. This includes changes which simplify the system and make it easier to understand, especially where the changes will encourage more Australians to engage in their retirement plans and save more where necessary to help prepare for a dignified retirement.

[3] Our Discussion Paper considers the current superannuation taxation system as the baseline for comparison, a summary of which can be found here: Budget Explainer - How is super taxed? (pbo.gov.au).
https://www.pbo.gov.au/about-budgets/budget-insights/budget-explainers/how-super-taxed

[4] Retirement Income Review, The Australian Government the Treasury.

2.2. Purpose of this Discussion Paper

This Discussion Paper examines the existing taxation framework for superannuation and suggests changes which could benefit the system in many areas. The Actuaries Institute public policy position in relation to retirement incomes has the goal of enhancing the ***Simplicity, Efficiency, Equity, Adequacy*** and ***Sustainability*** of the system.

Our analysis of reform options includes the impact on individuals and households, the Government and superannuation funds. While we provide a clear and a positive path forward, we note that the Government will still adjust thresholds from time to time as it balances the incentives versus fiscal costs.

We acknowledge that there are a variety of changes that could be applied to the taxation of the superannuation and retirement system. The proposals in this Discussion Paper are intended to generate debate on an important matter, with the intention of ultimately improving the system across and within generations of members.

2.3. Superannuation Taxes

2.3.1. Global Tax Structures

The taxation of global pension systems varies, but a common structure is Exempt Exempt Taxed (EET).[4] In an EET system, contributions made to the fund are not taxed within the fund, investment earnings within the fund are tax-free but all benefit payments are taxed, often as part of the individual's annual personal income tax obligation.

These EET systems are arguably more equitable than the Australian one in that very large benefits can be taxed at high personal tax rates in retirement. Further, the absence of tax on contributions and earnings allows the general population to build larger balances for retirement.

Australia has evolved differently due to two past policy changes. In 1988, contributions that were a taxable deduction for the payer (usually an employer) were taxed at 15% with a corresponding reduction in the tax on (lump sum) benefits from 30% to 15%. In 2007, all retirement benefits became tax-free. The result has been a system where some contributions are taxed at entry, investment earnings are taxed at 15% on earnings (but earnings held in retirement phase accounts are tax-free) and most retirement benefits are tax-free (but benefits to non-dependants on the death of a retiree are taxed at 17%).

Therefore, our system could be described as close to Taxed Taxed Exempt (TTE), with all components taxed but at relatively low rates. The complexity of varying tax rates on contributions, earnings and benefits is a major factor in making the system complex. Lay people find the system to be incomprehensible and many experts struggle to keep up with legislative change.

2.3.2. Taxation Charging Points

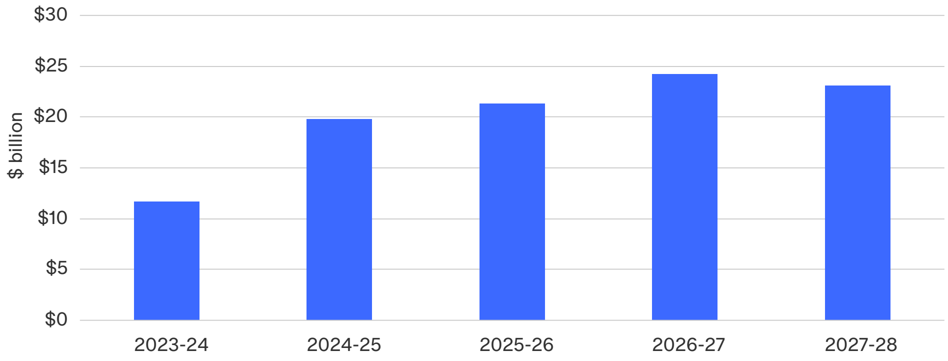
Taxes related to superannuation are reported in four different areas:

- taxes raised by superannuation funds;
- taxes raised by wealth management companies which provide superannuation services (shown under company taxation);
- taxes on benefits (withdrawals under age 60, death benefits to non-dependants, etc.), shown under personal taxation; and
- taxes on contributions from those on high incomes (the Division 293 Tax), shown under personal taxation.

The estimated taxes raised by superannuation funds (the first dot point above) are set out in Table 5.7 of Budget Paper No 1 (May 2024). These figures are reproduced in Figure 2 and reflect that in the medium term (over the coming five years), the system is expected to produce approximately $20 billion per annum in fiscal revenue.

[5] E is exempt from tax and T is taxed.

Figure 2. Projected Tax Receipts from Superannuation Sources



The annual variations reflect the different fund earnings which vary considerably from year to year, with the taxes paid by funds averaging 5% of all taxes collected. Taxes raised by wealth management companies on their superannuation business and the tax on benefits are not published but are relatively small compared to taxes raised by the funds themselves.

From July 2017, the Division 293 Tax threshold was lowered from $300,000 to $250,000. This raised an extra 15% tax on contributions where salary and contributions together exceeded $250,000. At introduction, it was estimated that the policy would raise $9.2 billion over 10 years and affect 60,000 members with balances over $1.5 million.

The proposed Division 296 Tax is an extra 15% on earnings (including unrealised capital gains) for those holding more than $3 million in all superannuation accounts. It is proposed to apply from the 2025 financial year and is projected to affect about 80,000 members in its first year. The amount of tax to be raised is difficult to quantify as many members will withdraw money from superannuation to avoid the tax. Budget estimates suggests that the tax collected will be $900 million per annum.

We estimate that across all the sources of taxes from superannuation, the amounts published in the Budget Papers understate the total taxes raised by at least 25%, and we expect this to grow should the Division 296 Tax be implemented as proposed.

3. Analysis of Current Position

3.1. Simplicity

Australia's superannuation system is complex and the issues that the system seeks to address are also complex. Individuals do not know how much they will need to save over their careers, nor how much money they are likely to have when they retire. Few can estimate their future retirement income when also considering the means-tested Age Pension. This can lead to a lack of confidence in retirement and a lack of trust in the system. The National Seniors 2023 study into ageing preparedness found that 60% of respondents expressed various levels of uncertainty and negativity about being financially prepared or not having enough money to live on in retirement.[6]

Many do not engage with the system, and for those who do it can be a daunting experience. The Quality of Advice Review noted that our financial system requires consumer engagement, but it is complex — contribution and tax rules are complex; the choices of superannuation fund, investment portfolio and insurance matter; and decisions about retirement products are difficult and important.[7] Superannuation has its own jargon which compounds the problem of financial illiteracy in the population.

A combination of these matters can lead to disengagement which has not been overcome despite the efforts of many funds. A simpler system would:

- enable better engagement to be provided at a lower cost;
- make compliance easier and should lead to lower costs and better net member returns; and
- provide less opportunity or need for complex, expensive processes and behaviour aimed at minimising current and future tax.

3.2. Efficiency

Complexity within the superannuation system is generally passed on to funds to address through their operations while still seeking to ensure satisfactory member experiences and outcomes. There is a plethora of rules, rates and thresholds for different types of contributions, assets held in the accumulation and retirement phases, and the different types of benefits to be paid to members or their beneficiaries. Funds must administer the complicated processes that are needed to deal with this complexity and to legitimately minimise tax across this complex landscape.

The superannuation system is also the largest provider of life insurance coverage in Australia, collecting about 40% of all premiums. Funds must also deal with non-core activities such as the First Home Super Savers Scheme.

Australian Prudential Regulation Authority (APRA) regulated superannuation funds reported that their spend on total administration and operating related costs was almost $5 billion over the period 1 July 2022 – 30 June 2023.[8]

[6] National Seniors, Preparedness for ageing and later life: The sentiments and experiences of people aged 50-plus in Australia.
[7] Quality of Advice Review Final Report, page 106.
[8] APRA, Annual fund-level superannuation statistics June 2023.

3.3. Adequacy

The Australian superannuation system will provide a dignified retirement income for most Australians entering the workforce today. The mandatory contribution rate will rise to 12% of salaries from July 2025, equivalent to 10.2% of salaries after deducting the 15% tax on these contributions.

Together, superannuation and the Age Pension, provide adequate outcomes for most cohorts of the population when measured as a "replacement rate" (which is the ratio of a person's income or spending power after retirement to that before retirement). Modelling conducted for the Retirement Income Review identified that:

- current replacement rates for middle to higher income earners are generally adequate;
- for many lower income earners, the replacement rate is estimated to be above 100 per cent since the Age Pension payments are higher than some other forms of government support (such as unemployment benefits). However, the quantum of benefits is insufficient to provide renters with an adequate income in retirement and many are in poverty; and
- future replacement rates are projected to be above 65-75% for most income levels.

However, there are gaps and not all Australians will receive the 12% contributions. Many people work in the so-called "gig" economy where they have less secure employment as contractors or casual workers. Many are self-employed and most do not earn enough to set aside much, if any, of their earnings into superannuation. Research estimates that only approximately 78.5% of the working-age population hold a superannuation account.[9]

Further, an increasing number of Australians are entering retirement as renters, so they have much greater expenses than homeowners. While the Age Pension is a sound safety net, it does not provide enough for renters to compensate for their extra expenses, even after the most recent increases in Commonwealth Rent Assistance. Where people retire as renters following a career of low-incomes and small superannuation balances, they will be poor and are likely to be subject to poverty during their retirement years. This is a failure of our retirement system and our society. If extra tax is raised through some of the reforms we have suggested, we believe it is vital that this be used, in the first instance, to improve the situation of those poorer Australians who rent in retirement.

3.4. Equity

Equity reflects the extent to which various cohorts of Australians fairly receive benefits from the system (in terms of both tax concessions and benefits). On balance, equity issues (inequity) stem from inefficiencies or imbalances in the extent to which:

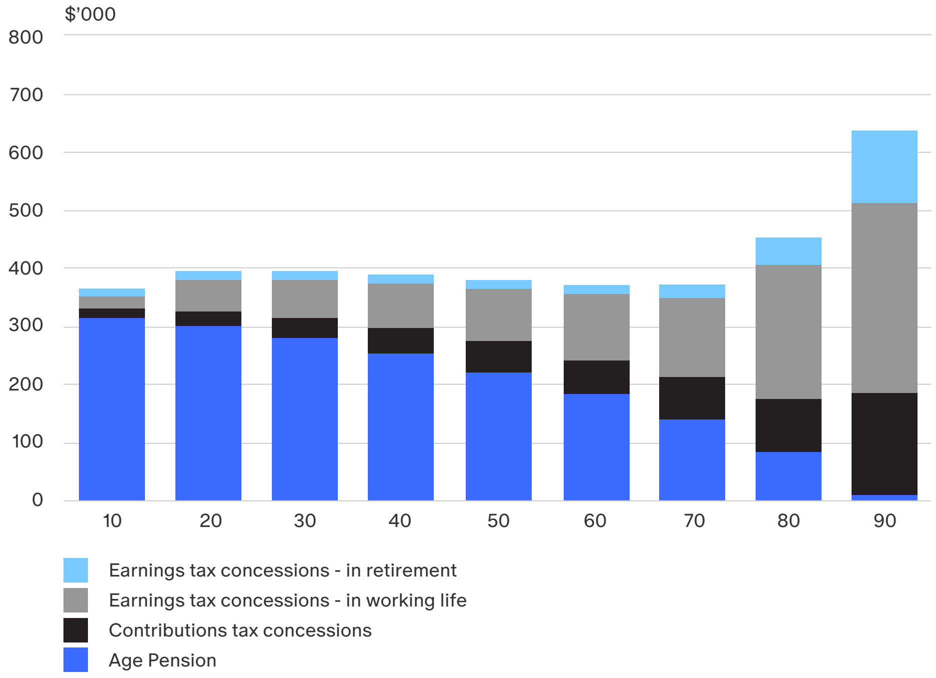
- governmental support (in the form of the Age Pension) is targeted to cohorts of individuals; and
- tax concessions accrue according to income and asset values and are therefore disproportionately allocated to the wealthy.

Figure 3 reproduces the Retirement Income Review's projection of the lifetime fiscal support received by various income deciles through the retirement income system. It shows that the current system allocates a very large proportion of the tax concessions on contributions, fund earnings and benefits to high income Australians. This is because superannuation is taxed at concessional rates and high-income earners make larger contributions, have higher superannuation balances, and pay income tax at higher marginal rates.

In short, notwithstanding measures to limit concessions, higher-income earners gain proportionally more from the flat 15% rate of tax on superannuation contributions and earnings than do lower-income earners.

[9] Mercer, Shaping Super 2024, March 2024.

Figure 3. Projected Lifetime Government Support from the Retirement Income System by Income Decile



We consider that there remains inequity across the superannuation and retirement income system, specifically as it relates to lower-income earners and to those who rent accommodation in retirement. This inequity is not overcome even with the receipt of a full Age Pension and Commonwealth Rent Assistance.

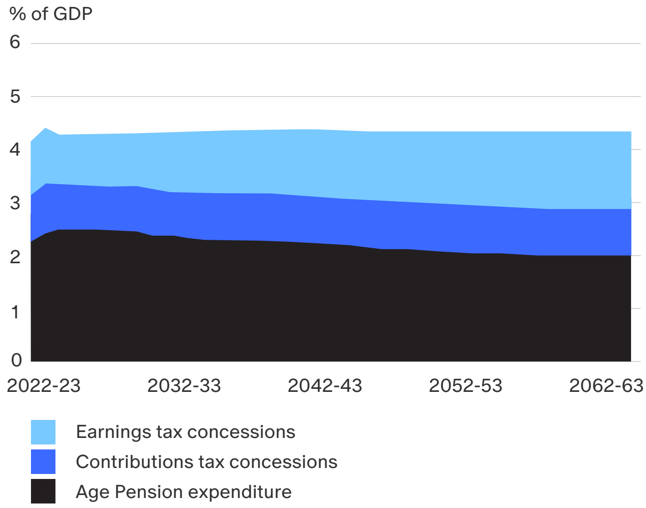
3.5. Sustainability

The aggregate cost of the superannuation and retirement income system is typically measured by combining total Australian Government pension spending for those over the Age Pension age with the revenue forgone from the two main superannuation tax expenditures: concessions on contributions and earnings.[10] Technically, the first item is current expenditure whereas the tax concessions are made to reduce future expenditure. However, the change in the combined cost over time is a useful statistic.

Modelling suggests that the total projected annual cost[11] to Government of Australia's retirement income system is expected to remain relatively steady over the next 40 years, at around 4.0–4.5% of GDP. Spending on Age and Service Pensions is projected to fall from 2.3% to 2.0% of GDP in 2062–63 despite the ageing population. Concurrently, the cost of superannuation tax concessions is projected to increase, driven by earnings on the larger superannuation balances held by Australians.

[10] Intergenerational Report 2023. https://treasury.gov.au/sites/default/files/2023-08/p2023-435150.pdf
[11] The aggregate cost of the retirement income system has been measured by combining total Australian Government pension spending for those over the Age Pension age with the revenue forgone from the two main superannuation tax expenditures: concessions on contributions and earnings, Intergenerational Report 2023.

Figure 4. Components of the "Cost" of Australia's Retirement System



Projected tax concessions on contributions are linked to total employee wages and are therefore driven by the same factors that drive Australia's GDP, namely wage growth and the size of the workforce. Once compulsory contributions reach the ongoing rate of 12% on 1 July 2025, contributions tax concessions are projected to remain steady as a proportion of GDP over the period to 2062–63.

In contrast, projected earnings tax concessions are dependent on the rate of growth of the superannuation system and the rates of return on these assets. As both are assumed to exceed GDP growth, tax concessions on earnings are projected to increase over time as a percentage of GDP. Our suggestion to tax earnings of retirees will temper this growth rate.

On balance we consider the superannuation and retirement income system to be sustainable on the basis that modelling indicates government support is likely to remain close to the current level into the future. However, we must also consider wider economic factors at play, including:[12]

- a large Federal Government debt and, while the most recent budgets yielded small budget surpluses, there are growing deficits projected across the forward estimates which could mean it will take decades to reduce the debt position. Many state governments are also running historically high debts, with no plans to reduce them in the foreseeable future;
- Government spending on health and aged care is projected to increase as a proportion of GDP. For health, it rises from 4.2% of GDP in 2022–23 to 6.2% of GDP in 2062–63 and, for aged care, from 1.1% in 2022–23 to around 2.5% in 2062–63. This is supported by the 2023 Intergenerational Report (IGR) which indicated that total government spending is projected to rise by 3.8 percentage points of GDP over the next 40 years with demographic ageing causing around 40% of this increase;[13]
- Government spending on interest payments on Government debt has also grown due to higher borrowing and increasing interest rates;
- Government spending on defence and the National Disability Insurance Scheme (NDIS) are also much larger components of overall expenditure; and
- wider and newer calls for funding, including for example greater support for resilience and adaptation to climate change are not yet fully factored into Government budget projections.

In this environment, there will be pressure to raise taxes, and superannuation is a potential target.

[12] 2023 Intergenerational Report. [2023 Intergenerational Report | Treasury.gov.au]
[13] 2023 Intergenerational Report. [2023 Intergenerational Report | Treasury.gov.au]

4. Tax Reform

4.1. Realistic Reform

4.1.1. Approach to Reform

We have approached reform in the context of the current TTE tax structure (Contributions Taxed, Earnings Taxed, Benefits Exempt).[14] We have assumed that the current means-tested Age Pension system will continue, though we note some enhancements that could be made to improve equity of the whole retirement income system.

The key to our proposed tax reform is to:

- simplify the treatment of tax on fund earnings and the administration of accounts in the accumulation and retirement phases;
- reform the tax payable on benefits to make these more equitable;
- simplify the treatment of contributions; and
- modify Age Pension benefits to compensate for the higher taxes from the reforms on some pensioners, especially those on lower incomes.

Collectively, the proposed changes will lead to a more equitable structure that is simpler and cheaper to administer. There are benefits, but any tax reform that raises taxes for some population groups while lowering it for others creates relative winners and losers. Consequently, changes should be announced and implemented sensitively with sufficient transition.

4.1.2. Areas Out of Scope

For simplicity, we have only considered the taxation of defined contribution funds as they represent the vast bulk of the superannuation system. We have not considered the taxation of defined benefits which would need to be addressed separately. These are more complex funds, mostly closed to new members and in decline. Current defined benefit liabilities amount to 11% of industry assets and are expected to decline to 3% by 2048. We have also not considered the taxation of "untaxed funds", such as Government Employees Superannuation Board (GESB) WA and Super SA. These are constitutionally protected schemes which represent a relatively small, and non-material, proportion of members and assets.

[14] The momentum of the superannuation guarantee (SG) system makes it difficult to change the underlying structure, though many economists and academics are attracted to the more common global base of taxing benefits and not contributions and earnings (EET). Our Discussion Paper considers the current superannuation taxation system as the baseline for comparison, a summary of which can be found here: Budget Explainer - How is super taxed? (pbo.gov.au). https://www.pbo.gov.au/about-budgets/budget-insights/budget-explainers/how-super-taxed

4.1.3. Proposed Changes

Our process to identify the changes to focus on, was to consider those aspects of the current superannuation system which contribute to its complexity and cost. We also considered the equity of the current system. We have focused on a limited number of proposed changes that will make material improvements to the superannuation taxation system.

Table 1. Proposed Reforms Modelled

Item	Proposal	Modelling considerations
Earnings	Apply a single rate of tax across all accumulation and retirement accounts	• Consider rates of 10% and 15% and identify a cost-neutral rate
Benefits	Apply a tax to high annual benefits above a threshold	• No tax on pension benefits under (say) $150,000 a year • No tax on lump sum payments up to (say) $250,000, in total, over the period from age 60 to age 70 • Benefit payments (including any lump sums above the $250,000 threshold) above a threshold of $150,000 a year to be added to personal assessable income. Only those receiving benefits exceeding about $180,000 in a year would pay any tax if they had no personal income • Tax all death benefits after age 67 at 17% above a tax-free threshold of $2,000,000 if paid to a spouse or other dependant, and above $500,000 if paid to other beneficiaries
Contributions	Remove the distinction between concessional and non-concessional contributions once they have been made to the fund	• Leave the tax treatment of concessional contributions unchanged but remove the distinction between them and non-concessional contributions once they are within the fund

4.2. Tax on Earnings

4.2.1. Potential Reform

Earnings on superannuation assets are taxed at a rate of 15% during accumulation and are tax free in the retirement phase of superannuation. Many commentators, including Henry (2009 tax review), the Grattan Institute and Rice Warner, have suggested having a uniform rate across all accounts. The Retirement Income Review also noted:

> *Changes to earnings tax concessions would increase the system's cost-effectiveness and directly contribute to improving its sustainability by reducing the growth in costs relative to growth in GDP. In particular, the cost of the earnings tax exemption in the retirement phase is likely to grow as the superannuation system matures. Extending earnings tax to the retirement phase could also simplify the system by enabling people to have a single superannuation account for life and would improve the sustainability of the system. Changes to superannuation earnings tax concessions would improve equity, and in turn boost public support for the system.*

A uniform tax rate would greatly simplify the system by removing the need for separate accumulation and retirement accounts, the separate investment portfolios to support them, and the complex administration required for moving assets between them, including the Transfer Balance Cap. This simplification would yield cost savings that could be passed on to members and/or the Government/taxpayers (as expanded upon below).

Tax on earnings could also be simplified by bringing the rate of capital gains tax into line with the tax on income. It is currently discounted to 10% but the earnings tax of 15% is already low, so there seems little need to have a further discount. A uniform tax for pre- and post-retirement earnings, which would be lower than 15% for tax neutrality, would remove the need for a discount.

4.2.2. Analysis — Members

Implementing a uniform tax (of below 15%) on earnings in the accumulation and retirement phase would have the following impact on members:

- accumulation members would pay less tax and therefore retire with higher balances;
- retirement phase members would pay more tax, with the dollar value being:
  - low for those with small to medium-sized balances. Compensation could be provided for those with low wealth by adjusting the Age Pension thresholds and means tests;
  - high for those with large pension accounts. This group would pay more tax which would materially improve equity by reducing the concessions this group receives;
- most members would hold a single account for all their superannuation investments which would greatly simplify their affairs; and
- retirement-phase members would be able to change funds more easily, noting that account-based pensions cannot be rolled over under current system settings.[15]

To estimate the impact on individuals, we considered cameo modelling. Appendix A details the approach and assumptions for this work. The cameo modelling considered projected account balances and income scenarios using the current taxation system compared to the introduction of a flat rate of 10% or 15% earnings tax. It shows that:

- a lower earnings rate of 10% compared to the current 15% in the accumulation phase means that projected balances at retirement are higher under this scenario, meaning that all members would benefit from larger balances at retirement under this proposal. As expected, there is no change to projected balances at retirement under the 15% tax on earnings scenario; and
- a flat rate of 15% tax on earnings across accumulation and retirement phases then all cameo accumulation members, regardless of gender, age or income decile, would be worse off because of the change, as expected. This is because of the additional tax payable on the retirement phase earnings.

Tables 2–4 show the expected income to age 92[16] for the 30-year-old, 60-year-old and 75-year-old cohorts, with household wealth at the 10th, 30th, 50th, 70th and 90th percentiles of the population, and considers the impact of moving to a flat 10% tax on earnings rate. We note that this rate is slightly lower than the revenue-neutral rate (identified in Section 4.2.3) but allows us to identify how different cohorts would be impacted by one of the key proposed reforms. It shows:

- For a current 30-year-old couple, there is little impact across each of the wealth percentiles as the reduction in the rate of tax on earnings in the accumulation phase broadly offsets the payment of tax on earnings in the retirement phase.
- A current 60-year-old couple who is closer to the retirement phase, and therefore has a lower offset from the lower tax in accumulation phase, would be more adversely impacted than younger households. Couples in higher income percentiles would be most impacted, with the expected annual retirement income reduced by up to 3% per annum for households in the wealthiest 30% of the population (i.e. the 70th percentile and above).
- The largest impacts would be felt by members currently in the retirement phase because the change will simply be an additional tax on earnings, given they are no longer in the accumulation phase. As with the other cameo members considered, the higher wealth households would be more impacted proportionately, compared to the lower wealth households.

[15] Account-based pension accounts can be converted back to accumulation accounts, then rolled into a different fund, and then converted back to an account-based pension account. This is a messy procedure which might deter some members from changing funds.
[16] Our analysis in these cameos assumes a drawdown period of 25 years. Given the male partner is more likely to die first, and his balance is higher in each decile, it is likely that this overstates the expected income under the modelled approach, especially compared to current taxation system.

Table 2 - Expected Income to Age 92 for the 30-Year-Old Cohort — Couple

Taxation scenario	Estimated annual income to age 92 (wealth percentiles) – couples 10th	30th	50th	70th	90th
Current taxation system	$36,000	$50,300	$60,200	$70,000	$90,500
Uniform 10% tax on earnings in accumulation and retirement phases	$36,200	$50,300	$59,900	$69,500	$90,700

Table 3 - Expected Income to Age 92 for the 60-Year-Old Cohort — Couple

Taxation scenario	Estimated annual income to age 92 (wealth percentiles) – couples 10th	30th	50th	70th	90th
Current taxation system	$28,400	$36,700	$50,000	$73,800	$104,500
Uniform 10% tax on earnings in accumulation and retirement phases	$28,300	$36,200	$48,900	$71,500	$100,900

Table 4 - Expected Income to Age 92 for the 75-Year-Old Cohort — Couple

Taxation scenario	Estimated annual income to age 92 (wealth percentiles) – couples 10th	30th	50th	70th	90th
Current taxation system	$24,700	$31,200	$51,300	$72,500	$138,500
Uniform 10% tax on earnings in accumulation and retirement phases	$24,600	$30,900	$50,100	$70,300	$133,300

In considering these changes, we note that:

- refinement of the proposed flat rate would need to be considered to take account of any unintended consequences of the proposed reform. This includes, for example, ensuring younger, wealthier households do not become excessively better off due to the increase in account balance over the accumulation phase. This is more likely for younger members who have a longer period of paying less on earnings tax in the accumulation phase;
- it will also be important to consider the wider proposed reforms as it relates to benefits, summarised in Section 4.3. Additional tax revenue could be sought via the proposed tax on very high benefits to enhance the fairness of the system; and
- the changes in tax and the savings generated would also provide the opportunity to make some meaningful changes to the Age Pension system in the interests of equity and fairness.

4.2.3. Analysis — Government

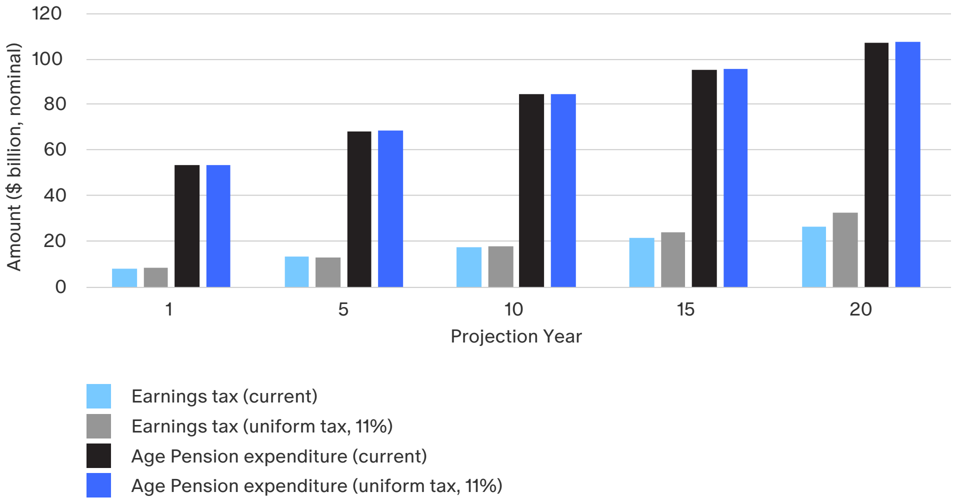
Our modelling shows that a uniform tax rate of 11% would collect approximately the same tax as the current two-tiered system over a 10-year period. Thereafter, it produces more tax than the current system providing scope for a reduction in the rate below 11% or for funding other changes to improve retirement equity. This increase over time compared to the current system is due to the increasing proportion of assets in the retirement phase.

A uniform tax rate of 11% would result in only a modest 0.5% increase in Age Pension costs due to lower account balances. It would also provide scope to reduce the uniform rate progressively to 10% and then 9% while maintaining tax neutrality. Alternately, a higher rate could be considered if major reform of social security benefits were considered. For example, a rate of 12% would generate additional tax revenue of approximately $2.5 billion over each of the first five years. The extra tax revenue would come from higher taxes on retirement accounts with a reduction of tax on accumulation accounts.

Table 5. Comparison of Uniform Tax Rate of 11% with Current System

Projection year	Current tax ($b)	Uniform tax ($b)	Change ($b)
1	8.1	8.7	0.6
5	13.5	13.3	–0.2
10	17.5	17.8	0.3
15	21.6	24.2	2.6
20	26.6	32.9	6.3

Figure 5. Projected Earnings Tax and Age Pension Expenditure



Our analysis indicates what the effect of a uniform tax rate would be if:

- **the current tax rate on earnings of 15% is applied across accumulation and retirement:** There would be substantial increase in tax revenue compared to the current regime. This amount is $8.5 billion in the first year and increases over time. We do not consider this to be a tenable option as it would impair outcomes in retirement in a material way;
- **a flat earnings tax rate of 10% were to be applied across accumulation and retirement:** Less tax would be generated initially, but there would be more tax than the current regime from 2042 onwards. The initial drop in tax revenue is driven by the fact that the 5% reduction in tax on the pre-retirement assets is not matched by the 10% increase in tax on post-retirement assets. This balances out over time as the proportion of post-retirement assets grows. It reaches a balance point in 2041–42, after which the extra tax on post-retirement assets more than compensates for the reduction in tax rate on pre-retirement assets; and
- **a "neutral" position is required relative to current tax settings:** The earnings tax rate that matches the current regime starts at 10.7% in Year 1; rises to 11.1% in years 5–7 and then falls to 8.8% by 2061. A flat rate of 10.8% would result in a largely cost-neutral fiscal position over a 20-year modelling period, though there is scope to reduce the rate in future years. This means that there would be no cost to Government for many years if the tax on earnings was set at 10.8% across all accounts. It could also be set to 10% for simplicity.

Beyond budgetary implications, a lower than 15% uniform tax rate would:

- **on accumulation phase earnings, yield higher superannuation balances at retirement:** Those taking cash (lump sum) benefits (mainly lower-income earners) would benefit directly while those transferring their benefits to the retirement phase would have higher balances at the point of retirement to compensate for higher taxes in retirement; and
- **result in higher superannuation tax from the retired population:** This could also help address one of the growing inequities in the tax system which sees health and aged care costs increasing due to our ageing population, but with little contribution from the elderly, due to the tax-free status of their family home and their retirement accounts. This approach could provide the facility to increase taxes should the Government want to improve equity in other parts of the superannuation system and is desirable given the levels of poverty amongst retirees who rent, though we note that governments might use any increased revenue for other purposes (such as debt reduction).

Implementation of this reform would also mean that the:

- neutral tax rate for earnings could also be used for all capital gains thereby simplifying tax administration. Currently, CGT on assets held for longer than 12 months is at 10% rather than 15%; and
- proposal to tax earnings on total superannuation balances above $3 million (The Division 296 Tax[17]) at an additional 15% could be retained as a method for limiting concessions to higher-income earners. The tax might not be required if the proposed reform on superannuation benefits is adopted.

4.2.4. Analysis — Superannuation Funds

The key benefit for superannuation funds is the simpler product structure and hence administration. This includes:

- a single set of investment portfolios and unit prices for all accounts. Currently, accumulation and retirement accounts have different unit prices due to the tax differences;
- simpler documentation on investments, as the accumulation options can continue unchanged into retirement;
- a reduction in the number of accounts held by retirees;
- the elimination of a complex, and expensive, set of administrative tasks to move assets between accumulation and retirement phases and to keep track of the balances moved;
- easier record-keeping as there would be no Transfer Balance Cap; and
- removing inefficiencies for those who stay (unwittingly) in accumulation phase when they could move to retirement phase.

Revised rules would be required on what contributions could be placed in the account, and what and when benefits could be withdrawn. These rules would generally replicate the current rules for contributions and benefits without the need for the complex, and administratively expensive, arrangements needed to move assets between accumulation and retirement accounts.

[17] This Discussion Paper does not consider the appropriateness of the proposed Division 296 tax given this is still under debate.

Once implemented the proposed reforms would be expected to simplify the system. Among other benefits, this should enable a reduction in costs through:

- removal of "double charging" of administration fees by enabling a single account to be used by retirees who are still working (currently, they need an accumulation and, generally, several retirement accounts);
- enabling the use of one set of portfolios and unit prices over accumulation and retirement phases;
- simplification or removal of many processes including those relating to the Transfer Balance Cap, transition to retirement accounts, transfer of balances from one fund to another, transaction costs when entering retirement, contributions and recontribution strategies, and the simplification of processes around death benefits.

While the impact of this simplification is difficult to quantify, we estimate that fee savings could be at least $850 million per year. This reflects:

- **savings from consolidation in unit pricing of approximately $250 million per year—**We estimate that unit pricing costs are approximately 10% of the "operational" cost of operating investment options (i.e. fees and costs excluding the internal cost ratio). If costs relating to retirement investment options represent half the unit pricing costs (given the mirroring of options between accumulation and retirement) this would reflect a fee saving of 1.25 basis point (bps) on the approximately $2.4 trillion held in non-self-managed super funds (SMSF) defined contribution plans;
- **savings of circa $600 million per year by consolidating duplicate retiree accounts—**Fees across the retirement phase are estimated to be $5.6 billion per year assuming that there are 1.45 million retirees with an average retirement balance of $360,000 paying average (industry wide) fees of 93 bps per annum. If it is assumed that across the retirement market, 12% of retirees have a duplicate account (half of the circa 24% of members with a duplicate account across the system) this yields savings of circa $600 million; and
- **savings from simplification of administration systems and processes—**These savings are difficult to quantify without detailed costings but include simpler computer systems requiring simpler development and maintenance, simpler administration process requiring fewer people, simpler and reduced training requirements, less rework due to errors from complexity and reduced operational risks.

4.2.5. Other Implications of This Proposed Reform

Implementation of this reform would allow other issues to be addressed. For instance:

- the Transfer Balance Cap system is unnecessarily complex. It would be abolished under this change. Current contribution rules would still limit (to some extent) the amount of assets that could be accumulated through superannuation; and
- Capital Gains Tax (CGT) (which is at a highly concessional level) would be paid on all asset sales whereas at present assets sold in the retirement phase are exempt from CGT. For instance, it is possible for members of SMSFs to deliberately wait until entering retirement before selling assets and then sell and re-invest all assets to remove all accumulated capital gains. They thereby avoid the CGT paid by APRA-regulated funds. APRA-regulated funds, in turn, have complex arrangements to give their members some of the CGT benefits when they move from the accumulation phase to the retirement phase by providing pension bonuses for those who transfer into a retirement income stream within the fund.

4.3. Tax on Benefits

4.3.1. Potential Reform

The current tax regime could be considered generous for retired members who can draw out unlimited benefits tax-free at any time. In fact, members solely in the retirement phase can withdraw their full account balance which will be tax-free to them and will also incur no CGT on the realisation of underlying assets.

We consider that there is scope to impose a tax on very high benefits to improve equity and align the taxation of benefits with the objective of superannuation, as supported by the 2019 Actuaries Institute Green Paper.[18] If the distinction between concessional and non-concessional contributions is removed as described in Section 4.4, the current separation into tax-free and taxable components of a benefit should be removed.

The system could be:

- no tax on retirement income benefits under (say) an amount in the range of $150,000 to $190,000 a year, or the highest marginal tax bracket;
- no tax on lump sum payments in aggregate over the period from age 60 to age 70, up to (say) an amount in the range of $250,000 to the Age Pension Asset Test lower limit;
- the excess of payments above these thresholds would be added to personal assessable income; and
- tax at 17% on all death benefits, after age 67, above a threshold of (say) $500,000, paid to any beneficiary, excluding a spouse or other dependant. A higher tax-free threshold of (say) $2,000,000 could be applied to benefits paid to a spouse or other dependants.

The Age Pension eligibility age is a useful guide as to when people retire, even if some are still working. The proposal is intended to apply to withdrawals during the retirement phase and is separate to taxes on death benefits while working (deemed to be under age 67). Implementation of these changes to tax on benefits would leave the system unchanged for most retirees and still allow members to make large withdrawals at retirement for the purpose of immediate needs.

Under the current system, those in retirement phase can withdraw their entire account balance as a tax-free benefit. When done by those with a terminal diagnosis, or by their enduring power of attorney, the full account balance can be withdrawn and distributed to dependents and non-dependents free of tax. This is despite current tax settings which levy a tax on death benefits which flow to non-dependents.

The extent of the practice is not known, but case law indicates that, while not widespread, the practice, especially when dealing with large accounts, is not uncommon. This approach would increase taxes and would have a retrospective element in that a portion of any benefit is derived from after-tax, non-concessional contributions. The extent and impact of this will need to be considered, but the thresholds will limit the impact to wealthier Australians and improve equity in the system.

4.3.2. Analysis — Members

The proposed reforms would have the following impact on members:

- under the proposed parameters, only those receiving annual benefits exceeding about $180,000 would pay any tax, if they had no other personal income;
- imposing tax on very high benefits would leave the system mainly unchanged. This still allows members to make large withdrawals at retirement for the purpose of capital payments (such as home renovations, paying off mortgage, replacing family car);
- Australians would be (potentially) encouraged to spend their superannuation for retirement, in line with the proposed objective of superannuation;
- the tax on death benefits would reduce the tax on benefits paid to non-dependants but increase the tax on very large benefits paid to dependants. Note, the tax on death under age 67 is treated separately as most of these members are still working and the benefit has a different purpose; and
- there is a small retrospective element in that a portion of any benefit is derived from after-tax, non-concessional contributions. The extent and impact of this will need to be considered, but the thresholds will limit the impact.

[18] Actuaries Institute – Options for an Improved and Integrated System of Retirement – Green Paper, 2019. https://actuaries.asn.au/Library/Opinion/SuperannuationRetirementIncomes/2019/RETIREMENTINCOMESGREENPAPERFINALWEB.pdf

4.3.3. Analysis — Government

This approach provides the facility to increase taxes should the Government want to improve equity in other parts of the superannuation system. This could be desirable given the unsatisfactory levels of poverty amongst retirees.[19]

Our modelling indicates that taxing retirement income streams above $150,000 per year would yield approximately $200 million in tax revenue which is currently forgone. Taxing retirement income streams above $150,000 per year would also ensure a more equitable tax outcome between younger and older taxpayers.

4.3.4. Analysis – Superannuation Funds

Systems and processes would need to allow for the taxation of benefits which would require a period of change for superannuation funds and the associated change costs. Therefore, although there would be initial upfront change costs, the expectation is that that processes could be streamlined going forward, leading to efficiencies.

4.4. Tax on Contributions

4.4.1. Potential Reform

Concessional contributions are tax-deductible for the payer, usually an employer or a member making a personal contribution on which they expect a tax deduction. Conversely, non-concessional contributions are made from after-tax monies.

Both types are subject to annual thresholds (which is further complicated by allowing unused contributions to be carried forward in some circumstances). Separately, non-concessional contributions can be made from the proceeds of the sale of a small business and from selling a home if it has been lived in for 10 or more years.

Each contribution type is treated differently once made to a fund. Concessional contributions form part of a superannuation fund's assessable income, so they are effectively taxed at 15% on entry. Non-concessional contributions are deemed to be capital and are deducted from the amount of any benefit that is taxed, such as a death benefit to a non-dependant. This separation of contributions adds unnecessary complexity to the system and has perverse outcomes, including so-called "recontribution strategies" which have the sole purpose of increasing the quantum of non-concessional contributions.

We consider that sensible reform would be to remove the distinction between concessional and non-concessional contributions once they have been made to the fund. This could be implemented in a variety of ways, namely:

- **over the short-term**, we propose leaving the tax treatment of concessional contributions unchanged but to remove the distinction between them and non-concessional contributions once they are invested within the fund. This requires a change to the taxation of benefits as described above; and
- **over the longer term**, we recommend that the proposal be implemented by stopping tax on concessional contributions by removing them from the fund's assessable income and increasing taxes on earnings to compensate. We consider this to be simple and reasonably efficient.

[19] Who benefits? The high cost of super tax concessions (page 7). https://australiainstitute.org.au/report/who-benefits/ Minh Ngoc Le, The Australian Institute

4.4.2. Analysis — Members

The proposed reforms would have the following impact on members:

- there would be a single record of all contributions made into the fund by a member or their employer, removing a level of complexity and some jargon;
- recontribution strategies, which are artificial devices to reduce potential tax on benefits, would disappear thereby reducing administration complexity and costs for funds, and hence for members;
- the Division 293 Tax (on high income earners) would be unaffected by the change; and
- the proposed Division 296 tax could be modified or removed given the increased tax on high benefits.

4.4.3. Analysis — Government

The proposed reforms would have the following impact on Government:

- proposed changes to the treatment of contributions do not have any budgetary impact except on benefit payments; and
- the ATO would still maintain limits on levels of concessional and non-concessional contributions for each member, but these would be treated at the source and not within the superannuation system.

4.4.4. Analysis — Superannuation Funds

The proposed reforms would have the following impact on superannuation funds:

- it would no longer be necessary to separate contributions into different types within fund accounts and to track them over time. This would improve the simplicity of the system and fund operating processes; and
- the separate treatment of concessional and non-concessional contributions when determining the tax on benefits would be removed, further simplifying the system. The details are discussed in Section 4.3.

5. Further Considerations

5.1. Combined System Reform

Through this Discussion Paper we have proposed reforms that can be implemented on a piecemeal basis. This acknowledges that widespread tax reform may be politically difficult. Despite this design, we believe that **the reforms discussed are best implemented as a package**. This reflects that there are synergies between the proposals.

For instance, a uniform tax on the earnings of accumulation and retirement accounts means that members need not hold separate accounts but can combine them. Further simplicity comes from the amalgamation of concessional and non-concessional contributions. In fact, these changes could even lead to the establishment of a joint account for married/de facto couples as Rice Warner first proposed a decade ago.[20]

If implemented as a complete tax-neutral package, we estimate that our combined reform would:

- reduce the level of complexity within the system
- produce over $1 billion in annual cost savings, which could be passed on to members
- improve the equity between cohorts in the system without impairing intergenerational equity.

5.2. Implementation Considerations

The key issue with these proposals, as with all tax reforms, is that there will be winners (who will pay less tax) and losers (who will pay more tax). Debate will tend to focus on the losers to the exclusion of the overall equity and sustainability of the system. In this section we provide our high-level thoughts on the issues that will arise in implementing the proposals, with a focus on issues that we expect to cause the greatest issue.

The adoption of a uniform rate of tax on all superannuation earnings would be the most significant in this regard with working-age members paying less tax and those in the retirement phase paying more. This is the intention of the proposal because of the inequity in the current taxation system between younger members who pay tax on their incomes, contributions and fund earnings, and retirees who pay no tax on their fund earnings or the incomes they derive from their superannuation. The proposal is designed to reduce this inequity and improve the sustainability of the system. Nonetheless, the implementation of the proposal will need to consider the reduced incomes of those already in the retirement phase.

The major concern with an increased tax on retirement assets is for those with small and moderate asset balances. They have lower incomes and the increased tax, even though small in absolute terms, will have a disproportionate impact on their modest incomes. The overwhelming majority of these members will be eligible for full and partial Age Pensions, and this means these members can be compensated for the increased earnings tax via an increase in the Age Pension and adjustments to the Income and Asset means tests.

Over time, the impact on those in retirement phase will disappear because those moving into the retirement phase will increasingly have higher balances due to having paid lower taxes in the accumulation phase.

The proposal could, therefore, be implemented with little impact on the incomes of most retired members and could be modified over time to ensure an equitable, sustainable system.

The imposition of tax on retirement phase earnings might also prompt those in the retirement phase to consider withdrawing their assets from superannuation to avoid the tax. This would not be a major concern as it would only be relevant to assets sufficient to generate an income below the tax-free threshold. This would be little different from the current situation in which an equivalent asset value can be withdrawn and held tax-free outside the superannuation system and therefore free of the complications of the superannuation system and the need to make minimum withdrawals.

[20] https://www.ricewarner.com/joint-superannuation-accounts/

Some retired members make use of annuities and other guaranteed income products. The implementation of an earnings tax for annuities already in payment would be quite complex and potentially require revision of contracts. This would be messy and expensive. A simple solution would be to make a small adjustment to the withholding (PAYG) tax on the annuity payments for contracts in place prior to an implementation date. An alternative solution is to allow existing annuities to retain their tax-free status on earnings.

While not a significant component of the superannuation system, proposed changes to the superannuation system always raise the question of what to do with respect to defined benefits. There is no simple answer to this question because of the significant differences in contractual arrangements and funding positions across funds. There would appear to be no significant issues for those funds that provide lump sum benefits at retirement – including those arrangements at retirement with commutation terms that favour lump sums. The funding costs of these benefits would be reduced under these proposals providing the opportunity for reduced contribution rates or higher benefit accrual rates.

Defined benefit arrangements already in payment could be treated as proposed for annuities in payment — namely via an adjustment to the PAYG tax on the benefit payments.

The situation is not clear for those funds that genuinely provide and provide benefits in retirement because of the range of fund rules, funding positions and splits between pre-retirement and post-retirement members. The reduced funding costs pre-retirement and increased costs post-retirement will have a singular impact on individual funds. A combination of changed contribution rates, accrual rates and PAYG tax should be able to resolve the positions of these funds, but there may need to be a special discretion for the ATO to deal with these funds.

Changes to taxation will also require changes to administration systems and processes. The changes proposed will reduce the complexity and cost of these systems and processes over time, but there will be a cost of implementation, and the implementation will take time. The timetable for implementation will therefore need to allow enough time for funds to do what is necessary and to, wherever possible, include upgrades to systems, processes, products, marketing material, etc. into their regular annual cycles.

5.3. Further Thoughts

Australia's superannuation system is sustainable and provides strong outcomes for the 17 million Australians it supports. However, the system is complex and inefficient in areas and could go further to reduce inequality. Through this Discussion Paper we have presented several options which would improve outcomes for Australians without impairing Australia's budget position.

It is possible to go further. We consider that the changes in tax and the savings generated would also provide the opportunity to make some meaningful changes to the Age Pension system in the interests of equity and fairness ***for the overall retirement income system***. The cost of the Age Pension as a percentage of GDP has been reducing as superannuation balances at retirement have grown, since those with large assets have reduced pensions due to the means-testing of that benefit. Our social security costs for the aged are already low relative to other advanced economies and this downward trend will continue.[21] While the pension costs are low and sustainable, there are some equity and fairness issues which can and should be resolved.

An example is the treatment of the family home, which is exempt from the asset test for the Age Pension. This results in the situation where a person who rents will receive a much smaller pension than a homeowner with a similar amount of assets. For example, a single person with a family home of $700,000 and holding $300,000 in superannuation and other assets will receive a full Age Pension (about $29,000 a year). Conversely a renter also with $1,000,000 in assets will receive no Age Pension as they exceed the asset test threshold. This is perverse as:

- renters are heavily disadvantaged relative to homeowners;
- homeowners receive the Age Pension even where they have a large investment via their family home;
- renters are further disadvantaged by the income test. They will have higher consumption than homeowners (mainly rental accommodation costs), so will have a greater need to work part-time in retirement to supplement their income;

Reform of the Age Pension should be considered on the following basis:

- limit the exemption of the family home to the first (say) $1,500,000;
- raise the asset-test thresholds for renters by (say) $300,000; and
- allow renters to earn more income in retirement by raising the threshold for their income-test.

Even if the tax rate on earnings is set to be revenue-neutral, the proposed changes to benefits will increase taxes. Implementation of the Division 296 Tax (which is not strictly necessary given our proposed tax on high benefits) would further increase overall revenue.

The Government can consider different ways to allocate this additional revenue, including:

- retaining the tax and using it for other fiscal purposes, such as debt reduction
- changing thresholds to reduce the additional tax raised
- improving Age Pension entitlements to reduce poverty in retirement

We favour the last option given the unsatisfactory levels of poverty amongst Australia's aged population. Collectively, these changes should be considered and costed.

[21] Spending on Australian Government Age and Service Pensions is projected to fall from around 2.3% of GDP in 2022–23 to 2.0% of GDP in 2062–63. (Intergenerational Report 2023, Treasury).

Appendix A

Modelling Approach and Assumptions

To understand the impact of potential reforms from both a fiscal perspective and on individuals, the following modelling was undertaken by Deloitte:

A.1 Fiscal Modelling — Scenarios

Fiscal modelling undertaken focused on the impact of implementing a uniform tax rate on earnings, removing the need for separate Accumulation and Retirement accounts. The modelling considered three scenarios:

- 10% uniform tax rate on earnings across accumulation and retirement
- 15% uniform tax rate on earnings across accumulation and retirement
- A uniform tax rate which would result in a broadly tax-neutral fiscal position compared to the current superannuation tax system.

A.2 Fiscal Modelling — Methodology and Assumptions

The Deloitte Superannuation, Pension, and other Retirement OUTcomes (SPROUT) model is utilised within the Deloitte Superannuation Market Projections and Dynamics of Australian Superannuation System publications. This model reflects the current taxation system and the impact on the overall lifetime retirement income for different cohorts with the ability to vary assumptions and account for changing work life patterns. It calculates the total taxation from the current system and any proposed changes to the system.

The methodology adopted and assumptions applied are therefore consistent with the Deloitte's Dynamics of the Australian Superannuation System report and further details can be obtained from the "Assumptions and Methodology Report — Superannuation Market Projections 2023". Note that it has been assumed there would be no behavioural change associated with the proposed reform for modelling purposes.

A.3 Cameo Modelling — Scenarios

Similar to the fiscal modelling, the cameo modelling undertaken focused on the impact of implementing a uniform tax rate on earnings. The modelling considered two scenarios:

- 10% uniform tax rate on earnings across accumulation and retirement
- 15% uniform tax rate on earnings across accumulation and retirement

A.4 Cameo Modelling – Methodology and Assumptions

A.4.1 Methodology

The Deloitte Flexible Interactive Retirement Estimates (FIRE) API was utilised to support the cameo modelling. Full details of the modelling approach can be obtained from the FIRE API methodology and assumptions report. Note that it has been assumed there would be no behavioural change associated with the proposed reform for modelling purposes.

A.4.2 Assumptions

The assumptions applied are consistent with the Deloitte's Dynamics of the Australian Superannuation System report and further details can be obtained from the Assumptions and Methodology Report - Superannuation Market Projections 2023. A summary of the key input assumptions applied to the cameo modelling are below.

Table G. Assumed Cameo Member Details

	Age 30				Age 60				Age 75			
Income decile	Salary		Super Balance		Salary		Super Balance		Salary		Super Balance	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
10%	22,500	17,500	20,000	10,000	27,500	20,000	7,500	5,000	-	-	12,500	5,000
30%	52,500	37,500	25,000	15,000	57,500	42,500	45,000	45,000	-	-	52,500	42,500
50%	72,500	52,500	37,500	30,000	82,500	60,000	120,000	100,000	-	-	197,500	147,500
70%	92,500	67,500	60,000	55,000	112,500	82,500	245,000	230,000	-	-	342,500	267,500
90%	135,000	100,000	97,500	90,000	172,500	125,000	537,500	460,000	-	-	827,500	737,500

Table H. Economic and Product Assumptions

Assumption	Value	Rationale
CPI	2.50%	Mid-point of RBA target range
Wage inflation	4.00%	Assumes salary growth of 1.5% above CPI
Admin fees – accumulation	\$90 p.a. + 0.75% p.a.	Based on APRA Quarterly MySuper Statistics June 2023 – Industry Fund average
Admin fees – retirement	\$63 p.a. + 0.80% p.a.	Based on APRA Quarterly MySuper Statistics June 2023 – Industry Fund average
Retirement age	67	
Drawdown period	25 years	
Insurance premiums	Age 30: Male: \$388 Female \$385 Age 60: Male: \$599 Female \$591	Based on an analysis of average premiums by sector from Chant West's Group Insurance Comparator

Table I. Investment Return Assumptions

	Investment return	
Scenarios	Pre retire	Post retire
Baseline	5.87%	6.78%
Uniform 10% earnings tax	6.18%	6.18%
Uniform 15% earnings tax	5.87%	5.87%

- Based on Deloitte's Dynamics of Superannuation modelling which considers investment earnings, before the deduction of fees, and considers the average asset allocations for the Industry Fund superannuation sector, based on APRA statistics.

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