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From tax expenditures to rebates: An 'output based equity' approach for Australia's retirement policies

Lidia Xynas

Deakin University, Burwood, Victoria, lidia.xynas@deakin.edu.au

Steve Jaynes Dr.

Deakin University, Burwood, Victoria, steve.jaynes@deakin.edu.au

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Abstract

Australia's retirement policies are geared to shifting reliance from the Age Pension to private superannuation, predominately via the use of tax expenditures. This article examines tax expenditures in this area and concludes that inequities and inefficiencies abound. Reform is required. It is argued that the functions of revenue collection and social support should be separated, and the use of tax expenditures in superannuation should be discarded. A rebate system, or a spending initiative, is proposed. This 'output based equity' approach will address fairness and equity issues at the time of retirement - when full benefits are received.

Keywords

age pension, superannuation, retirement, tax expenditures, benefits, policy

FROM TAX EXPENDITURES TO REBATES: AN 'OUTPUT BASED EQUITY' APPROACH FOR AUSTRALIA'S RETIREMENT POLICIES

LIDIA XYNAS* AND DR STEVE JAYNES**

Australia's retirement policies are geared to shifting reliance from the Age Pension to private superannuation, predominately via the use of tax expenditures. This article examines tax expenditures in this area and concludes that inequities and inefficiencies abound. Reform is required. It is argued that the functions of revenue collection and social support should be separated, and the use of tax expenditures in superannuation should be discarded. A rebate system, or a spending initiative, is proposed. This 'output based equity' approach will address fairness and equity issues at the time of retirement - when full benefits are received.

INTRODUCTION

The majority of individuals in Australia rely on private savings typically in the form of superannuation combined with the Australian Government Age Pension for their financial wellbeing in retirement.¹ Faced with the fiscal pressures of an ageing population,² Australia, like most Organisation for Economic Co-operation and Development ('OECD')³ countries, has sought,

* Lidia Xynas is a lecturer in law in the School of Law at Deakin University, Burwood Victoria.

** Dr Steve Jaynes is a lecturer in the Deakin Graduate School of Business at Deakin University, Burwood Victoria.

¹ The Age Pension is an age-tested income support payment that helps give older people a sufficient standard of living in retirement: Department of Human Services, Australian Government, *Age Pension* (2013) <<http://www.humanservices.gov.au/customer/services/centrelink/age-pension>>.

² The notion of an ageing population is discussed in Part 2.

³ Organisation for Economic Co-operation and Development ('OECD') is an organisation that 'provides a forum in which governments can work together to share experiences and seek solutions to common problems.' Organisation for Economic Co-operation and Development, *About the OECD* (2013) <<http://www.oecd.org/about/>>.

To partially shift the burden of its ageing population away from government and on to individuals, with the emphasis on self-funded retirement rather than public pension arrangements.⁴

The Australian government's current policy objectives are to assist and to encourage its older citizens to attain in retirement a greater standard of living than they would have on a government-funded pension alone.⁵ These objectives have been addressed to a degree via recent reforms, including the lifting of the eligibility age for public pensions, the introduction of a mandatory private pension scheme ('The Superannuation Guarantee'), and favourable taxation treatment of voluntary private saving for retirement.⁶ It is anticipated that these and further reforms to the Australian retirement savings scheme, including superannuation, will result in the Age Pension eventually providing a supplement to private savings.

A number of tax expenditures are utilised to achieve the Australian government's current retirement policy objectives. Positive perceptions of the fairness and efficiency of these retirement income 'arrangements are important if voluntary and compulsory savings through superannuation are to have the confidence and support of the community'.⁷ This article considers whether tax expenditures are an equitable, efficient and effective form of government assistance to encourage saving for retirement. Since tax expenditures are effectively regressive in nature, their use in encouraging superannuation

⁴ Corinne Cortese and John Glynn, 'Taxation and the Australian Superannuation System: An International Comparison' (2006) 16(39) *Australian Accounting Review* 77.

⁵ Diana Warren, 'Australia's Retirement Income System: Historical Development and Effects of Recent Reforms' (Working Paper No 23/08, Melbourne Institute of Applied Economic and Social Research, 2008).

⁶ Peter Siminski, 'Do Government Benefits for High Income Retirees Encourage Saving?' (2009) 12(3) *Australian Journal of Labour Economics* 247, 247.

⁷ Ross Clare, 'Equity and retirement income provision in Australia' (Report, The Association of Superannuation Funds of Australia Limited, 2001) <<http://www.superannuation.asn.au/ArticleDocuments/116/equity.pdf>>.

investment results in inequality for particular classes of individuals. In particular, those with broken work patterns or those on low incomes and the self-employed will not obtain the full benefit. Middle to high-income earners are the main beneficiaries of tax expenditures, as the design of tax expenditures favours those with greater purchasing power.

This article also articulates why the current Australian government's retirement policy objective - to encourage individuals to save for their own retirement – is not being achieved in an efficient or effective manner. For example, many Australians have an expectation that they will be supported by the government-provided Age Pension. This exacerbates the costs to government in direct spending and lost revenues by supporting both the Age Pension and the provision of tax expenditures. In addition, the costs of managing superannuation funds can be self-defeating. The disparity between the financially literate and illiterate can have a negative impact on investment. Furthermore, the ability of many taxpayers to dissipate their retirement savings prior to retirement is also problematic.

We conclude that while tax expenditures play an important role in encouraging savings for use in retirement, they are neither fair in applying equitably to all members of society, nor do they operate efficiently. Their use is not an effective means of addressing the government's retirement policy objectives. An alternative approach is required. It is suggested that a system of rebates coupled with provisions for government assistance for Australians on low incomes, with broken work patterns, and persons experiencing gender inequities would achieve a fairer output based equity outcome.

PART 1: TAX EXPENDITURES

I WHAT ARE TAX EXPENDITURES?

Tax expenditures are not easily defined. In 1985, Stanley Surrey, the Assistant Secretary of the US Treasury for Tax Policy, was one of the first to attribute certain characteristics to tax expenditures. Surrey, together with his co-author Paul R McDaniel, noted:

The tax expenditure concept posits that an income tax is composed of two distinct elements. The first element consists of structural provisions necessary to implement a normal income tax, such as the definition of net income, the specification of accounting rules, the determination of the entities subject to tax, the determination of the rate schedule and exemption levels, and the application of the tax to international transactions. The second element consists of the special preferences found in every income tax. These provisions, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favour a particular industry, activity, or class of persons. They take many forms, such as permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates. Whatever their form, these departures from the normative tax structure represent government spending for favoured activities or groups, effected through the tax system rather than through direct grants, loans, or other forms of government assistance.⁸

Following this, tax expenditures can be identified as a 'departure from the generally accepted tax structure that produces a favourable treatment of particular types of activities or taxpayers'.⁹ Indeed, the Commonwealth Treasury in Australia also considers a tax expenditure to be,

⁸ Stanley S Surrey and Paul R McDaniel, *Tax Expenditures* (Harvard University Press, 1985) 3.

⁹ Organisation for Economic Co-operation and Development, *Tax Expenditures: A Review of the Issues and Country Practices* (OECD Paris, 1984) 7.

A provision of the tax law that provides a benefit to a specified activity or class of taxpayer that is concessional when compared to the 'standard' tax treatment that would apply¹⁰ (and can be regarded as) an alternative to direct expenditures as a method of delivering government assistance or meeting government objectives.¹¹

Tax expenditures can also be described as 'concessions that allow people to get out of paying tax'.¹² These concessions can take many 'forms including deductions, rebates, reduced rates and deferred liabilities'.¹³

There are many reasons why a government may choose to fund certain activities via tax expenditures. These reasons are typically concerned with political and public administration considerations, for example, the limitation of public scrutiny. The very nature of tax expenditures allows an escape from thorough public examination which is associated with direct spending initiatives. This was noted by the OECD in 1996, the 'concept of a tax expenditure [or tax concession] was developed because accounting for the costs and benefits of tax measures is often less rigorous than for direct expenditures'.¹⁴ Tax concessions are popular with governments:

Because they represent a way of increasing Federal support for social policy, while seeming to be tax cuts rather than increases in spending. Compared to direct outlay programs with similar goals, [tax

¹⁰ The Treasury, 'Tax Expenditures Statement 2011' (Report, Australian Government, January 2012) 13.

¹¹ Ibid.

¹² Ben Spies-Butcher and Adam Stebbing, *Labour's new upper class welfare – the first Home Savers Account* (March 2008) Australian Review of Public Affairs <http://www.australianreview.net/digest/2008/03/spies-butcher_stebbing.html>.

¹³ Julie Smith, 'Tax expenditures: The \$30 billion twilight zone of government spending' (Research Paper No 8, Department of the Parliamentary Library, 2003) 1.

¹⁴ Organisation for Economic Co-operation and Development, *Tax Expenditures: Recent Experiences* (OECD Paris, 1996).

concessions] better meet the need of politicians to appear to favour spending restraint.¹⁵

Tax expenditures, when used as an indirect spending approach, do have a significant fiscal impact especially on the amount of revenues forgone by a government. In Australia, the impacts of these forgone revenues are to a degree exemplified in the yearly Australian government's 'Tax Expenditures Statement'.¹⁶ Unless the reader holds a degree in forensic accounting, deciphering the content and valuation methods used in these Statements can be a challenging task. For example, the Tax Expenditures Statement of 2011 notes that there are three differing approaches to measuring tax expenditures and each will 'yield significantly different estimates of the value of the tax expenditure'.¹⁷ So problematic is the measurement of tax expenditures, the Australian government acknowledges in its yearly report that the figures are not reliable. Whilst the Australian approach follows the OECD, in applying estimates of tax expenditures by using the revenue forgone approach, the Australian government itself notes that:

Care should be taken when interpreting [them since] they are not necessarily reliable indicators of the budgetary impact of removing particular tax concessions. Nor are they ... reliable indicators of the

¹⁵ Smith, above n 13, 31.

¹⁶ See, eg, The Treasury, above n 10, 16. There are three main methods used to measure tax expenditures. These include the revenue forgone approach where it 'measures the difference in tax paid by taxpayers who receive a particular concession relative to similar taxpayers who do not receive that concession'. This approach is the one adopted by the Australian government in line with the OECD. The other approaches available are the revenue gain approach, which 'measures how much revenue could increase if a particular tax concession was removed'; and the outlay equivalence approach, which 'estimates how much direct expenditure would be needed to provide a benefit equivalent to the tax expenditure'.

¹⁷ Ibid.

total value of expenditures, in particular as tax expenditures are not additive.¹⁸

Accordingly, it is arguable that the Australian government is able to manipulate certain social policies without thorough scrutiny of the measures undertaken.

II TAX EXPENDITURES AND THE AUSTRALIAN GOVERNMENT RETIREMENT POLICY

The Australian government foregoes a significant amount of tax revenue to encourage individuals and families to invest privately and build up their own asset base for retirement. The majority of these asset and investment building initiatives are encouraged by tax expenditures, rather than through direct spending initiatives.

Many government initiatives focus on the provision of tax expenditures applicable to superannuation investment, tax exemptions for owner-occupied housing and other concessionary treatment of other longer-term investments.¹⁹ The tax concession goals are to incentivise people to save at particular rates; consequently the government influences the national rate of saving (a broader policy consideration). The government's strategy is to encourage individuals to build up sufficient private funds and assets during their working lives to enable them to fund, either wholly or partially, their own retirement. This reduces the future financial burden on the Australian government of a government-funded Age Pension (discussed below). These exemptions and expenditures are discussed in further detail in Part 2 below.

¹⁸ Ibid 19.

¹⁹ Rosanna Scutella, 'Three Priorities to Reform Inequities and Inefficiencies in the Tax and Transfer System', *Impact Magazine* (online), Winter 2009 <<http://www.questia.com/library/1G1-248916406/three-priorities-to-reform-inequities-and-inefficiencies>>.

PART 2: AUSTRALIAN RETIREMENT POLICIES

I THE FIVE-PILLAR APPROACH

In 1994, to minimise the adverse fiscal and social effects of population ageing, the World Bank published a recommendation to assist countries.²⁰ The recommendation advanced a model for a 'national superannuation policy known [at the time] as the three-pillar model, which emphasise[d] a move away from public pension arrangements and towards self-funded retirement'.²¹ In 2008, the World Bank revised its three-pillar approach to incorporate five-pillars.²² Australia has adopted a multi-pillar architecture for its retirement income system based on a hybrid of the current five-pillar approach of the World Bank. The World Bank pillars include a non-contributory 'Zero Pillar' (in the form of social assistance financed by government), a 'First Pillar' (contributions linked to earnings), a 'Second Pillar' (usually an individual savings account), a voluntary 'Third Pillar' (flexible and discretionary in nature), and a non-financial 'Fourth Pillar' (informal support, eg, from family or health care).²³

Australia's current retirement savings regime predominantly encompasses the Age Pension (the Zero Pillar), the Superannuation Guarantee (the First Pillar), voluntary superannuation (the Third Pillar) and other private investment. While the pillars are generally viewed as different aspects of the one system, they often lack integration as a result of being developed separately. Consequently, they do not function together well as intended.²⁴ Given the needs of an

²⁰ The World Bank, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (Oxford University Press, 1994).

²¹ Cortese and Glynn, above n 4, 78.

²² The World Bank, *The World Bank Pension Conceptual Framework* (Pension Reform Primer, The World Bank, September 2008).

²³ *Ibid.*

²⁴ Hazel Bateman and Geoffrey Kingston, 'The Henry Review and Super Saving' (2010) 43(4) *The Australian Economic Review* 437.

ageing population, Australia's retirement policies, as encompassed under the 'Pillars', now need to be addressed.²⁵ Currently,

Most individuals will rely on a mixture of private savings, principally superannuation, and the government-provided Age Pension for their income in retirement [where] private savings provide a supplement to the Age Pension.²⁶

The aim of the government is to reset savings and retirement policies so that the Age Pension acts only as a supplement to private savings.

The following discussion examines the Zero, First and Third Pillars of the World Bank model, as they apply in Australia.

A *Zero Pillar - The Age Pension*

The Age Pension in Australia operates by providing a 'guaranteed minimum income stream which is means-tested on income and assets, and provided that the means tests are satisfied it is payable for life with universal coverage'.²⁷ This Zero Pillar of the Five Pillar World Bank model 'is a type of safety net which provides social security retirement benefits that are not conditional upon past employment'.²⁸ According to Barrett and Chapman, 'this is a publicly-provided social security benefit that is funded by the federal government'.²⁹ Sadiq

²⁵ Bryce Figot and Daniel Butler, 'Superannuation: Henry and Cooper – what does it mean for you?' (2010) 44(11) *Taxation in Australia* 649, 649.

²⁶ Clare, above n 7.

²⁷ Kerrie Sadiq, 'Tax Expenditures in Australia: The Elevation from 'Disguised' Expenditures to Architectural Pillars of the 21st Century' (Paper presented at the Tax Expenditures and Public Policy in Comparative Perspective, Osgoode Professional Development Centre, Toronto, 11-12 September 2009).

²⁸ Hazel Bateman and John Piggott, 'Private Pensions in OECD Countries: Australia' (Labour Market and Social Policy Occasional Papers No 23, OECD, 1997).

²⁹ Jane Barrett and Keith Chapman, 'The Australian Superannuation System' (Research Working Paper, Australian Prudential Regulation Authority, 2000) 2.

states, 'it ensures support for the aged once they are no longer able to work, with eligible individuals receiving the Age Pension from 65 years of age'.³⁰ The use of an Age Pension is in line with other OECD countries and can be said to be compensatory in nature, akin to fairness, because it 'supports individuals whose connection with the workforce does not allow them to provide for themselves in retirement'.³¹

1. *Population Ageing and the Age Pension*

The Age Pension currently 'represents a large proportion of most people's retirement income in Australia'.³² In 2006, Cortese and Glynn commented that, based on data gathered by the Australian Bureau of Statistics and the Department of Veteran Affairs, the total number of people receiving the Age Pension equated to 77% of the total aged population.³³ In 2010, Sadiq highlighted the enormity of the costs of the Age Pension in direct expenditure terms for the 2008-09 year of 'A\$28.59 billion'.³⁴ In the 2010/11 budget outcomes, The Treasury noted that this figure rose to over A\$44 billion for the 2010/11 period.³⁵ Approximately one-third of all federal government spending is currently committed to Centrelink payments such as the Age Pension, parenting payments and unemployment benefits.³⁶

³⁰ Kerrie Sadiq, 'Equity for Taxpayers within Australia's Retirement Savings Regime: A Dissenting Opinion' (2010) 7 *Pandora's Box* 9.

³¹ The Treasury, 'Australia's future tax system: Retirement income consultation paper' (Report, Australian Government, December 2008) 9.

³² Australian Bureau of Statistics, *Superannuation: Coverage and Financial Characteristics* (17 September 2001) <<http://www.abs.gov.au/ausstats/abs@.nsf/productsbytitle/99726666BEFEA136CA256AC90080C009?OpenDocument>>.

³³ Cortese and Glynn, above n 4.

³⁴ Sadiq, above n 30.

³⁵ Australian Government, *Final Budget Outcome 2010-11* (Report, Australian Government, 2011) 92.

³⁶ *Ibid.*

Faced with an ageing population, these exponentially increasing costs will not be economically feasible or sustainable in the future.³⁷ Over the next 40 years Australia faces drastic changes to its demographic make-up, with a significant increase in the number of retirees compared to the number of people of working age.³⁸ While the post-war 'baby boom' contributes significantly to the growth of the retired population, 'lifestyle preferences and medical advances [also mean] that Australians are increasingly retiring younger and living longer'.³⁹ The Australian government's Intergenerational Report noted that in '2007 there were five people of working age to support every person aged 65 and over. By 2047, 'there will only be 2.4 people of working age supporting each person aged 65 and over'.⁴⁰ The Australian government's 2010 Intergenerational Report supplements this by predicting that by 2050,

The percentage of the population aged 85 or over will increase from 1.8 % to 5.1 %⁴¹ (and that unless some action is taken, by 2050, Australia) will be spending more than it receives in revenue by 2.75 % of gross domestic product.⁴²

Increased life expectancy, early retirement and insufficient future resources to support the Age Pension give rise to the question: How does a government financially, socially and economically prepare itself

³⁷ The Treasury, 'Australia's Future Tax System, The Retirement Income System: Report on Strategic Issues' (Strategic Issues Paper, Australian Government, May 2009), s 5.2. See also Australian Bureau of Statistics, *Superannuation: Coverage and Financial Characteristics* (17 September 2001) <<http://www.abs.gov.au/ausstats/abs@.nsf/productsbytitle/99726666BEFEA136CA256AC90080C009?OpenDocument>>.

³⁸ Cortese and Glynn, above n 4.

³⁹ Ibid.

⁴⁰ The Treasury, *Intergenerational Report 2007* (Report, Australian Government, 2 April 2007) xi.

⁴¹ Trish Power, *2010 Intergenerational Report: Australia in 40 years' time (2050)* (12 February 2010) Super Guide <<http://www.superguide.com.au/the-soapbox/2010-intergenerational-report-australia-in-40-years'-time-2050>>.

⁴² Ibid.

for the future? In response, the Australian government has implemented major reforms to its retirement policies. The Australian government considers the 'ability of Australians to provide financially for their own retirement, particularly through superannuation'⁴³ is of vital importance to ensure adequate and secure income for retirement. According to the Australian Bureau of Statistics, 'it is expected that superannuation will eventually replace (to some extent) taxpayer-funded income support as seniors' main source of income in retirement.'⁴⁴ To achieve this objective, the Australian government has focused predominantly on the use of tax expenditures in the superannuation system to encourage individuals to save for their own retirement. But Tax expenditures alone cannot address these issues equitably or efficiently. The government must reconsider its retirement policies and how they are supported to ensure that all of its citizens will be provided for adequately in their retirement.

II THE FIRST AND THIRD PILLARS: THE SUPERANNUATION GUARANTEE AND VOLUNTARY RETIREMENT SAVINGS/INVESTMENT

A *The Superannuation Guarantee*

The First World Bank Pillar is made up of '(often compulsory) employment-related superannuation contributions that are accumulated during a retiree's working life'.⁴⁵ When arrangements are compulsory, as in Australia, 'a minimum level of employer contribution must be paid on behalf of all employees'.⁴⁶ These private retirement savings are mandated in Australia by the Superannuation

⁴³ Australian Bureau of Statistics, above n 32.

⁴⁴ Australian Bureau of Statistics, *Australian Social Trends* (25 March 2009) <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Main+Features70March%202009#1>>.

⁴⁵ Cortese and Glynn, above n 4.

⁴⁶ *Ibid.*

Guarantee.⁴⁷ Under the Australian Superannuation Guarantee scheme, an additional minimum amount of 9% of employees' 'normal-time' wages is contributed by their employers⁴⁸ to a superannuation fund,⁴⁹ to provide a minimum benefit available to them upon retirement.

The Australian Superannuation Guarantee scheme was initially introduced to assist Australian people who fail to save adequately for retirement, because for many of them, it was too far into the future.⁵⁰ In its introductory phase, The Treasury noted:

[A] major challenge for retirement incomes policy is the need for current consumption to be deferred in favour of future income in retirement ... No loss of remuneration is involved in meeting this national challenge. What is involved, rather, is foregoing a faster increase in real take-home pay in return for a higher standard of living in retirement.⁵¹

Sadiq comments that 'the government motivation driving the introduction of the guarantee was the so called life-cycle "myopia" of

⁴⁷ The Superannuation Guarantee scheme is administered by the Australian Taxation Office, and governed by the *Superannuation Guarantee Charge Act 1992* (Cth) and the *Superannuation Guarantee (Administration) Act 1992* (Cth) ('SGAA') and its Regulations ('SGAR'). Employers are currently required to contribute 9% of an employee's income. If they fail to do so, the shortfall is subject to a charge (shortfall plus interest and administrative charges). See SGAA ss 17, 31–2; SGAR reg 7A.

⁴⁸ Employers are generally not obliged to pay this amount into a complying superannuation fund for employees whose salary is less than A\$450 per month, or who are under 18 years old and working less than 30 hours per week, or who are aged 70 years or more. See *Superannuation Guarantee (Administration) Act 1992* (Cth), s 27.

⁴⁹ *Superannuation Industry (Supervision) Act 1993* (Cth) s 10 ('SISA'), defines a superannuation fund as: '(a) a fund that is an indefinitely continuing fund which is a provident, benefit, superannuation or retirement fund; or (b) a public sector superannuation fund'.

⁵⁰ The Treasury, 'Towards Higher Retirement Incomes for Australians: A History of the Australian Retirement Income System since Federation' (2011) 2 *Economic Round-up* 65.

⁵¹ The Treasury and John Dawkins, *Security in Retirement: Planning for Tomorrow Today* (Australian Government Publishing Service, 1992).

the population in failing to save adequately for retirement because it was too far in the future'.⁵²

The Australian Superannuation Guarantee scheme is predominantly supported by tax expenditures. For example, employers are able to fully deduct all contributions that they have made to a complying superannuation fund for all employees under the age of 75.⁵³ Upon retirement, benefits paid from taxed funds⁵⁴ to members over the age of 60 years are generally exempt from tax.⁵⁵ Complying superannuation funds⁵⁶ are also entitled to concessional tax treatment. For example, most employer contributions made on behalf of employees as well as most income received by complying superannuation funds are taxed in the fund at a rate of 15%.⁵⁷ Complying superannuation funds can also benefit from favourable

⁵² Sadiq, above n 27.

⁵³ *Income Tax Assessment Act 1997* (Cth) ss 290-60 – 290-80. Note, where conditions are met under s 290-B, this deduction would apply to both mandatory and voluntary contributions.

⁵⁴ A 'superannuation benefit' is defined in *Income Tax Assessment Act 1997* (Cth) s 307-5(1). See also *Income Tax Assessment Act 1997* (Cth) pts 2-40 and 3-30.

⁵⁵ Where a member of a complying superannuation fund is aged 60 years or more, and the superannuation benefit is paid from a taxed source (an element taxed in the fund), then the benefit received (either as a lump sum or income stream) will not be assessable income and not exempt income. See *Income Tax Assessment Act 1997* (Cth) s 301-10.

⁵⁶ A superannuation fund must be a 'complying superannuation fund' in order to access concessional tax treatment under the *Income Tax Assessment Act 1997* (Cth) div 295. In order to be a complying superannuation fund, the superannuation entity must obtain a notice under the *Superannuation Industry (Supervision) Act 1993* (Cth) ss 37–50 ('SISA'), from the Australian Prudential Regulation Authority ('APRA') stating that it is a complying fund. APRA is 'the prudential regulator of the Australian financial services industry': Australian Prudential Regulation Authority, *About APRA* (2013) <<http://www.apra.gov.au/AboutAPRA/Pages/Default.aspx>>. Under the SISA, to be a complying fund it must be a 'regulated superannuation fund' and comply with regulatory provisions (see *Superannuation Industry (Supervision) Act 1993* (Cth), *Financial Sector (Collection of Data) Act 2001* (Cth), *Corporations Act 2001* (Cth) and *Tax Administration Act 1953* (Cth) sch 1); *Superannuation Industry (Supervision) Act 1993* (Cth) s 19.

⁵⁷ *Income Tax Assessment Act 1997* (Cth) div 295.

capital gains tax treatment, with a one-third discount applying on the capital gain from assets held by the fund for 12 months or more.⁵⁸

If the Australian Superannuation Guarantee Scheme continues at the current rate of 9% (set to increase to 12% by 2020), it has been argued that by 2037 when the program matures, there will be a shift from a system 'where superannuation supplements the Age Pension, to one where the Age Pension supplements superannuation'.⁵⁹ This move would be in line with the Australian government's intention to shift its citizens' reliance for retirement funds away from the government-funded Age Pension system (Zero Pillar) towards a predominantly self-funded retirement scheme (First Pillar).

B *Voluntary Saving for Retirement and other Investments*

The Third Pillar consists of voluntary superannuation and retirement savings added to a superannuation or pension fund. In Australia, employers and employees are able to contribute additional funds voluntarily into employee superannuation funds, under the current superannuation scheme. Contributions are aimed at increasing the amount of funds contained within an individual's superannuation fund (over and above that prescribed under the government's Superannuation Guarantee Scheme).⁶⁰

These additional voluntary contributions to superannuation funds are also encouraged via the use of tax expenditures. For example, additional contributions to superannuation funds made up to the caps (concessional and non-concessional) set by the government are generally tax-exempt.⁶¹ Generous concessional contribution caps apply

⁵⁸ *Income Tax Assessment Act 1997* (Cth) ss 115-5 – 115-50.

⁵⁹ The Treasury, above n 31.

⁶⁰ Cortese and Glynn, above n 4.

⁶¹ Concessional contributions are those made by, or on behalf of, an individual to a complying superannuation fund, and are included as assessable income of the

to encourage individuals who are employees to apply for salary sacrifice- to make extra contributions to their superannuation funds pre-tax.⁶² In addition to receiving the concession, such contributions also reduce the employees' assessable income for the purposes of calculating their individual applicable marginal tax rate, as these amounts are removed from an individual's income pool before income tax is applied. Employees can also make further 'non-concessional' contributions to their superannuation funds. Generous non-concessional caps apply to encourage those individuals with greater than required disposable income to make further contributions to their superannuation fund from post-tax income.⁶³

Within the current Australian superannuation scheme, there are some tax expenditures available to low income earners. These tax

superannuation fund. See *Income Tax Assessment Act 1997* (Cth) ss 292-10 – 292-25. If the concessional contributions exceed the A\$25,000 per annum cap (or A\$50,000 per annum for individuals over 50 years in the 2011/2012 income tax year, or there is an account balance of A\$500,000 or less), the individual will be liable for tax on the excess at a rate of 31.5% *Income Tax Assessment Act 1997* (Cth) s 292-20. Excess concessional contributions tax is imposed under the *Superannuation (Excess Concessional Contributions Tax) Act 2007* (Cth). The total tax liability on excess contributions is 46.5%, as the superannuation fund is also obliged to pay tax at the rate of 15% on amounts received under the *Income Tax Assessment Act 1997* (Cth) s 295-160.

⁶² A salary sacrifice arrangement will exist where employees contract with their employer to give up part of their salary or remuneration that they would have ordinarily received as salary or wages. The effect is that they receive superannuation benefits of a similar value. See also Australian Taxation Office, *Employees Income Tax*, TR 2001/10, 10 October 2001: under certain conditions, superannuation contributions made by employers on behalf of employees under effective salary sacrifice arrangements are treated as deductible contributions for employers.

⁶³ The non-concessional contributions cap is six times the concessional contributions cap for the year: *Income Tax Assessment Act 1997* (Cth) s 292-85(2). For the 2010/2011 financial year, this amount is A\$150,000. Note, for taxpayers aged less than 65 years, the bring forward rule allows for the 'bringing forward' of two years' worth of entitlements over a three-year period: *Income Tax Assessment Act 1997* (Cth) s 292-85(3)–(4).

expenditures involve a government co-contribution scheme,⁶⁴ and a means-tested tax offset for contributions to spouse accounts.⁶⁵ There are also deductions available for contributions by the self-employed with the same tax rates that apply under the employee Superannuation Guarantee Scheme.⁶⁶

Additional tax expenditures also apply to encourage other forms of savings and individual asset building to reduce the reliance on the

⁶⁴ Eligible personal superannuation contributions are those made by individuals to a complying superannuation fund. The current eligibility thresholds for the government co-contribution scheme for the 2010/2011 income year range from the 'lower income threshold' of A\$31,920, to the 'higher income threshold' of A\$61,920. Where a taxpayer's total income falls below the lower income threshold, the Australian Government matches their personal superannuation contributions. For the 2010/11 income year, the government co-contribution is set at a maximum of A\$1000. See *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth) ('CCA') and its Regulations, *Superannuation (Government Co-contribution for Low Income Earners Regulations 2004* (Cth) ('CCR').

⁶⁵ For the 2010/2011 income year, where certain conditions are met and the total of a taxpayer's spouse's assessable income, reportable employer superannuation contributions and reportable fringe benefits is less than A\$13,800, a taxpayer may be entitled to a tax offset for contributions to a complying superannuation made on behalf of their spouse: *Income Tax Assessment Act 1997* (Cth) s 290-230(1)–(2). See also Australian Taxation Office, *Income Tax: Superannuation Contributions*, TR 2010/1, 8 December 2010. For the 2010/2011 income year, the tax offset is determined as 18% of the lesser of: (a) A\$3000, reduced by A\$1 for each A\$1 that the total of the spouse's assessable income, reportable employer superannuation contributions and reportable fringe benefits is over A\$10,800; or (b) the total of the spouse's contributions made in that year: *Income Tax Assessment Act 1997* (Cth) s 290-235.

⁶⁶ For self-employed taxpayers, contributions made to a complying superannuation fund will be deductible where conditions are met under *Income Tax Assessment Act 1997* (Cth) sub-div 290-C. For the 2010/2011 income year, deductible contributions are treated in the same manner as they are for employees. Concessional contributions are taxed as assessable income in the superannuation fund at 15%. Excess contributions tax will apply at the rate of 31.5% where the concessional contributions cap is exceeded. For taxpayers who are both self-employed and also earn income as an employee, where certain conditions are met, their personal contributions may still be deductible; in particular, only where 10% or less of the total of the taxpayer's assessable income, reportable employer superannuation contributions and reportable fringe benefits is associated with the taxpayer's activities as an 'employee': *Income Tax Assessment Act 1997* (Cth) s 290-160.

government Age Pension in the future. For example, 'Retirement Savings Accounts' ('RSAs') allow employers to make contributions on behalf of their employees to specified savings accounts (not a superannuation fund). These accounts are a lower cost and lower risk alternative to superannuation funds. Where certain conditions are met, tax expenditures apply for employers, employees and benefit payments equivalent to the taxation regime that applies to complying superannuation funds.⁶⁷

The Australian government acknowledges that investment in housing is the 'dominant form of saving in [many] Australian households'.⁶⁸ To promote and encourage such investment, the government provides additional tax expenditures to qualified individuals under the First Home Saver Accounts ('FHSAs') scheme.⁶⁹ This scheme allows for a government contribution that assists first homebuyers to save for a first home. Such 'buyers' are generally able to access a A\$7000 grant, plus an additional A\$13,000 first home bonus where certain conditions are met.⁷⁰ This scheme aims to encourage asset building for individuals by individuals. Any earnings on FHSAs are taxed to the FHSA providers at a rate of 15% and not the individual FHSA holders.⁷¹ Where a payment is made from a FHSA account to a superannuation account on behalf of an individual, the amount will be included as a non-concessional contribution⁷² on behalf of the individual and will not be assessable income of the recipient fund.⁷³ In addition, some tax expenditures are available in relation to owner-occupied housing, even

⁶⁷ *Income Tax Assessment Act 1997* (Cth) div 320.

⁶⁸ National Commission of Audit, 'National Commission of Audit Report' (Report, NCAR, 19 June 1996) pt 6.5.

⁶⁹ See *First Home Saver Accounts Act 2008* (Cth) ('FHSA') and *Income Tax (First Home Saver Accounts Misuse Tax) Act 2008* (Cth).

⁷⁰ See State Revenue Office, *Overview* (16 January 2012) State Government Victoria <<http://www.sro.vic.gov.au/sro/SROnav.nsf/alltitle/First%20Home%20Owners?open>>.

⁷¹ *Income Tax Assessment Act 1997* (Cth) s 345-50(1).

⁷² *Income Tax Assessment Act 1997* (Cth) s 292-90.

⁷³ *Income Tax Assessment Act 1997* (Cth) s 295-171.

where they are not 'first homes'.⁷⁴ Other tax expenditures and capital gains tax exemptions also apply on gains 'arising from the sale of active small business assets ... up to a life-time limit of A\$500,000 where the proceeds of sale are used for retirement'.⁷⁵

The regime of tax expenditures has inequitable outcomes for some classes of individuals. The regime lacks efficiency and effectiveness in achieving the Australian government's underlying retirement policy goal in this area – to encourage investment in individuals' private savings for their own retirement. These arguments are set out in Part 3 below.

PART 3: CONCEPTS OF FAIRNESS, EQUITY, EFFICIENCY AND EFFECTIVENESS

Perceptions of the fairness and efficiency outcomes of retirement income 'arrangements are important if voluntary and compulsory savings through superannuation and the government's retirement income strategy are to have the confidence and support of the community'.⁷⁶ Do government-provided incentives in the form of tax expenditures, in so far as they relate to encouraging private savings for retirement, operate in a fair and efficient manner?

I DO TAX EXPENDITURES APPLY 'FAIRLY'?

Whether the application of tax expenditures to encourage private investment for retirement operates 'fairly' or 'unfairly' depends on

⁷⁴ See, eg, *Income Tax Assessment Act 1997* (Cth) sub-div 118-B: a capital gains tax exemption will apply if the home is classified as a 'home residence'.

⁷⁵ Smith, above n 13, 31. See also *Income Tax Assessment Act 1997* (Cth) sub-div 152-D: where certain conditions are met, a 'small business taxpayer' or 'entity' may be able to choose to disregard a capital gain from a capital gains tax event happening to an asset of the small business, where the capital proceeds are used in connection with the retirement of the small business individual.

⁷⁶ Clare, above n 7.

how it applies across socioeconomic classes of individuals. Fairness and equity are difficult concepts in relation to taxation. Fairness can be viewed in terms of horizontal fairness (taxpayers with the same income pay the same amount of tax), and vertical fairness (taxpayers with higher income pay more tax than those with lower incomes). Tax expenditures lessen the tax burden on targeted taxpayers or activities. Selected favourable tax treatment narrows the tax base at odds with the Commonwealth Governments focus on tax reforms including the lowering of taxes.⁷⁷ One of the non-revenue objectives of using tax expenditures applicable to superannuation investment by taxpayers is to mould and manipulate pension policy. This can 'hamper effective tax administration and enforcement',⁷⁸ and the promotion of unethical behaviour can occur.⁷⁹

The Commonwealth Treasury measures tax expenditures on a 'revenue forgone' approach. This approach:

Gauge[s] the magnitude of tax expenditures arising from a particular tax concession by reference only to the market for the particular commodity or activity in isolation ... It [however] ... ignores any product/factor market interactions or macroeconomic implications.⁸⁰

While the various tax expenditures are available to everyone, they apply in an unfair manner, because the framework views equity at the

⁷⁷ Ken Messere, *Tax Policy in OECD Countries: Choices and Conflicts* (IBFD Publications BV, 1993).

⁷⁸ Julie Smith, 'Tax Expenditure: the \$30 Billion Twilight Zone of Government Spending' (Research Paper No 8, Economics, Commerce and Industrial Relations Group, 26 May 2003).

⁷⁹ Alan Kohler, 'Tax lurks and brass tacks' *Australian Financial Review* (Australia), 18 April 2000, 16.

⁸⁰ Julie Smith, 'Tax Expenditures and public health financing in Australia' (Discussion Paper No 33, The Australian Institute, September 2000) 4.

input stage and not at the actual outcome when it really matters – at retirement.⁸¹

When examining the retirement funds available for all individuals at retirement, it is apparent that this approach does not result in a fair or equitable outcome.

A *Benefiting the rich*

Australia has a 'burgeoning system of middle-class welfare'⁸² fanned largely by tax expenditures which have been characterised as 'handouts to people who are far from poor'.⁸³ It is generally accepted that middle to high-income earners in Australia are the main beneficiaries of tax expenditures. This is largely because the common design of tax expenditures 'such as flat rate rebates, concessional tax rates and tax exemptions – benefit those with greater purchasing power'.⁸⁴ For example, in the 2005-2006 financial year it was estimated that:

5 per cent of individuals accounted for over 37 per cent of concessional superannuation contributions. These 5 per cent of individuals have higher salaries with the subsequent superannuation guarantee contribution being larger, and they have greater capacity for voluntary contributions. These taxpayers are also likely to receive greater benefits from the concessions which apply to earnings as they have a larger pool of assets to which these concessions apply.⁸⁵

⁸¹ Sadiq agrees with this sentiment, above n 27, 10.

⁸² Adam Stebbing, 'A war on the middle class? Middle class welfare and the 2011-12 Budget' (June 2011) *Australian Review of Public Affairs* <<http://www.australianreview.net/digest/2011/06/stebbing.html>>.

⁸³ Smith, above n 13, 1.

⁸⁴ Stebbing, above n 83.

⁸⁵ Sadiq, above n 27, 11.

Many of the tax expenditures available are of greater benefit to those individuals on higher personal tax rates. According to Spies-Butcher and Stebbing, taxpayers in the marginal tax bracket of 15% or less (ie, those who were earning less than A\$35,000 in the 2008/2009 income year) received no assistance. Those in the top income bracket (those earning over A\$180,000 in the 2008/2009 income year) received, on average, more than A\$11,000 per annum in expenditures.⁸⁶ For taxpayers who earned over A\$180,000, which in Australia is still currently the top marginal tax bracket, the concession was equivalent to a rebate of 31.5%.

The Treasury's subsequent analysis shows the tax expenditure on superannuation savings for the 2009-10 financial year, had an average value of A\$900 per person overall. However, the average for the top 1% of income earners was A\$10,600.⁸⁷ When examining the 'level of support provided by the age pension and superannuation combined', it is those persons in the lower income brackets who receive the highest age pension support. Whereas it is those persons who fall within the higher income brackets who receive higher superannuation tax concessions support. The Treasury also notes that, 'total combined support starts to increase clearly for the top 10 per cent of income earners ...[where] the top 1 per cent of income earners receive the most combined support'.⁸⁸ Treasury figures indicate that around 90% of

⁸⁶ Ben Spies-Butcher and Adam Stebbing, 'Reforming Australia's Hidden Welfare State: Tax Expenditures as Welfare for the Rich' (Occasional Papers No 6, Centre for Policy Development, February 2009) 3.

⁸⁷ The Treasury, 'Australian Government, Distributional Analysis of Superannuation Taxation Concessions, (as presented to the superannuation roundtable of 23 April 2012)' (April 2012) <<http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/Superannuation-Roundtable/Distributional-analysis-of-superannuation-taxation-concessions>>. This paper also notes that 'The analysis does not include many 2012 Budget measures which reduced concessions on contributions for very high income earners'.

⁸⁸ *Ibid* see Figure 2. Figure 2 examines total government retirement support for males. It combines age pension support and tax concession support and measures this in dollars over a person's lifetime.

'male' earners can expect around A\$250,000 - A\$270,000 in total retirement support. 'Male' earners who fall in the top 10% however can expect retirement support to lie between A\$330,000 and A\$520,000.⁸⁹

In relation to voluntary superannuation savings, the current system also does not apply equitably across taxpayers. Despite caps existing on the amounts that can be invested in superannuation, middle to high-income earners, with more disposable income, have the financial ability to make greater voluntary contributions. As a result, higher income earners are able to manipulate the tax system and use it as a mechanism to build wealth, by accumulating in their superannuation funds amounts far in excess of what they require for retirement.

B Disadvantaging low income individuals

The design of the Superannuation Guarantee Scheme is also disadvantageous to those on low incomes because:

The key feature of the Superannuation Guarantee is that it is a defined contributions scheme rather than a defined benefits scheme and, as such, the level of benefit is dependent on an employee's salary or wages, the period in the workforce, and the returns on investment.⁹⁰

The lower the income and the more broken work periods an individual experiences, the higher the negative effect on their retirement income. In addition, the Superannuation Guarantee, which is theoretically imposed on the employer, can be passed on to the employee in the form of 'lower take home remuneration'.⁹¹ The effect being - the individual will have a lower disposable income. The impact of this would be more readily felt by low-income individuals. The Superannuation Guarantee scheme is also disadvantageous to those

⁸⁹ Ibid.

⁹⁰ Sadiq, above n 27, 9.

⁹¹ Ibid.

who rely on not only 'normal time salary' but also bonuses and overtime. For example, the current Superannuation Guarantee requires employers to contribute an amount equivalent to 9% of an employee's 'normal time salary' into a complying superannuation fund. Overtime and bonuses paid to an employee are not included in calculating compulsory contributions. Consequently, those employees who work substantial overtime will only receive compulsory contributions equal to 9% of their 'normal time salary' and not of the actual salary received. Also problematic for low-income workers is the current Superannuation Guarantee income threshold of A\$450 per month. Those employees who are on a 'normal time salary' of A\$450 per month or less will not benefit at all from the employer provided 9% Superannuation Guarantee contribution.⁹² Nor will those individuals who are not defined as 'employees'. Whether an individual is considered an 'employee' for the purposes of the Superannuation Guarantee is a question of fact.⁹³ There may be scope for some employers to avoid their obligation to make contributions for individuals all together where they can identify them not as employees but rather as independent contractors.⁹⁴

The effect of the Australian government's initiative of the FHSA's (as discussed above) further highlights the divide between high and low-income earners. The FHSA is a superannuation style investment account designed to help individuals to maximise savings through various tax breaks and government contributions. Earnings on these accounts are 'concessionally taxed at 15% and the government pays a

⁹² *Superannuation Guarantee (Administration) Act 1992* (Cth) s 27.

⁹³ See Australian Taxation Office, *Superannuation guarantee: who is an employee*, SGR 2005/1, 23 February 2005, paras 31–61, for an outline of the key factors that must be considered when determining if an individual is an employee or an independent contractor.

⁹⁴ This issue was considered by the Federal Court of Australia in *On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation (No 3)* [2011] FCA 366. The ATO was successful in its bid to address businesses claiming their labour structure was that of Principal/Independent Contractor and not Employer/Employee, and thus, inter alia, avoiding their obligations under the Superannuation Guarantee scheme.

flat rate co-contribution of 17% on the first A\$5,500 or part thereof, saved in any one year. Government contributions are tax free'.⁹⁵ Where funds in the account are not utilised for the purpose of purchasing a property or land on which to build a property, these funds must be transferred to a superannuation fund.⁹⁶ As with the superannuation expenditures, the expenditures that apply to this account, once again, will be more beneficial to middle and high income earners than to low income earners. Higher income earners are more likely to have the capacity to deposit funds to the maximum amount entitling them to a government contribution of A\$935.00 per year.⁹⁷ Greater deposits enhanced by the greater government contribution equate to higher returns on which the concessional tax rate of 15% is paid.

C *Gender Inequities*

Incentives that are provided under the current Australian superannuation scheme assume that an individual is in full time work. The greater the salary, the greater the incentives.⁹⁸ It is argued that this approach has 'resulted in men receiving greater benefits than women'.⁹⁹ A number of underlying reasons for this have been put forward. Women tend to experience more broken work patterns, receive relatively lower wages and have greater responsibility for unpaid work compared to men, and are therefore less likely to accumulate superannuation assets.¹⁰⁰

⁹⁵ *First Home Saver, How Does it Work?* (7 June 2011) <<http://www.firsthomesaver.com.au/facts/how-does-it-work>>.

⁹⁶ A payment made to a complying superannuation fund is not assessable income of the fund: *Income Tax Assessment Act 1997* (Cth) s295-171; *First Home Savers Accounts Act 2008* (Cth) ss 22, 34.

⁹⁷ *First Home Saver*, above n 95.

⁹⁸ Sadiq agrees with this observation, noting the incentives are 'based upon a normal taxpayer being a fulltime, lifetime, working male', above n 27, 10.

⁹⁹ Sadiq, above n 27, 10.

¹⁰⁰ *Ibid.*

It has been estimated that, in total, women will only accrue about half the superannuation retirement benefit of men, because of the differences in workforce participation and average earning levels.¹⁰¹ For example, it has been estimated that female baby boomers will,¹⁰² over their lifespan, spend '35% less time in paid employment than their male counterparts'.¹⁰³ This figure will be reflected in these women's earnings-based retirement incomes by a similar amount.¹⁰⁴ Disparities between male and female salaries also contribute to retirement savings inequities. Women are generally employed in lower paid occupations and industry sectors. Indeed, traditionally low-paying industries such as child care, nursing and teaching predominantly employ women.¹⁰⁵ Despite Australia having a female Prime Minister since mid-2010, 'women still earn just 84% of their male counterparts, according to the Australian Bureau of Statistics'.¹⁰⁶

D *The Self-Employed*

The self-employed in Australia, who represent 12% of the Australian population, are treated unfairly under the Australian superannuation scheme, since they are not included in the Superannuation Guarantee Scheme.¹⁰⁷ While the self-employed 'may voluntarily save for retirement',¹⁰⁸ and by doing so would be entitled to the tax expenditures given through the 'deduction for contributions at the

¹⁰¹ Alison Preston and Therese Jefferson, 'Australia's "Other" Gender Wage Gap: Baby Boomers and Compulsory Superannuation Accounts' (2005) 11 *Feminist Economics* 79, 95.

¹⁰² According to the Australian Government, 'baby boomers' are those persons born between 1946–1961: About Australia, *Baby boomers* (2 December 2007) Australian Government <<http://australia.gov.au/about-australia/australian-story/baby-boomers>>.

¹⁰³ Preston and Jefferson, above n 101.

¹⁰⁴ Ibid.

¹⁰⁵ Sadiq, above n 27, 10.

¹⁰⁶ Cassie White, 'Mind the gap: women still chasing pay equality', *ABC News* (online), 8 March 2011 <<http://www.abc.net.au/news/2011-03-08/mind-the-gap-women-still-chasing-pay-equality/2666164>>.

¹⁰⁷ Sadiq, above n 27, 12.

¹⁰⁸ Ibid.

concessional tax rate of 15% on contributions and earnings ... their decisions [to do so] will [nonetheless] be influenced by factors such as earnings and capital flow'.¹⁰⁹ If a self-employed individual is not financially secure, they would be less likely to make additional contributions for their retirement. In addition, 'while there are tax expenditures upon the sale of a business [or business assets as discussed above] these may not benefit those self-employed who have minimal business assets to finance their retirement.'¹¹⁰ Disparities will be evident when they retire and it is possible that such individuals may have significantly lower retirement investment savings than a person working as an employee on a high salary, who had worked full time for most of their working lives.

E *Other disadvantaged individuals*

Other individuals who may not obtain the full benefit of the tax expenditures under the current superannuation scheme are those 'individuals with broken work patterns (intermittent workers, carers and individuals with disabilities), [and] those with income of less than A\$450 per month [as noted above]'.¹¹¹

Not only are there inequities that arise from the use of tax expenditures to encourage individuals to privately invest in their own retirement, their effectiveness in achieving the government's objective is also questionable.

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

¹¹¹ The Treasury, above n 31, 16.

PART 4: THE INEFFECTIVENESS OF TAX EXPENDITURE

Effective can be defined as 'serving to effect the purpose; producing the intended or expected result'.¹¹² To reiterate, the government's purpose in using tax expenditures in retirement policy applications is predominantly to encourage individuals to save for their own retirement. A number of explanations can be given as to why tax expenditures when used to encourage private investment in superannuation are not effective. These include:

- The expectation of most Australians that they will be provided for by the government in their retirement and old age;
- The defeating costs of management of superannuation funds, global economic factors and the disparity between the financially literate and illiterate;
- The ability to utilise the tax expenditures to dissipate savings prior to or early into retirement; and
- The increasing costs to government in lost revenue in supporting tax expenditures together with the cost of direct spending on the Age Pension.

I AN ENTITLEMENT MENTALITY: THE EXPECTATION OF GOVERNMENT ASSISTANCE

Relying on the Age Pension, even though means-tested, can result in people saving less or not at all.¹¹³ The current level of income support, predominantly available via the Age Pension to a vast number of Australians ranging from the low-income earners to the middle and even high-income earners, is 'likely to cultivate expectations as to the availability and generosity of [the] government'.¹¹⁴ Such expectations can reduce the incentive to save for retirement, in order to ensure

¹¹² *The Macquarie Australian Encyclopaedic Dictionary* (Macquarie Dictionary Publishers, 2006) 1300.

¹¹³ The Treasury, above n 31.

¹¹⁴ National Commission of Audit, above n 69, 6.3.

eligibility for the Age Pension at retirement age. These expectations result in an entitlement approach to the Age Pension, as identified by the National Commission of Audit Report:¹¹⁵

one aspect of the expectations problem, known as the 'invisible debt' problem, arises when current taxpayers regard themselves as having earned entitlements to assistance due to their support of already retired generations through the existing system. This perceived right to a 'claw back' can itself be a motive for individuals to arrange their affairs so as to maintain eligibility for government support and avoid saving.¹¹⁶

The reality is that a large proportion of Australians view the taxes they have paid during their working life as their personal superannuation fund. They seem to forget that these taxes have been used to provide services and infrastructure which have been utilised by all taxpayers during their lifetime; for example, health services, education, roads and child care assistance, to name a few. It is this attitude and the understanding that too much savings will 'reduce or eliminate their eligibility for the age pension and related benefits'¹¹⁷ that arguably prompts people either not to save or to dissipate their savings prior to or early into retirement, so that they are eligible at retirement age for the Age Pension.

Most problematic are the 'means-testing criteria' used for the Age Pension. The Age Pension is means-tested, where the capital an individual has already accrued is used as a basis for allocation. Nevertheless, this capital does not include the family home. Since the family home is not considered an asset for the purpose of means-tested eligibility for the Age Pension, this can allow individuals to reduce retirement savings by simply upgrading the family home. In doing so, they can still fall within eligibility criteria for the Age Pension. In

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ibid 6.5.

addition, what arguably makes the Age Pension even more valuable and creates an even greater disincentive to privately save for retirement, is the range of associated concessions which are not affected by the level of pension received. These concessions include 'subsidised pharmaceutical benefits, hearing aids and a range of state government-provided concessions (for example, concessional housing and transport)'.¹¹⁸

II THE COST OF MANAGING SUPERANNUATION FUNDS AND THE DISPARITY BETWEEN THE FINANCIALLY LITERATE AND ILLITERATE

Managing superannuation funds is a costly exercise. These costs impact on the effectiveness of the superannuation system as a whole. Under the current compulsory superannuation scheme, the bulk of superannuation contributions are paid on behalf of employees into managed superannuation funds¹¹⁹ where the fund managers charge administration fees. Fund managers are currently estimated to receive fees of approximately A\$18 billion a year.¹²⁰ These fees will increase substantially with the move to 12% compulsory Superannuation Guarantee contributions by 2019,¹²¹ and will amount to an even further substantial collective loss in savings for the average income earner. Added to these costs is also the recent poor performance of the funds themselves. For example, the Australian Prudential Regulation Authority noted that the 'average nominal annual super fund return over the ten years to 30 June 2011 was ... [only] 3.3 per cent'.¹²² As Toohey notes:

¹¹⁸ Ibid.

¹¹⁹ Brian Toohey, 'Compulsory Superannuation: A Policy in Search of Evidence', *Inside Story* (online), 3 February 2011 <<http://inside.org.au/compulsory-superannuation-a-policy-in-search-of-evidence/>>.

¹²⁰ Ibid.

¹²¹ Ibid.

¹²² Ibid.

[G]iven that the average annual increase in the CPI over that period was 3.2 per cent returns only beat inflation by the slimmest of margins. Australians would have been better off putting their money into government bonds and term deposits, or reducing their mortgage, or upgrading their educational qualifications or those of their children.¹²³

These figures, both the return to fund managers and the nominal investment return, do little to enhance savings and can impact upon the incentive to the average income earner to make additional voluntary contributions to superannuation. In fact, it can be argued that the tax expenditures applicable to superannuation funds are probably 'eaten up' by management fees and poor returns, thereby making them almost completely ineffective.

Whilst the government provides income tax expenditures for both the Superannuation Guarantee and voluntary superannuation contributions, under such regimes it is the individual who carries the greater opportunity of higher returns and the greater risk, than under the retirement income which is government funded.¹²⁴ Risks the individual carries are associated with investment, inflation and longevity.¹²⁵ These risks are exaggerated where an individual is financially illiterate. It was noted in the Super System Review ('Cooper Review'),¹²⁶ although a system should facilitate active choices, it still needs to provide optimal results for those individuals who are not interested or who are not financially literate.¹²⁷ The Cooper Review recommended that no commissions be paid for any of the products within superannuation.¹²⁸ The Cooper Review also explained that the

¹²³ Ibid.

¹²⁴ The Treasury, above n 31.

¹²⁵ Ibid.

¹²⁶ *Super System Review, Final Report – Part One: Overview and Recommendations* (2010) <http://www.supersystemreview.gov.au/content/downloads/final_report/part_one/Final_Report_Part_1_Consolidated.pdf> ('Cooper Review').

¹²⁷ Ibid 1.

¹²⁸ Ibid 2.

current Australian superannuation system is ambiguous, as to the role of the trustee and degree of responsibility, to look after the member for those that do make active choices about their account.¹²⁹ In order to readdress this issue, the Cooper Review recommended that the superannuation industry standardise performance and product reporting so those who do wish to make active choices can make an accurate comparison of the available options.¹³⁰ Access to information and levels of financial literacy of members are important issues that need addressing. For example, a study of the retirement saving habits of just over 6000 Europeans found that financial literacy and a higher level of income have a positive correlation with the likelihood one will save for retirement.¹³¹

III DISSIPATING SAVINGS PRIOR TO RETIREMENT

Current arrangements under the voluntary superannuation contributions scheme allows contributors to sacrifice a portion of their salary into their superannuation fund, subject to certain cap limits. Some superannuation contributors over the age of 55 years are able to access some of their superannuation benefits early (prior to retirement age of 60) whilst still in employment.¹³² Under the 'Decision to start a transition-to-retirement pension' ('TRIP'), some superannuation contributors are able to access a portion of their superannuation funds prior to retirement as a non-commutable income stream. TRIPs are

¹²⁹ Ibid 6.

¹³⁰ Ibid 2.

¹³¹ Sara Fernandez-Lopez et al, 'What are the Driving Forces of Individuals' Retirement Savings?' (2010) 60 *Czech Journal of Economics and Finance* 3, 248.

¹³² A contributor's benefits in a superannuation fund can consist of 'preserved benefits', 'restricted non-preserved benefits' and 'unrestricted non-preserved benefits'. If certain conditions are met, only preserved and restricted non-preserved benefits can be 'cashed' in. Unrestricted non-preserved benefits will not be taxed at concessional rates, but will be taxed in the hand of the member as ordinary income at their own marginal tax rate: *Superannuation Industry (Supervision) Regulations 1994* (Cth) sch 1.

generally encouraged via the use of tax expenditures. As Power comments:

[A]lthough some individuals use TRIPs for a gradual transition into retirement, the majority of TRIPpers use the strategy for boosting super savings and tax minimisation ... One of the more popular TRIP strategies is to salary sacrifice into your super fund up to your concessional (before-tax) contributions cap, and replace that income with tax-free (if over 60) or concessional tax pension payments (if under 60).¹³³

Despite a withdrawal limit of 10% of a superannuation account balance per annum under this arrangement, this 'cashing in' of benefits over a sustained period of time can have a substantial diminishing effect on an individual's superannuation fund. This type of arrangement can 'allow individuals to use superannuation benefits to withdraw early from the labour force and rely later on the pension'.¹³⁴ Not only has the government lost substantial income on the amount sacrificed, it will lose again when the individual requires increased government support. The National Commission of Audit, in its independent review of public spending in 1996, commented that such an arrangement 'produces a direct loss to national welfare through lost production and also encourages dissipation of benefits prior to the individual reaching pensionable age'.¹³⁵

The ineffectiveness of tax expenditures as a means of enhancing savings for use in retirement, reducing the reliance on the Aged Pension, begins to become apparent.

¹³³ Trish Power, *Transition-to-retirement pension: How does a TRIP work?* (22 February 2011) Super Guide <<http://www.superguide.com.au/boost-your-superannuation/transition-to-retirement-pension-how-does-a-trip-work>>.

¹³⁴ National Commission of Audit, above n 69, 6.4.

¹³⁵ National Commission of Audit, above n 69, 6.1.

IV COST TO THE GOVERNMENT IN SUPPORTING BOTH THE AGE PENSION AND SUPERANNUATION

Currently, the Australian government supports the provision of an Age Pension and uses tax expenditures to encourage superannuation savings by individuals.¹³⁶ If current trends continue, the costs associated in supporting both schemes will be a significant burden on the government. According to the Australian Government's Final Budget Outcome 2010-11, the provision of the Age Pension for the 2010-11 period, measured as direct expenditure, was over A\$44 billion, representing more than 12% of all direct expenditures for the period.¹³⁷ According to the Budget Report 2012-13, this figure is projected to rise to over A\$57 billion for the 2014-15 period.¹³⁸

According to The Treasury's 2011 Tax Expenditures Statement, the overall cost of superannuation tax expenditures was estimated to be over A\$27 billion for the 2010-2011 year, projected to rise to over A\$40 billion in 2014-2015.¹³⁹ According to the Statement, 'in dollar terms, total measured tax expenditures in 2010-11 are estimated at around A\$112 billion and ...superannuation tax expenditures comprise around a quarter of total measured tax expenditures'.¹⁴⁰ The cost of the superannuation tax expenditures is likely to rise even further as the increase in compulsory contribution from 9% to 12% takes effect, with

¹³⁶ See The Treasury, above n 10, 13. Whilst the cost of providing the Age Pension can be measured as a direct expenditure, measuring the costs/ revenue foregone in providing tax expenditures to encourage private savings for retirement is more problematic. 'Tax expenditures are ...an alternative to direct expenditures and ...[also] have an impact on the budget position... [They] do not [however] include the impact of the exercise of administrative discretion or the impact of taxpayer non-compliance with the tax law'. Indeed, the Australian Treasury measures tax expenditures on a 'revenue foregone' approach. This 'calculates the benefits to the taxpayer of the tax provisions concerned, measured relative to a non-concessional tax benchmark, rather than in terms of the budgetary costs of those provisions'.

¹³⁷ Australian Government, above n 35.

¹³⁸ Ibid 6-55.

¹³⁹ The Treasury, above n 138.

¹⁴⁰ Ibid ch 1, 3.

full implementation by the year 2019-20. In this regard, Toohey comments:

The increase in super contributions to 12% is likely to cost the budget at least A\$8 billion a year when fully implemented in 2019. Even before then, the combined budgetary cost of the age pension and the super tax concessions is likely to hit an annual A\$100 billion.¹⁴¹

A *Household savings and superannuation*

The impact that superannuation has on household savings is also important. As household savings are 'critical to the effectiveness of superannuation in achieving its main policy goals of increasing both provisioning for individual retirement and raising aggregate national saving'.¹⁴² Since,

Superannuation expenditures involve a direct loss to national saving through revenue cost to government ...[they must] be justified by a greater increase in private household saving which would also enable reductions in future pension outlays.¹⁴³

According to The Treasury, household savings ratios fell in the early 1970s from a peak of 18.5 % of net household disposable income to around 3% over the course of the 1990s.¹⁴⁴ The Budget Report 2012-13 notes that this decline continued into the mid-2000s, but a turnaround was noted in the 'second half of 2000s, [where] the gross household

¹⁴¹ Brian Toohey, 'Compulsory Superannuation: A Policy in Search of Evidence', *Inside Story* (online), 3 February 2011 <<http://inside.org.au/compulsory-superannuation-a-policy-in-search-of-evidence/>>.

¹⁴² National Commission of Audit, above n 69, 6.5.

¹⁴³ *Ibid.*

¹⁴⁴ The Treasury, 'The Measurement of Saving in Australia' (1999) 3 *Economic Round-up* 21.

saving rate increased significantly and is currently 11.5 % of GDP, up from a low 5.8 % in 2002-03'.¹⁴⁵

Despite assertions made in the Budget Report 2012-13 that 'the compulsory superannuation system has made an important contribution to household saving since it began to be phased in in the mid-1980s',¹⁴⁶ the net impact of the policies on 'overall household savings ... is [still] unclear'.¹⁴⁷ In 2011, it was argued that 'the budget papers estimate that lifting compulsory contributions to 12 per cent of salaries will add a tiny 0.4 per cent to national saving by 2035'.¹⁴⁸ The Budget Report of 2012-13 also indicated that this increase in the Superannuation Guarantee 'in conjunction with the maturing of the existing superannuation system, is projected to [only] add 1.5 per cent of GDP to national savings over the next 25 years'.¹⁴⁹ In addition, the Budget Report 2012-13 indicates that with respect to voluntary retirement savings, the government is to defer 'the higher concessional contribution caps for individuals over 50 with superannuation balances below A\$500,000 to 1 July 2014, which was due to start on 1 July 2012'.¹⁵⁰ The original objective of this change in retirement policy was to encourage individuals approaching retirement with minimal savings to drastically increase their balances.¹⁵¹ Its deferral leaves superannuation policy and its effect on overall household savings uncertain.

¹⁴⁵ Australian Government, above n 35, 4–6.

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

¹⁴⁸ Toohey, above n 119.

¹⁴⁹ Australian Government, above n 35, 4–9.

¹⁵⁰ Ibid 3–11.

¹⁵¹ Figot and Butler, above n 25.

PART 5: REFORMS

Whilst the Age Pension has largely remained the same for the past century, the concept of superannuation has evolved from,

beginning as a benefit available to a small group of salaried employees. After spreading gradually among white-collar employees, superannuation became more widely available in the 1970s through negotiation on its inclusion in industrial awards.¹⁵²

The introduction of the Productivity Award Superannuation and the Superannuation Guarantee Schemes further accelerated the expansion of the Australian superannuation system.¹⁵³ In 2007, a major overhaul of the Australian superannuation system was made. In July 2007 a more simplified superannuation system was introduced, rewriting the superannuation rules from the *Income Tax Assessment Act 1936 (Cth)*¹⁵⁴ into the new *Income Tax Assessment Act 1997 (Cth)*.¹⁵⁵ According to the Explanatory Memorandum:

[T]he Government is sweeping away the current raft of complex tax arrangements and restrictions that apply to superannuation benefits. This will improve retirement incomes and increase incentives to work and save.¹⁵⁶

Some of the improvements of this new 'Simplified Superannuation' system of 2007 included making superannuation benefits paid out of a taxed fund tax free to those persons over 60 years of age. Previously, these benefits were taxed at different rates, depending on factors such as whether the benefits were lump sum benefits or income streams.

¹⁵² The Treasury, 'Towards Higher Retirement Incomes for Australians: A History of the Australian Retirement Income System Since Federation' (2001) 4 *Economic Round-up* 65.

¹⁵³ Ibid.

¹⁵⁴ *Income Tax Assessment Act 1936 (Cth)* ('ITAA36').

¹⁵⁵ *Income Tax Assessment Act 1997 (Cth)* ('ITAA97').

¹⁵⁶ Explanatory Memorandum, Tax Laws Amendment (Simplified Superannuation) Bill 2007 (Cth).

There was also a lowering of the tax paid on superannuation benefits paid from untaxed funds for persons aged 60 and over.¹⁵⁷ The 2007 reforms also abolished the 'Reasonable Benefits Limit' ('RBL'), to make investment in superannuation funds more certain and clear. The old RBL rules limited the amount of concessional tax benefits a taxpayer could receive from the superannuation funds. The new rules instead provided for certain excess contributions to be subject to additional taxes. This was introduced to combat abuse of the system. The new rules also allowed complying superannuation funds to access tax expenditures. For example, superannuation plans are generally subject to a concessional rate of tax of 15% on their earnings. In relation to events/transactions involving capital assets of a complying fund, superannuation funds could now also benefit from a one-third discount on their capital gains under the Capital Gains Tax regime.¹⁵⁸

The reforms of 2007 were made so that inter alia, retirees and those aged over 60 could deal with a simpler system when deciding on how to draw on superannuation. This would diminish the disparity between the financially literate and illiterate. It was assumed that making withdrawals tax exempt for those over 60, would address concern over whether income streams were complying or non-complying ones for tax purposes. The changes were also made to remove disincentives for people to continue with work while drawing on superannuation, to reduce financial advice costs, encourage an increase in retirement income and to ensure equity when dealing with the self-employed.

In 2010, further recommendations were made for reform to the Australian superannuation scheme. As part of the 'Australia's future tax system' report, also known as the 'Henry Review' released in early 2010, a number of recommendations for further reform in relation to

¹⁵⁷ *Income Tax Assessment Act 1997* (Cth) s 280-5.

¹⁵⁸ *Income Tax Assessment Act 1997* (Cth) s 295-85.

retirement income policy in particular to the Australian superannuation scheme were made.¹⁵⁹ The 'Cooper Review', published in June 2010, also made a similar series of recommendations for reform of Australian superannuation.¹⁶⁰

To date, only a small percentage of the recommendations made in both reports have been adopted by the Australian government. Most were either rejected outright or deferred for consideration at a later date. Of the small number of reforms that were proposed and implemented, they do not go far enough and even exacerbate the existing inequities present in the Australian retirement savings system, which further disadvantages many taxpayers in their retirement years. An examination is made of both the 'Henry Review' and 'Cooper Review' recommendations below.

I THE HENRY REVIEW

On 2 May 2010, the Australian government released the 'Henry Review' of Australia's future tax system. 138 recommendations were made in total, grouped under nine broad themes. One of which was addressing retirement income reform and securing aged care.¹⁶¹ Whether the current superannuation and retirement planning scheme in Australia was the most beneficial way of establishing maximum individual savings for retirement was in question.¹⁶²

¹⁵⁹ *Australia's Future Tax System Review Panel, Final Report* (Report, Australian Government, 2010) ('Henry Review').

¹⁶⁰ Super System Review, above n 126.

¹⁶¹ Figot and Butler, above n 25.

¹⁶² Chelsea Mes, 'The Henry Review: what it means for you', *news.com.au* (online), 3 May 2010 <<http://www.news.com.au/money/money-matters/the-henry-tax-review-what-it-means-for-you/story-e6frfmd9-1225861163137>>.

Based on the projection that by 2050, 23% of Australia's population will be over the age of 65,¹⁶³ the Henry Review made a number of recommendations with regard to Australia's retirement policy, rather than adopting a 'wait-and-see' approach.¹⁶⁴ The Henry Review recommended that superannuation contributions at the fund level should not be taxed.¹⁶⁵ To address equity issues, the Henry Review also proposed that the employer contributions be viewed in the same light as an employee's income and as a result, be 'taxed at the employee's marginal rate and receive a flat rate refundable tax offset'.¹⁶⁶ The offset would be applicable to contributions up to an annual cap (the suggested cap was A\$25,000 subject to indexation) and the rate of rebate would result in most taxpayers paying a maximum of 15% tax on their superannuation contributions.¹⁶⁷ The suggestions made (which were not adopted) by the Henry Review had much merit and could have been utilised to create a fairer system regarding retirement savings. Rebates would apply equally amongst taxpayers, however those on higher salaries would pay a higher contributions tax.

The *Review* also suggested halving the complying superannuation tax rate from 15% to 7.5%, although this was combined with the recommendation that the pension exemption and fund level be abolished.¹⁶⁸ This was not adopted by the Australian government. This approach could have addressed some of the inefficiencies apparent within the funds themselves by increasing investment funds available for growth. By not taking on board the recommendations, another opportunity for reform has been lost.

¹⁶³ Hazel Bateman and Geoffrey Kingston, 'The Henry Review and Super Saving' (2010) 43 *The Australian Economic Review* 4, 437–48.

¹⁶⁴ *Ibid* 439.

¹⁶⁵ Australia's Future Tax System Review Panel, above n 158, 85.

¹⁶⁶ *Ibid*.

¹⁶⁷ *Ibid*.

¹⁶⁸ *Ibid*.

II THE COOPER REVIEW

The Cooper Review was also commissioned by the Australian government in 2009 to establish a series of recommendations to further strengthen Australia's retirement savings scheme and to make superannuation more equitable.¹⁶⁹ It operated alongside the Henry Review with a focus on superannuation.¹⁷⁰ Whilst a number of recommendations were made by the Cooper Review, the key recommendation revolved around 'MySuper.' 'MySuper' was designed to be a default designated fund for all taxpayers unless the taxpayer nominated another fund. The objective of 'MySuper' was to lower superannuation fees for a proposed 80% of employees in order for them to save up to A\$40,000 extra for retirement.¹⁷¹

III CHANGES ADOPTED

The Australian government indicated that it would not make any changes to the level of tax expenditures currently in place.¹⁷² Nevertheless, a number of other changes made subsequent to both Reviews indicate that the Australian government recognises some of the inequities and inefficiencies created under the current approach to its retirement policies, in particular with respect to superannuation.

Interestingly, one government response to the Henry Review voiced an intention to increase the Superannuation Guarantee rate to 12%, from its current rate of 9% (starting from 2013, and continuing with gradual increases until 2020), despite this not being a recommendation made in

¹⁶⁹ Super System Review, above n 126.

¹⁷⁰ Graeme Howatson and Randal Dennings, 'Cooper Review Recommends Major Changes to Super' (2010) 26(2) *Australian Banking and Finance Bulletin* 8.

¹⁷¹ Peter Ryan, 'Cooper super review urges sweeping changes', *ABC News (Online)*, 5 July 2010 <<http://www.abc.net.au/news/2010-07-05/cooper-super-review-urges-sweeping-changes/892860>>.

¹⁷² Figot and Butler, above n 25.

the Review.¹⁷³ This intention does follow a number of submissions that had been made to the Henry Review, supporting the position that an increase in the Superannuation Guarantee contribution rate to 12% would achieve adequate retirement savings, particularly for those on low incomes.¹⁷⁴ According to the Australian Treasury's Budget Report 2012-13 'the maximum age limit for the superannuation guarantee will be abolished, to increase incentives for workers aged 70 and over to remain in the workforce and further boost retirement savings'.¹⁷⁵ In this Report, the government also recognised that further support for low-income workers in the superannuation system is required. In a bid to eliminate the 15% contributions tax paid by superannuation funds for contributions for low-income earners, the government has indicated that it will make a 15% contribution for every dollar of contribution up to a total of A\$500 per annum (for low income earners - on a salary of A\$37,000 pa or less). This applies from 1 July 2012.¹⁷⁶ This initiative could enable low-income earners to receive both the benefit of the Superannuation Guarantee as well as the low-income earner's government contribution without the need to salary sacrifice.

To ensure that the superannuation system operates more equitably, the Australian Treasury's Budget Report 2012-13 also addresses a number of tax expenditures that are available to high-income earners. For those taxpayers on an income of A\$300,000 or more, 'the tax concession on

¹⁷³ The Superannuation Guarantee (Administration) Amendment Bill 2011 (Cth) was introduced in the House of Representatives on 2 November 2011. One purpose of the Bill was to be 'an increase in the rate of employer contributions from the current rate of 9 % to 9.25 % in 2013-14, and then incremental increases in each subsequent year to 12 % in 2019-20'. Importantly, it was also noted that '[t]he implementation of the changes proposed by this Bill are dependent on the passage of the Minerals Resource Rent Tax Bills, with the provisions not coming into effect unless the four Bills that relate to the proposed Minerals Resource Rent Tax have commenced before 1 July 2013'.

¹⁷⁴ See eg, Australian Council of Social Service, Submission to the Taxation Review Panel, *Adequate, fair, sustainable, and simple: Retirement incomes reform*, 2 March 2009.

¹⁷⁵ Australian Government, above n 35.

¹⁷⁶ Ibid.

their contributions [will be] cut from 30% to 15% (excluding the Medicare levy)¹⁷⁷. This is so they are 'more in line with the concession received by average income earners'¹⁷⁸.

It is questionable if these reforms adopted (or to be adopted) sufficiently address issues of equity. The reforms indicated will have little impact on actual benefits received at retirement by women, low-income workers, those with broken work patterns and the self-employed. Such individuals are arguably the 'forgotten'.

With respect to the Cooper Review, whilst many of its recommendations were supported by the government, other recommendations were only noted or were not supported at all.¹⁷⁹ The more substantial recommendations taken into consideration were those that concerned MySuper as noted above. Under this approach, MySuper has taxpayers paying fees or rates at the same level unless they voluntarily opt out of the MySuper fund.¹⁸⁰ Inefficiencies apparent within the funds (dissipating invested funds through exorbitant management fees) may be addressed by MySuper to some degree. Does this move signal the Australian government's desire to equalise the influence of a superannuation fund for Australian taxpayers whilst still allowing their savings to be handled at their own personal discretion?¹⁸¹ Perhaps. It is most likely that the MySuper approach entails only a minor change to the nature of the default superannuation fund for taxpayers and is not a substantial change that will significantly alter the retirement savings system.

¹⁷⁷ Ibid.

¹⁷⁸ Ibid 35.

¹⁷⁹ The Treasury, *Stronger Super* (2010) Australian Government
<<http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm>>.

¹⁸⁰ Ryan also agrees with this point, above n 171.

¹⁸¹ Howatson and Dennings, above n 170.

Another recommendation to be adopted by the Australian government as put forward by the Cooper Review, is the introduction of 'SuperStream'.¹⁸² This initiative also addresses high superannuation fees charged by funds, in order to 'deliver a competitive market that reduces costs for members'.¹⁸³ Under 'SuperStream', reforms to the quality of the data in the system, using tax file numbers as a primary identifier, improving technology and processing efficiencies and improving the way rollovers and contributions are addressed.¹⁸⁴ According to The Treasury, most measures will be in place by 1 July 2015, with 'arrangements relating to common data standards and electronic transmission of linked personal and financial data settled by 1 July 2012'.¹⁸⁵

The Australian government in its Budget Report 2012-13 indicated that it was moving forward with the implementation of the

'SuperStream' initiatives, in which a temporary SuperStream levy will be paid by Australian Prudential Regulation Authority ('APRA') regulated superannuation funds to support the costs to government of implementing the SuperStream reforms.¹⁸⁶

These costs will need to be absorbed by fund managers. Where they are passed on to fund members, this will defeat to a degree one of the reforms objectives – to reduce fund management costs.

Beyond the introduction of MySuper, the opportunity for more transparency in the system stands to operate as a significant change. The power to set standards is taken from the hands of the government

¹⁸² The Treasury, above n 179, 'Key Points', 3.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

¹⁸⁵ Ibid 'Key Points', 5.

¹⁸⁶ Bill Shorten, '2012-13 Budget – superannuation reforms' (Media Release, 024, 8 May 2012).

and placed with the Australian Prudential Regulation Authority ('APRA').¹⁸⁷ How this would affect the use of tax expenditures as an effective means of encouraging retirement savings remains to be seen. As the opportunity to have a new body controlling standards outside of government (and theoretically free of the policy or political discretions which may influence government) has not been substantially considered.

PART 6: FROM TAX EXPENDITURES TO REBATES: DEVELOPING AN EQUITABLE, EFFICIENT AND EFFECTIVE RETIREMENT SAVINGS POLICY

Australia's retirement system was ranked second in the 2009 Melbourne Mercer Global Pension Index that judged the adequacy, sustainability and integrity of private and public pensions around the world.¹⁸⁸ Despite this, there is room for improvement.

As Mercer notes:

[A]ll three pillars of the Australian retirement system need to be integrated and refined to reduce reliance on the age pension alone; to help mitigate the impact of market volatility on superannuation savings; to encourage Australians to remain in the workforce longer, and to improve the sustainability of our system.¹⁸⁹

There are many challenges facing Australia's retirement savings policies, including an ageing population, increased life expectancy of its citizens, skills shortages in the labour force, the current economic downturn and market volatility in light of the 'Global Financial

¹⁸⁷ See Australian Prudential Regulation Authority, *About APRA* (2013) <<http://www.apra.gov.au/AboutAPRA/Pages/Default.aspx>>. APRA 'oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies and most members of the superannuation industry. APRA is funded largely by the industries that it supervises. It was established on 1 July 1998'.

¹⁸⁸ Mercer, 'Australia amongst the best in Global Pension Index' (Media Release, 15 October 2012).

¹⁸⁹ Ibid.

Crisis'.¹⁹⁰ These factors, inter alia, are highly likely to place economic, fiscal and social policy constraints on the Australian government to sustain its support for both the Age Pension and the provision of tax expenditures in the superannuation system.

Unfortunately, many of the recommendations contained within the Henry Review were not embraced by the government. Recent government initiatives following the Cooper Review have not addressed adequately the equity issues concerning the final amount of retirement savings available for all Australians at retirement. Even the expansion of the Superannuation Guarantee from the current 9% level to 12% by 2020, whilst increasing retirement savings, will not on its own equate to better retirement funding for taxpayers or to equity within the retirement savings regime.¹⁹¹

There are a number of suggestions for further reform in this area. Using an output based equity approach, the suggestions, when considered together and/or compared to each other, promise a positive impact by ensuring that all individuals are provided for in their retirement in an equitable manner.

I SUGGESTION 1

To adequately address equity issues, the Superannuation Guarantee system must also cover the self-employed, those on worker's compensation and parental leave, those with broken work patterns,

¹⁹⁰ The 'Global Financial Crisis' refers to a downturn in the financial worldwide markets that began in 2007. 'In the space of just 18 months, this crisis has become one of the greatest assaults on global economic stability to have occurred in three-quarters of a century': Kevin Rudd, 'The Global Financial Crisis', *The Monthly* (online), February 2009 <<http://www.themonthly.com.au/monthly-essays-kevin-rudd-global-financial-crisis--1421>>.

¹⁹¹ Sadiq, above n 27, 11.

women, the disabled and carers.¹⁹² Where such an expansion is adopted, eligibility for the government co-contribution scheme would be a further benefit for these groups.¹⁹³

II SUGGESTION 2

Following on from this suggestion, the co-contribution scheme should also be further revised, so that low-income earners receive a larger proportional contribution based on their income.¹⁹⁴ Consequently, the government would still be able to encourage retirement savings, but rather than utilising tax expenditures there would be a 'direct co-contribution matching both compulsory and voluntary contributions up to an annual ceiling'.¹⁹⁵

Whilst both these suggestions are in line with an output based equity approach, the authors recognise that both suggestions can be very costly and difficult to implement and administer. Tracking such individuals via the Australian social security system (assuming that they are part of such a system) would be an administrative minefield. Those individuals who are not part of the social security system would not benefit at all.

III SUGGESTION 3

An alternative and preferable suggestion for reform is that income directed to superannuation is taxed at the applicable individual marginal tax rate, as suggested in the Henry Review, together with the scrapping of the superannuation co-contribution scheme altogether.¹⁹⁶

¹⁹² Ibid.

¹⁹³ Ibid.

¹⁹⁴ Scutella, above n 19.

¹⁹⁵ Ibid.

¹⁹⁶ A reform similar to this has been proposed by the Australian Council of Social Services ('ACOSS'): Scutella, above n 19, 11.

Complementing this approach is the removal by the Australian government of the retirement policy from the taxation system. The taxation system should focus on revenue raising to be distributed to those in need. In relation to retirement policies, rather than using tax expenditures to encourage private savings, the Australian government can implement a series of rebates (which would apply equally to all taxpayers).¹⁹⁷

Spies-Butcher and Stebbing explain this approach as follows:

A flat rate rebate of 20% support for those earning up to A\$80,000 per annum [could be provided] and then decreasing the rebate by 1 percentage point for each additional A\$1,000 of earnings, until it is phased out completely for those earning over A\$100,000 per annum ... In 2005/06, this model would have left over 85% of wage earners better off ... Under this (second) model, a worker on the minimum wage would receive an additional A\$509 per annum in government support, and would expect an increase in the value of their superannuation over their lifetime of A\$32,000 in real terms – more than a year’s salary.¹⁹⁸

Such an approach would also have positive benefits for other components of Australia’s Superannuation Scheme.

[It] could easily be applied to the other components of superannuation – earnings and voluntary contributions. Here there would be additional benefits from changed incentives ... [These] incentives would be changed to promote savings from middle-income earners not currently

¹⁹⁷ Spies-Butcher and Stebbing also agree with this approach. They argue that in order to ‘achieve a more transparent, more efficient and more equitable system’ where the government should focus on ‘separating out the functions of revenue collection and social support, with the tax system focused on the former and the payments system focused on the later’: Spies-Butcher and Stebbing, above n 87, 11.

¹⁹⁸ Ibid 12.

eligible for the low-income earner co-contribution, potentially further decreasing the reliance of these groups on the aged pension.¹⁹⁹

IV SUGGESTION 4

To improve upon the approach in Suggestion 3, gender equity issues together with inequities that exist for those individuals who are self-employed, low-income individuals, those on worker's compensation and parental leave, those with broken work patterns, the disabled and carers in the current Australian retirement savings scheme must also be addressed. A gender budget analysis should be conducted as it is 'integral to a full assessment of the equity and efficiency of budgetary measures, such as those related to retirement incomes'.²⁰⁰ Implementation of a gender perspective in public finance, analysis of the government's expenditure and revenue and its effect on men and women (and further subdivisions of men and women based upon socio-economic status, age, location, ethnicity, race, etc) must also be considered.

Inequities that arise from the current input-based approach for those on low incomes, those individuals who are self-employed, those on worker's compensation and parental leave, those with broken work patterns, women, the disabled and carers also need to be taken into account. A system of rebates operating in conjunction with a sustainable social security program can further address these inequity issues.

¹⁹⁹ Ibid.

²⁰⁰ Rhonda Sharp and Siobhan Austen, 'The 2006 Federal Budget: A Gender Analysis of the Superannuation Taxation Concessions' (2007) 10(2) *Australian Journal of Labour Economics* 64.

CONCLUSION

The Australian retirement system is complex. This is a result of the system being developed over time to meet the sometimes conflicting needs of the government, trade unions and also the individual taxpayers.²⁰¹ To ensure that the Australian government's retirement policies meet the needs of a changing population and dynamic economic environment, continuous refinement of Australia's multi-pillar retirement system is required.

The Australian government, faced with projected increasing costs of supporting an ageing population, has over the last 15 years embarked on a retirement policy which endeavours to shift reliance of its citizens away from the government supported Age Pension, towards individuals saving for their own retirement. The retirement policy has encouraged its citizens to invest in private retirement savings predominantly via superannuation. In this article it has been argued that a number of inequities and inefficiencies arise when using tax expenditures to achieve this objective.

To address some of the problems associated with superannuation investment, many recommendations have been made and a number of changes have been effected. Most recently, one new reform proposed is the increase from 9% to 12% of the Superannuation Guarantee. However, such a change does not go far enough because it is an input-based equity approach. This approach does not address gender inequities, inequities affecting low-income earners and those with broken work patterns, as well inequities that arise for the self-employed.

²⁰¹ Australian Council of Trade Unions, *History of Super* (21 February 2005) <http://www.actu.org.au/super/about/super_history.html>.

The efficiency and effectiveness of using tax expenditures to shift reliance from the Age Pension to individuals saving for their own retirement must be examined further. Changes are required with regard to public retirement benefits and means testing for the Age Pension, to address income shifting into the family home and the dissipation of superannuation funds before retirement. Costs associated with the management of superannuation funds and the disparity between the financially literate and illiterate are further concerns that need addressing. The introduction of 'MySuper' and 'SuperStream' and the proposed increase to the Superannuation Guarantee go some way to addressing these particular concerns. However, they do not solely address many of the inefficiencies inherent within the superannuation system.

The government should separate its revenue collection functions from social support and discontinue using tax expenditures as a means of encouraging superannuation savings. It is postulated that a system of rebates in the superannuation system would apply more equitably amongst taxpayers. These rebates should be coupled with some means of social support for individuals on low incomes, the self-employed, those on worker's compensation and parental leave, those with broken work patterns, women, the disabled and carers so that these groups are provided for sufficiently when they reach retirement age. Consequently, if these groups are supported before they reach retirement then reliance on the government-provided Age Pension can be decreased. Through these means a fairer and more equitable outcome in retirement can be achieved.