

## **SUPERANNUATION TAXATION REFORM: FROM THE FINANCIAL SYSTEM INQUIRY REPORT TO LEGISLATIVE CHANGES**

### ABSTRACT

This article examines the round of legislative changes to superannuation taxation that came into effect on 1 July 2017. It traces this process, beginning with the comments and recommendations made by the Murray Financial System Inquiry (the ‘Inquiry’). The Inquiry’s findings were predominantly aimed at abating what it perceived to be the disproportionate flow of superannuation tax concessions towards wealthier members of the community. A substantial number of its recommendations were eventually implemented, but only after a change of leadership within the government. Many of these legislative changes increase equity by improving the targeting of superannuation tax concessions, and they do so without any apparent substantial loss in economic efficiency, though there is an increase of complexity in the application of the superannuation system. Other changes, mainly those concerned with broadening eligible superannuation income streams, enhance the ability of some retirees to benefit from a reliable income stream. The article concludes that this recent phase in superannuation changes is a positive step in the evolution of Australia’s superannuation system.

### I INTRODUCTION

The Australian superannuation system has been subject to many changes over time, and this evolution is likely to continue. A major feature of the system is its concessional tax treatment. A number of changes to the taxation of superannuation came into effect on 1 July 2017. Most of these changes can be traced back to the Financial System Inquiry Reports (‘Inquiry Reports’). This article discusses those changes, explains their background, and critically evaluates them. Specifically, Part II of this article begins by outlining the laws relating to superannuation taxation prior to the July 2017 changes. Part III discusses the benchmark for evaluating tax laws, the general role of superannuation tax concessions, their cost, and the extent to which they benefit taxpayers of different income levels. Part IV then discusses the background to the July 2017 changes. Specifically, it examines the relevant comments of the Inquiry Reports relating to the superannuation tax changes and

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describes their implementation. Part V goes on to examine the specific July 2017 changes and their particular backgrounds, and offers a critical evaluation of each. Part VI concludes the discussion.

## II SUPERANNUATION TAXATION

Australia's superannuation system is characterised by individual retirement accounts to which employers make compulsory contributions where the worker earns at least \$450 a month.<sup>1</sup> The current contribution rate is 9.5 per cent of a worker's salary.<sup>2</sup> That rate is legislated to gradually increase to 12 per cent by 1 July 2025.<sup>3</sup> Voluntary contributions can also be made to superannuation accounts in the form of direct contributions by the member or increased contributions by their employer.<sup>4</sup>

As is the case with retirement savings in many other jurisdictions, the Australian superannuation system is subject to concessional tax treatment.<sup>5</sup> On 1 July 2017, a number of changes to the superannuation taxation regime commenced.<sup>6</sup> It is worthwhile to examine the law prior to these changes<sup>7</sup> and note, by way of background, that superannuation is potentially liable to taxation at three points: when money is contributed to the account; when the account earns a return on its investments; and when the account holder withdraws benefits.

### A *Superannuation Contributions Taxation*

A superannuation contribution that is subject to tax in the hands of the superannuation fund when deposited is referred to as a 'concessional contribution'.<sup>8</sup> For a typical employee, concessional contributions will include the 9.5 per cent of salary which employers are mandated to pay as an employer superannuation contribution, as well as any other employer contributions.<sup>9</sup> This means that amounts the employer must contribute pursuant to industrial agreements or through a salary sacrifice agreement are regarded as 'concessional contributions'. Concessional contributions are tax

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<sup>1</sup> *Superannuation Guarantee (Administration) Act 1992* (Cth) s 27(2).

<sup>2</sup> *Ibid* s 19(2).

<sup>3</sup> *Ibid*.

<sup>4</sup> Australian Securities and Investments Commission, *Salary Sacrifice Super* (22 January 2016) Moneysmart <<https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/super-contributions/contributing-extra-to-super#salary>>.

<sup>5</sup> Kwang-Yeol Yoo and Alain de Serres, 'Tax Treatment of Private Pension Savings in OECD Countries' (2004) 39 *Organisation for Economic Co-operation and Development Economic Studies* 73.

<sup>6</sup> *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth).

<sup>7</sup> When describing the law in this part of the article, the present tense is used for the law that is still current, and past tense for instances where it has been modified.

<sup>8</sup> *Income Tax Assessment Act 1997* (Cth) ss 291-25, 291-165.

<sup>9</sup> *Ibid* sub-div 295-C.

deductible to the employer,<sup>10</sup> and are taxed at the rate of 15 per cent in the hands of the superannuation fund.<sup>11</sup> This is a substantial discount on the marginal tax rates that apply to full-time salary earners.<sup>12</sup> In other words, full-time workers making concessional contributions obtain a tax benefit at the contribution stage as well as benefiting from the concessional earnings from which superannuation accounts benefit.<sup>13</sup> Until 1 July 2017, the annual concessional contributions cap was \$30 000 for those under 50 and \$35 000 for those 50 and over.<sup>14</sup> In general, until 1 July 2017, taxpayers could not make tax-deductible concessional contributions into their own superannuation accounts unless no more than 10 per cent of the taxpayer's income was salary income — this requirement in essence meant that in most cases only self-employed persons could make such tax-deductible contributions.<sup>15</sup> Taxpayers whose income, including concessional superannuation contributions, exceeds a certain threshold effectively have their concessional contributions taxed at 30 per cent rather than 15 per cent under the division 293 tax.<sup>16</sup> Prior to 1 July 2017, this threshold was \$300 000.<sup>17</sup>

Superannuation contributions that are typically paid out of after-tax salary or savings and are ineligible for a tax-deduction are termed 'non-concessional contributions' and are not subject to a contributions tax when deposited into the superannuation funds.<sup>18</sup> Although, unlike concessional contributions, there is no tax saving at the contribution stage, earnings on such contributions still benefit from the concessional tax savings that superannuation fund earnings are subject to. There is an annual non-concessional contribution cap, which until 1 July 2017 was \$180 000.<sup>19</sup> Those aged under 65 at any time during the financial year can bring forward three years' worth of this cap, meaning that until 1 July 2017 they could make up to \$540 000 in non-concessional contributions in a single year. However, such a contribution would result in a commensurate reduction in the cap for the next two financial years.<sup>20</sup>

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<sup>10</sup> Ibid sub-div 290-B.

<sup>11</sup> Ibid s 295-545; *Income Tax Rates Act 1986* (Cth) s 26.

<sup>12</sup> *Income Tax Rates Act 1986* (Cth) s 12(1) and sch 7 pt 1; *Medicare Levy Act 1986* (Cth).

<sup>13</sup> The concessional earnings of superannuation funds are discussed under sub-heading B below.

<sup>14</sup> *Income Tax Assessment Act 1997* (Cth) s 291-20; *Income Tax (Transitional Provisions) Act 1997* (Cth) s 291-20, as repealed by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 2 pt 1 s 9.

<sup>15</sup> *Income Tax Assessment Act 1997* (Cth) sub-div 290-C, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 5.

<sup>16</sup> Ibid div 293.

<sup>17</sup> Ibid div 293, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) s 17.

<sup>18</sup> Ibid s 292-90.

<sup>19</sup> Ibid s 292-85, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 3.

<sup>20</sup> Ibid.

Lower income earners can utilise some concessions that are potentially available to them at the contributions stage. One concession is the co-contributions scheme, which applies to non-concessional contributions made by lower income earners, resulting in the government contributing 50 cents (up to \$500 annually) for every \$1 of non-concessional contributions made by lower income earners.<sup>21</sup> The second, which applied until 30 June 2017, was the Low Income Superannuation Contributions Offset, which refunded up to \$500 of the amount of contributions tax paid on the concessional contributions of those earning up to \$37 000 annually.<sup>22</sup>

A tax offset is also available where one spouse contributes to the other's superannuation account. The offset is set at a rate of 18 per cent of the contribution, but is limited to \$540 a year.<sup>23</sup> Further, until 1 July 2017, the full offset was only available where the recipient spouse earned no more than \$13 000 in that year, with the \$540 limit being reduced where the spouse earned between \$10 000 and \$13 000.<sup>24</sup>

### B *Earnings Taxation*

Superannuation earnings are also highly concessional tax. In general, a superannuation account fund can be considered to be in either its 'accumulation' phase or its 'income stream' phase. Superannuation fund earnings made during its accumulation phase are taxed at the rate of 15 per cent,<sup>25</sup> though this is reduced for capital gains on assets owned for at least 12 months, which are only subject to 10 per cent tax (due to such capital gains being subject to a 33.3 per cent discount).<sup>26</sup> Importantly, unlike earnings on superannuation accounts in the accumulation phase, earnings supporting superannuation income streams are tax-free.<sup>27</sup>

In contrast, investment earnings made by individuals directly, such as interest on bank deposits or rental income, are generally taxed at their marginal tax rate. However, some non-superannuation earnings benefit from concessional tax treatment. For instance, if the capital gain is made on assets owned for at least 12 months, then the gain is discounted by 50 per cent before being taxed at normal progressive marginal tax rates.<sup>28</sup> Notwithstanding this discount, due to the low superannuation earnings tax rate, in most cases capital gains are taxed more heavily on assets directly owned

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<sup>21</sup> See *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003* (Cth).

<sup>22</sup> *Ibid* pt 2A, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 4.

<sup>23</sup> *Income Tax Assessment Act 1997* (Cth) s 290-235.

<sup>24</sup> *Ibid*, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 7.

<sup>25</sup> *Income Tax Rates Act 1986* (Cth) ss 26(1), 27(1), 27A.

<sup>26</sup> *Income Tax Assessment Act 1997* (Cth) s 115-100.

<sup>27</sup> *Ibid* ss 295-385, 295-390, 295-395; *Income Tax Assessment Regulations 1997* (Cth) reg 995.1.01.

<sup>28</sup> *Income Tax Assessment Act 1997* (Cth) s 115-100.

by individuals. An exception occurs where there are relatively minor capital gains and the taxpayer earns little other income; in those cases, a substantial part of the capital gain will fall within the taxpayer's tax-free threshold which could result in less tax payable than had the gain been made by a superannuation account in its accumulation phase.<sup>29</sup> Some other non-superannuation earnings are also subject to concessional tax treatment. For instance, owner-occupied housing is exempt from capital gains tax.<sup>30</sup> Further, any interest on moneys borrowed to purchase investment assets is deductible, and to the extent that it exceeds the income generated by the assets, can be used to offset other income such as salary income.<sup>31</sup>

Typically, superannuation accounts will be in their accumulation phase during the account holder's working life. Upon reaching preservation age, the law allows account holders who have fulfilled conditions relating to ceasing employment to access their superannuation in an unrestricted manner,<sup>32</sup> meaning they can take it in the form of a lump sum or an income stream, or some combination of these. The preservation age was originally 55 for all account holders, but staggered rises now mean that only those born before 1960 have unrestricted access at that age, and the preservation age for anyone born after 1 July 1964 is now 60.<sup>33</sup>

A superannuation income stream could be taken either as an annuity or an account-based pension.<sup>34</sup> An account-based pension is a phased withdrawal product, where the balance is invested in a pool of investments.<sup>35</sup> Account-based pensions are subject to age-based minimum withdrawal limits, in default of which they cease to benefit from tax-free earnings.<sup>36</sup> However, account-based pensions are not subject to maximum withdrawal limits, meaning that they provide the benefit of liquidity. An annuity, on the other hand, offers less flexibility and entitles the taxpayer to receive regular and predictable income payments.<sup>37</sup> Annuity income streams can be fixed, indexed to a set percentage, indexed to the Consumer Price Index ('CPI'), or indexed to Average Weekly Earnings ('AWE'), though in the case of CPI and AWE settings this amount can be capped by the annuity contract.<sup>38</sup> Such annuities can be either term or life annuities.<sup>39</sup> Retirees on a life annuity will get an income stream for the rest of their

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<sup>29</sup> *Income Tax Rates Act 1986* (Cth) s 12(1), sch 7 pt 1; *Medicare Levy Act 1986* (Cth).

<sup>30</sup> *Income Tax Assessment Act 1997* (Cth) sub-div 118-B.

<sup>31</sup> *Federal Commissioner of Taxation v Janmor Nominees Pty Ltd* (1987) 15 FCR 348.

<sup>32</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth) sch 1 item 101, reg 6.01.

<sup>33</sup> *Ibid* reg 6.01.

<sup>34</sup> *Income Tax Assessment Act 1997* (Cth) s 307-70; *Income Tax Assessment Regulations 1997* (Cth) reg 995.1.01.

<sup>35</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 1.06.

<sup>36</sup> *Ibid* reg 1.06(9A).

<sup>37</sup> *Ibid* reg 1.05.

<sup>38</sup> *Ibid* reg 1.05(11A), 1.05(13).

<sup>39</sup> *Ibid* reg 1.05(11A).

lives,<sup>40</sup> meaning that their income is free from investment risk and longevity risk, and if indexed, from inflation risk as well.<sup>41</sup> An account-based pension is by far the more popular option of the income stream options.<sup>42</sup>

In addition to the differential taxation of superannuation earnings, another major difference between accounts in income-stream and accumulation modes is that an accumulation account can receive deposits, while an income-stream account cannot.<sup>43</sup>

Taxpayers who have reached preservation age but have not triggered other conditions of release such as ceasing employment can access their superannuation funds through a ‘transition to retirement income stream’.<sup>44</sup> Such an income stream is essentially an account-based pension with the extra restriction that only a maximum of 10 per cent of the balance can be withdrawn in a financial year.<sup>45</sup> Importantly, until 1 July 2017, the earnings of a transition to retirement income stream were tax-free, just like other account-based pensions income streams.<sup>46</sup>

### C *Taxation of Superannuation Benefits Paid to Members*

Taxing withdrawal of superannuation benefits is dependent on a number of factors. To the extent that the withdrawn portion can be traced directly to non-concessional contributions, it is termed a ‘tax free component’<sup>47</sup> and is not subject to tax.<sup>48</sup> Other portions of the superannuation account — including amounts originating from concessional contributions as well as account earnings — constitute the ‘taxable component’.<sup>49</sup>

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<sup>40</sup> Ibid reg 1.05(11A).

<sup>41</sup> Investment risk is the risk of the investments falling in value or otherwise underperforming. Longevity risk is the risk of the retiree outliving their savings. Inflation risk is the risk of inflation eroding the purchasing power of the retirement income. See Janemarie Mulvey and Patrick Purcell, ‘Converting Retirement Savings into Income: Annuities and Periodic Withdrawals’ (Congressional Research Service Report for Congress, 2008) 2–4.

<sup>42</sup> Australian Prudential and Regulation Authority, ‘Annual Superannuation Bulletin: June 2017’ (Bulletin, 28 March 2018) 21 <<https://www.apra.gov.au/sites/default/files/2018-ASB-201706.pdf>>.

<sup>43</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth) regs 1.05(1)(a)(ii), 1.06(1)(a)(ii).

<sup>44</sup> Ibid sch 1 item 110, reg 6.01.

<sup>45</sup> Ibid reg 6.01.

<sup>46</sup> *Income Tax Assessment Act 1997* (Cth) ss 295-385, 295-390, 295-395, subdiv 307-B, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 11; *Income Tax Assessment Regulations 1997* (Cth) reg 995.1.01.

<sup>47</sup> *Income Tax Assessment Act 1997* (Cth) subdiv 307-C.

<sup>48</sup> Ibid ss 301-10, 301-15.

<sup>49</sup> Ibid subdiv 307-C.

For those who have attained their superannuation preservation age but are under the age of 60, lump sum withdrawals, to the extent they represent the taxable component, are tax-free up to a certain indexed amount (which was \$195 000 for the 2016–17 tax year), and above that amount are taxed at 17 per cent.<sup>50</sup> Income-stream benefits for those who have reached preservation age but are under 60, to the extent they represent a taxable component, are subject to normal marginal tax rates less a 15 per cent tax offset.<sup>51</sup> For account holders aged 60 and above, withdrawals are tax-free, whether the amount is withdrawn as a lump sum or taken out as a superannuation income stream.<sup>52</sup>

#### D *Untaxed Funds*

About 10 per cent of superannuation funds in Australia are untaxed funds<sup>53</sup> which for constitutional reasons do not pay tax on their contributions or earnings.<sup>54</sup> These funds consist of a limited number of state government superannuation schemes covering some public servants, members of the judiciary, and politicians.<sup>55</sup> To partially fill this lacuna in taxation, withdrawals from such funds are more heavily taxed at the benefits phase. Specifically, for those who are at least 60, the taxable components (up to an indexed threshold, which was \$1 415 000 in the 2016–17 tax year) are taxed at up to 17 per cent, whereas amounts over the threshold are taxed at the top tax rate of 47 per cent.<sup>56</sup> For taxpayers who have reached their preservation age but are under 60, withdrawals are taxed at up to 17 per cent (up to a lower indexed threshold, which was \$195 000 for the 2016–17 tax year). Amounts between this lower threshold and the higher threshold (\$1 415 000 in 2016–17) are taxed at 30 per cent, and anything over the higher threshold is taxed at the top marginal tax rate of 47 per cent.<sup>57</sup> As far as income-stream withdrawals from such funds are concerned, those who are at least 60 are subject to normal marginal tax rates for such withdrawals, less a 10 per cent offset.<sup>58</sup> On the other hand, those who have reached preservation age but are not yet 60 will be subject to normal marginal tax rates.<sup>59</sup>

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<sup>50</sup> Ibid ss 301-20, 307-345.

<sup>51</sup> Ibid s 301-25.

<sup>52</sup> Ibid s 301-10.

<sup>53</sup> Jonathan Barry Forman and Gordon D Mackenzie, 'Optimal Rules for Defined Contribution Plans: What Can We Learn from the US and Australian Pension Systems?' (2012) 66 *Tax Lawyer* 613, 627.

<sup>54</sup> *Income Tax Assessment Act 1997* (Cth) s 50-25 item 5.3, s 995-1; *Income Tax Assessment Regulations 1997* (Cth) reg 995.1; *Australian Constitution* s 114.

<sup>55</sup> *Income Tax Assessment Regulations 1997* (Cth) reg 995.1.04 and sch 4, reg 995.1.01.

<sup>56</sup> *Income Tax Assessment Act 1997* (Cth) s 301-95.

<sup>57</sup> Ibid s 301-105. Until 30 June 2017 such sums were also subject to the additional 2 per cent temporary budget deficit levy: *Income Tax (Transitional Provisions) Act 1997* (Cth) s 411.

<sup>58</sup> *Income Tax Assessment Act 1997* (Cth) s 301-100.

<sup>59</sup> Ibid s 301-110.

### III BACKGROUND FOR EVALUATING SUPERANNUATION TAX LAWS

Given that superannuation is subject to its own particular concessional tax treatment, it is worthwhile to examine the general benchmark for judging tax laws. This examination is followed by a discussion of the specific purposes of the superannuation tax concessions as well as their fiscal cost and the way their benefit is distributed among income levels. The discussion includes an evaluation of the purpose of the superannuation system, as this is relevant to many of the July 2017 superannuation tax changes.

#### *A Criteria for Evaluating Tax Laws*

Tax laws, including the ones applicable to superannuation, are generally evaluated according to the criteria of equity, efficiency and simplicity.<sup>60</sup> The first of these, equity, has vertical and horizontal aspects. Horizontal equity is the principle that those of similar financial means should be taxed similarly.<sup>61</sup> Vertical equity is the principle that those of greater means should pay more tax,<sup>62</sup> though to what degree they should do so is subject to a range of opinions.<sup>63</sup> A progressive tax system plays an important role in attaining a measure of such equity.<sup>64</sup>

The criterion of equity is related to the concept of distributive justice, which is the principle that the tax system has a role in redistributing money from those who are financially well-off to those who lack resources — to the extent that people have arrived at their position through factors beyond their control.<sup>65</sup> It has been argued that the equity of a tax system should be judged by a hypothetical outsider subject to a ‘veil of ignorance’ (not knowing what position they might occupy within a society, but expecting to become a random member of it). The greater the level and prevalence of poverty in such a society, the more likely it would result in the hypothetical person

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<sup>60</sup> Australian tax reviews papers have consistently used these three criteria. See Taxation Review Committee, ‘Full Report January 31 1975’ (Asprey Report) (Australian Government Publishing Service, 1975) [3.1]–[3.28]; Commonwealth of Australia, ‘Reform of the Australian Tax System: Draft White Paper’ (Australian Government Publishing Service, 1985) [1.1]–[1.10]; Review of Business Taxation, ‘A Strong Foundation: Establishing Objectives, Principles and Processes’ (Review of Business Taxation, 1999) 62–4; Commonwealth of Australia, ‘Re: Think’ (Discussion Paper, March 2015) 14, 29.

<sup>61</sup> Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice* (McGraw-Hill, 5th ed, 1989) 223.

<sup>62</sup> *Ibid.*

<sup>63</sup> Commonwealth of Australia, Draft White Paper, above n 60, [1.4].

<sup>64</sup> Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002) 120.

<sup>65</sup> Erik Schokkaert and Philippe Van Parijs, ‘Debate on Social Justice and Pension Reform: Social Justice and the Reform of Europe’s Pension Systems’ (2003) 13 *Journal of European Social Policy* 245, 246–7.



ending up in a negative situation, meaning that prior to entering the society, they would be more likely to believe in increasing its equity.<sup>66</sup>

The criterion of efficiency calls for the tax laws to minimise the degree to which they cause economic distortions that could impede economic growth,<sup>67</sup> whereas the criterion of simplicity calls for the law to be easy to understand and apply.<sup>68</sup> In juxtaposition, these criteria often require trade-offs: for example, laws improving equity often result in less simplicity.<sup>69</sup>

### B *Purposes of Superannuation Tax Concessions*

There are several justifications for subjecting superannuation to concessional tax treatment. An important justification is that since superannuation is an income-smoothing regime, its funds should be taxed similarly to someone who is in retirement and therefore subject to comparatively lower tax rates, as their income is lower.<sup>70</sup> A further reason for these concessions is that without them, after-inflation returns would in some cases be subject to excessive tax rates.<sup>71</sup> Such an outcome would be regarded as inefficient, as it would skew decision-making against investing and towards consumption.<sup>72</sup> It would also be inequitable to tax gains that represent inflation.<sup>73</sup>

Another justification that has been argued for the concessions is that they will save future pension payments.<sup>74</sup> However, this justification appears to lack substance, given that the evidence suggests the superannuation regime has a net cost, since the tax concessions cost more than savings on future pension expenditures.<sup>75</sup> Notwithstanding this, a more targeted superannuation tax system would abate this cost, as

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<sup>66</sup> John Rawls, *A Theory of Justice* (Belknap Press, 2nd ed, 1999) 118–23.

<sup>67</sup> Commonwealth of Australia, *Establishing Objectives, Principles and Processes*, above n 60, 63.

<sup>68</sup> Commonwealth of Australia, Draft White Paper, above n 60, [1.8].

<sup>69</sup> *Ibid* [1.10].

<sup>70</sup> Commonwealth of Australia, 'Australia's Future Tax System' (Report to the Treasurer, Part 2 Vol 1, December 2009) 96–7 <[http://taxreview.treasury.gov.au/content/downloads/final\\_report\\_part\\_2/afts\\_final\\_report\\_part\\_2\\_vol\\_1\\_consolidated.pdf](http://taxreview.treasury.gov.au/content/downloads/final_report_part_2/afts_final_report_part_2_vol_1_consolidated.pdf)>. The aim of taxing funds similarly to someone in retirement could be considered related to the principle of horizontal equity.

<sup>71</sup> *Ibid*.

<sup>72</sup> Commonwealth of Australia, 'Re:Think', above n 60, 58.

<sup>73</sup> Richard A Musgrave, 'An Evaluation of the Report' (1967) 15 *Canadian Tax Journal* 349, 353.

<sup>74</sup> David M Knox, 'Policy Forum: Saving for Retirement: The Fairness and Future of Australia's Retirement Income System' (2010) 43 *Australian Economic Review* 302, 304.

<sup>75</sup> David Ingles and Miranda Stewart, 'Superannuation Tax Concessions and the Age Pension: A Principled Approach to Savings Taxation' (Working Paper No 7/2015, Tax and Transfer Policy Institute, November 2015) 23–4.

higher income earners are unlikely to be eligible for the age pension irrespective of their superannuation balances;<sup>76</sup> reducing their entitlement to concessions will therefore result in a net fiscal saving.

Further, it has been argued that yet another reason for the superannuation tax concessions is that they increase voluntary superannuation contributions.<sup>77</sup> However, research has indicated that they do so to a very minor extent.<sup>78</sup> This is partially because higher income earners will merely increase their tax-preferred retirement savings at the expense of other savings vehicles.<sup>79</sup> As far as other income groups are concerned, notwithstanding previous claims that tax concessions do increase their voluntary retirement savings,<sup>80</sup> more recent research indicates that these groups generally do not respond to such incentives.<sup>81</sup> Consequently, it would be hard to argue that this is a valid justification for such tax concessions.

### C *Cost of Superannuation Tax Concessions*

According to the Commonwealth Treasury, the cost of superannuation tax concessions is substantial. Prior to these July 2017 changes, superannuation tax concessions were estimated to cost the government approximately \$35 billion in lost revenue for the 2016–17 tax year, using traditional tax expenditure calculations.<sup>82</sup> However, those estimates have been criticised as overestimating government revenue loss, for a number of reasons—most notably that the estimates do not fully take into account

<sup>76</sup> John Daley, Brendan Coates and Danielle Wood, ‘Super Tax Targeting’ (Research Report No 2015-11, Grattan Institute, November 2015) 26–7 <<http://grattan.edu.au/wp-content/uploads/2015/11/832-Super-tax-targeting.pdf>>.

<sup>77</sup> Knox, above n 74, 304.

<sup>78</sup> Raj Chetty et al, ‘Active vs Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark’ (2014) 129 *Quarterly Journal of Economics* 1141, 1215–16; Daniel J Benjamin, ‘Does 401(k) Eligibility Increase Saving?: Evidence from Propensity Score Subclassification’ (2003) 87 *Journal of Public Economics* 1259, 1285; Juan Ayuso, Juan F Jimeno, and Ernesto Villanueva, ‘The Effects of the Introduction of Tax Incentives on Retirement Savings’ (Working Paper No 0724, Banco De España, 2007) 32; Jun Feng, ‘The Effect of Superannuation Tax Incentives on Salary Sacrifice Participation’ (2014) 90 (special issue 1) *Economic Record* 59, 71; Orazio P Attanasio, James Banks, and Matthew Wakefield, ‘Effectiveness of Tax Incentives to Boost (Retirement) Saving: Theoretical Motivation and Empirical Evidence’ (Working Paper No 04/33, Institute for Fiscal Studies, 2004) 26.

<sup>79</sup> Chetty, above n 78, 1215–6; Benjamin, above n 78, 1285; Attanasio, above n 78, 26.

<sup>80</sup> OECD Tax Policy Studies, ‘Encouraging Savings Through Tax-Preferred Accounts’ (No 15, 2007).

<sup>81</sup> Chetty, above n 78, 1215–16.

<sup>82</sup> Commonwealth of Australia ‘Tax Expenditure Statements’ (Treasury, January 2017), 77–82 <<https://static.treasury.gov.au/uploads/sites/1/2018/01/2017-TES.pdf>>. This takes into account the concessional taxation on superannuation contributions and earnings and incorporates items C1, C2, C3 and C4, less items C10 and C11.

the behavioural changes that would occur in the absence of such concessions.<sup>83</sup> Consequently, the Commonwealth Treasury also models some of the aspects of the superannuation tax concessions that do take into account such behavioural changes. That modelling indicates that for the 2016–17 tax year, these concessions were responsible for a loss of revenue of a slightly more moderate \$33 billion.<sup>84</sup>

#### D *Distribution of the Benefits of Superannuation Tax Concessions*

A concessional tax, defined contribution system such as superannuation will by its nature lead to those with higher incomes getting a larger tax benefit. First, this is because superannuation contributions are, beneath a prescribed ceiling, taxed at a flat rate; higher income earners, being on a higher tax rate, benefit from a larger gap between their marginal tax rates and the superannuation contributions rate of 15 per cent.<sup>85</sup> Second, people with higher incomes typically have larger amounts contributed to their superannuation accounts, meaning that more of their dollars are subject to the concessional contributions tax rate than subject to the taxpayer's normal marginal rate.<sup>86</sup> Third, higher income earners will typically have higher superannuation balances, so the extent of their benefit from the concessional superannuation earnings rate is greater.<sup>87</sup>

The evidence indicates that for the pre-July 2017 rules, the benefit of superannuation tax concessions was highly skewed towards high income earners.<sup>88</sup> The degree of this bias can be considered suboptimal for two reasons. First, it can be argued that this bias breaches the principles of vertical equity (although the extent to which

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<sup>83</sup> George Rothman, 'Assessing the Equity of Australia's Retirement Income System' (Research Paper, Treasury, 6 July 2009) [4] <<http://www.docs.fce.unsw.edu.au/fce/Research/ResearchMicrosites/CPS/2009/papers/Rothman.pdf>>. Another criticism is that there is disagreement regarding whether an income tax or expenditure benchmark should be used, with the latter leading to a substantially lower tax expenditure figure: Commonwealth of Australia, 'Tax Expenditure Statements', above n 82, 77–8. A further issue with tax expenditure calculations is that they can be of limited reliability given that calculations such as those related to the superannuation tax expenditures rely on predictions: Commonwealth of Australia, 'Tax Expenditure Statements', above n 82, 12.

<sup>84</sup> Commonwealth of Australia, 'Tax Expenditure Statements', (Treasury, January 2016) <<https://static.treasury.gov.au/uploads/sites/1/2017/06/Tax-Expenditure-Statement-2016.pdf>>. The alternative modelling uses modified items C2 and C4, with an outcome for the 2016–17 tax year of two billion dollars less than the estimates that do not take into account behavioural change.

<sup>85</sup> Rami Hanegbi, 'Improving our Superannuation Regime: a Post-Henry Review Look at Superannuation Taxation, Raising Superannuation Balances and Longevity Insurance' (2010) 25 *Australian Tax Forum* 425, 441.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid.*

<sup>88</sup> David Murray, 'Financial System Inquiry Final Report' (Final Report, Treasury, November 2014) 138 <[http://fsi.gov.au/files/2014/12/FSI\\_Final\\_Report\\_Consolidated\\_20141210.pdf](http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated_20141210.pdf)>.

vertical equity should be implemented is open to debate, and needs to be seen in the context of the overall tax system).<sup>89</sup> Second, as the cost of superannuation is to some degree abated by reducing reliance on the age pension,<sup>90</sup> and higher income earners are unlikely to rely on the age pension even without the benefit of superannuation tax concessions,<sup>91</sup> it is more fiscally beneficial for superannuation benefits to be targeted away from higher income earners.

### *E Purpose of the Superannuation System*

Parliamentary debates regarding the legislation that introduced compulsory superannuation indicate that a major reason for its implementation was to give retirees an adequate level of retirement income.<sup>92</sup> Similarly, the more recent final Financial System Inquiry Report ('Final Report') stated that superannuation's primary objective was 'to provide income in retirement to substitute or supplement the Age Pension' and listed some subsidiary purposes, which for the most part were concerned with the welfare of retirees.<sup>93</sup> The government intends to legislate to formalise the stated purpose of superannuation to reflect the objectives stated in the report, although the legislation has yet to be passed.<sup>94</sup> Consequently, although no one source authoritatively states the purpose of superannuation, the evidence indicates that the superannuation regime is in place primarily to enhance retirement incomes.

## IV BACKGROUND TO THE JULY 2017 SUPERANNUATION CHANGES

Due to political realities and the fact that policy settings incorporate a range of trade-offs whose relative importance is debatable, the taxation of superannuation has, over the years, been the subject of several government reviews and numerous changes.<sup>95</sup>

For the most part, the July 2017 superannuation tax changes have their origins in comments and recommendations made by the Inquiry Reports. Consequently, it is useful to look at the relevant comments made in those reports and the political background against which they were implemented.

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<sup>89</sup> Commonwealth of Australia, 'Architecture of Australia's Tax and Transfer System' (Research Paper, August 2008) 180 <[http://www.taxreview.treasury.gov.au/content/downloads/report/Architecture\\_of\\_Australias\\_Tax\\_and\\_Transfer\\_System\\_Revised.pdf](http://www.taxreview.treasury.gov.au/content/downloads/report/Architecture_of_Australias_Tax_and_Transfer_System_Revised.pdf)>.

<sup>90</sup> Ingles and Stewart, above n 75, 24–5.

<sup>91</sup> Daley, Coates and Wood, above n 76, 26–7.

<sup>92</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 2 April 1992, 1763–4 (John Dawkins).

<sup>93</sup> Murray, Final Report, above n 88, 95.

<sup>94</sup> Superannuation (Objective) Bill 2016 (Cth).

<sup>95</sup> Lisa Marriott, *The Politics of Retirement Savings Taxation: A Trans-Tasman Comparison* (CCH Australia, 2010) ch 7.

### A *Inquiry Reports*

In July 2014 the interim Financial System Inquiry Report ('Interim Report')<sup>96</sup> was released with an invitation for public submissions. The Final Report<sup>97</sup> was released in December 2014. The government responded to the Final Report in October 2015.<sup>98</sup>

The Inquiry Reports contained substantial commentary on the taxation of superannuation. Broadly speaking, the Final Report suggested that consideration should be given to two interrelated issues. First was a proposal to align the earnings tax rates in accumulation and income-stream modes.<sup>99</sup> This recommendation has not been implemented. The second was to introduce policies to abate the problem of superannuation tax concessions disproportionately flowing to higher income earners.<sup>100</sup>

Regarding superannuation tax concessions, the Final Report specifically noted that the current superannuation tax arrangements disproportionately benefited higher income earners and those with large superannuation balances.<sup>101</sup> It pointed to that situation as a misuse of resources, given that the superannuation balances of such fund holders are unlikely to contribute to any reduction in expenditure on pensions.<sup>102</sup> The Final Report suggested that this concern be alleviated by better targeting of superannuation tax concessions, or through a larger earnings tax on those with high superannuation balance,<sup>103</sup> though the latter is in reality a form of better targeting of the superannuation tax concessions.

As to the first suggestion, that of better targeting of tax concessions, the Final Report mentioned the progressive but concessional contributions tax system recommended by the Australia's Future Tax System Review (also known as the 'Henry Review', a previous prominent tax review report).<sup>104</sup> The Final Report then went on to more strongly advocate reducing the non-concessional contributions cap as a way of better targeting superannuation tax concessions.<sup>105</sup>

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<sup>96</sup> David Murray, 'Financial System Inquiry Interim Report' (Interim Report, Treasury, July 2014) <[http://fsi.gov.au/files/2014/07/FSI\\_Report\\_Final\\_Reduced20140715.pdf](http://fsi.gov.au/files/2014/07/FSI_Report_Final_Reduced20140715.pdf)>.

<sup>97</sup> Murray, Final Report, above n 88.

<sup>98</sup> Commonwealth of Australia, 'Improving Australia's Financial System: Government Response to the Financial System Inquiry' (Treasury, 2015) <[https://static.treasury.gov.au/uploads/sites/1/2017/06/Government\\_response\\_to\\_FSI\\_2015.pdf](https://static.treasury.gov.au/uploads/sites/1/2017/06/Government_response_to_FSI_2015.pdf)>.

<sup>99</sup> Murray, Final Report, above n 88, 137–42.

<sup>100</sup> *Ibid* 137–42.

<sup>101</sup> *Ibid* 138.

<sup>102</sup> *Ibid*.

<sup>103</sup> *Ibid* 140–1.

<sup>104</sup> *Ibid* 140.

<sup>105</sup> *Ibid*.

In addition, the Final Report commented on superannuation income streams that benefit from tax-free earnings, suggesting that they be broadened to include a wider range of annuity-like products.<sup>106</sup>

### B *Background to the Implementation of the Inquiry Reports*

By way of background, the current Coalition Government, upon assuming power in 2013, initially expressed a reluctance to change the taxation of superannuation.<sup>107</sup> The comments on superannuation reform in the Final Report, made in 2014, were made in anticipation of superannuation being subject to further consideration as part of a general tax review process that was ongoing at the time.<sup>108</sup> Then, during September 2015, the Coalition government underwent a change of Prime Minister and Treasurer, and there were subsequent signs that the government was more willing to implement superannuation changes than under the previous leadership.<sup>109</sup> Shortly afterwards, in October 2015, when the government released an official response to the Final Report, it did not comment on these specific superannuation tax matters. Instead, it deferred any decision until the tax review process had progressed further.<sup>110</sup> However, by 2016, the government had retreated from that position and stated that there would be no final paper in the tax review process.<sup>111</sup>

Despite the general tax review process being halted, consistent with the government's earlier expression of willingness to reform superannuation the May 2016 budget outlined wide-ranging superannuation taxation reforms.<sup>112</sup> After the government's subsequent election victory, it made a further announcement on 15 September 2016 affirming its commitment to most of these budget announcements, though there was also some deviation from the original announcement.<sup>113</sup> During late November

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<sup>106</sup> Ibid 122, 125.

<sup>107</sup> Australian Broadcasting Corporation, *Promise Check: No Unexpected Adverse Changes to Superannuation* (8 May 2016) <<http://www.abc.net.au/news/2014-11-07/no-adverse-changes-to-superannuation-promise-check/5734364>>.

<sup>108</sup> Murray, Final Report, above n 88, 137; Commonwealth of Australia, 'Re:Think', above n 60, 67–70.

<sup>109</sup> Shalailah Medhora, 'Turnbull to Meet Business and Union Leaders to Outline Reform Agenda', *The Guardian* (online), 29 September 2015. <<http://www.theguardian.com/australia-news/2015/sep/29/turnbull-to-meet-with-business-and-union-leaders-to-outline-reform-agenda>>.

<sup>110</sup> Commonwealth of Australia, 'Government Response to the Financial System Inquiry', above n 98.

<sup>111</sup> Laura Tingle, 'Markets too Volatile for Big Tax Changes', *Australian Financial Review* (online) 5 February 2016 <<http://www.afr.com/news/politics/national/turnbull-rules-out-white-paper-denies-end-to-compulsory-super-20160204-gmmc59>>.

<sup>112</sup> Commonwealth of Australia, 'Budget 2016–17' (Budget Paper No 2, 3 May 2016) 27 <[https://www.budget.gov.au/2016-17/content/bp2/download/BP2\\_consolidated.pdf](https://www.budget.gov.au/2016-17/content/bp2/download/BP2_consolidated.pdf)>.

<sup>113</sup> Scott Morrison and Kelly O'Dwyer, 'Even Fairer, More Flexible and Sustainable Superannuation' (Media Release, 15 September 2016) <<http://sjm.ministers.treasury.gov.au/media-release/096-2016/>>.

2016, the government passed legislation which enacted the changes proposed in the September 2016 announcement.<sup>114</sup> These changes to some extent implemented the suggestions and recommendations made by the Final Report. Specifically, they relate to the Final Report's comments regarding abatement of the tax concessions flowing to higher income earners as well as widening the tax-free earnings exemption for a wider variety of income streams.<sup>115</sup> However, the government has not shown any intention to implement a universal and unified earnings rate regime as suggested by the Final Report.

## V JULY 2017 SUPERANNUATION CHANGES

There were numerous changes to the superannuation tax regime introduced on 1 July 2017. This part examines those changes, canvassing their background in the Inquiry Reports and evaluating them from a policy perspective. It considers, where relevant, the criteria of equity, efficiency and simplicity. In relation to efficiency, an issue that is potentially relevant for some of the changes is whether they have an impact on workforce participation.

### *A Lowering the Division 293 Threshold and Low Income Superannuation Tax Offset*

One of the July 2017 changes originally mentioned in the 2016 budget<sup>116</sup> was that the division 293 income threshold, which effectively makes concessional contributions subject to a 30 per cent tax rate rather than a 15 per cent tax rate, be lowered from an annual \$300 000 to a \$250 000 income amount.<sup>117</sup> Further, also announced in the 2016 budget and then legislated, was the continuation of the Low Income Superannuation Contribution Offset, which had been intended to be phased out from 1 July 2017<sup>118</sup>. It is now to continue under another name, the 'Low Income Superannuation Tax Offset'.<sup>119</sup> The effect of this offset is that the 15 per cent concessional contributions tax imposed on superannuation accounts is refunded in the case of lower income earners.<sup>120</sup>

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<sup>114</sup> *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth).

<sup>115</sup> Murray, Final Report, above n 88, 137–42.

<sup>116</sup> Commonwealth of Australia, Budget Paper No 2, above n 112, 28–9.

<sup>117</sup> *Income Tax Assessment Act 1997* (Cth) s 293-20, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) s 17.

<sup>118</sup> *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth) pt 2A, as repealed by *Minerals Resource Rent Tax Repeal and Other Measures Act 2014* (Cth) sch 7.

<sup>119</sup> *Ibid*, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 4, pt 1.

<sup>120</sup> *Ibid*.

### 1 *Background of Changes to Division 293 and Maintaining Low Income Offset*

The Final Report specifically suggested that superannuation concessions be taxed in a progressive manner to better target superannuation tax concessions away from higher income earners.<sup>121</sup> The division 293 contributions tax and a low-income superannuation tax offset do to some extent provide, albeit in an inelegant manner, a three-tier concessional contributions regime. As such, although the Final Report's suggestion of a progressive contributions tax was not explicitly implemented, maintaining the low-income superannuation tax offset and decreasing the division 293 threshold does to some extent mean that the system more effectively emulates a progressive regime.

### 2 *Evaluation of Changes to Division 293 and the Maintenance of Low Income Offset*

As discussed above, there are cogent arguments for better targeting of superannuation tax concessions for vertical equity and net fiscal impact. Changes that increase the progressivity of concessional contributions taxation do increase tax concession targeting. Further, one of the justifications for superannuation tax concessions is that retirement savings should be taxed at a lower rate because they represent income utilised when the taxpayer is in retirement, and so should be subject to a lower tax rate, since taxpayers in retirement would typically be on a lower tax rate.<sup>122</sup> Consequently, it is fair that higher income earners pay a higher, but still concessional, tax rate on their contributions — as compared with lower income earners — as this more closely approximates the situation that would result if the money had been earned in retirement.

Further, although the lowering of the division 293 threshold amounts in some cases leads to an increased tax on the remuneration of higher income earners, this is unlikely to have any substantial impact on the workforce participation of such workers. This is due to the very modest size of the increase in taxes<sup>123</sup> combined with the fact that higher income earners do not have a substantially higher relative tendency to reduce their work when subject to a higher tax burden.<sup>124</sup> Further, the work disincentive effect of an increase in tax on retirement fund contributions is substantially less than it is from an increase in tax on take-home salary, given that the former is only realised in the future.<sup>125</sup>

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<sup>121</sup> Murray, Final Report, above n 88, 140–1.

<sup>122</sup> Commonwealth of Australia, 'Australia's Future Tax System', above n 70, 97.

<sup>123</sup> For example, the maximum amount of extra tax potentially paid on someone fully utilising the \$25 000 concessional contributions cap would be  $\$25\,000 \times 15\% = \$3750$ .

<sup>124</sup> See Robert McClelland and Shannon Mok, 'A Review of Recent Research on Labor Supply Elasticities' (Working Paper No 2012–2, Congressional Budget Office, October 2012) 22–3.

<sup>125</sup> See Walter H Fisher and Christian Keuschnigg, 'Pension Reform and Labor Market Incentives' (2010) 23 *Journal of Population Economics* 769, 795.



While the July 2017 changes still fall far short of a genuinely progressive concessional contributions tax, they are a step in that direction. However, the reality remains that the \$250 000 threshold, although affecting substantially more taxpayers than the \$300 000 threshold, raises only a relatively modest amount of extra revenue.<sup>126</sup>

### B *Limiting Non-Concessional Contributions Cap*

The July 2017 changes included modifications to the non-concessional contributions cap. Specifically, the annual non-concessional contribution cap was lowered to \$100 000. From a legislative perspective this has been accomplished by stating that it is equal to four times the concessional contribution cap.<sup>127</sup> The ability to bring three years' worth of contributions within this cap has been retained.<sup>128</sup>

Another important legislated change prevents any non-concessional contributions once a member has a superannuation balance of at least \$1.6 million.<sup>129</sup> The new provisions regarding the \$1.6 million limit are also relatively simple, and expressed in terms of what the member's superannuation balance is at the beginning of the relevant financial year.<sup>130</sup> The superannuation balance is generally calculated by aggregating the value of the taxpayer's accounts in accumulation phase as well as their 'transfer balance cap' (as discussed later in this article, the transfer balance cap is the amount used to calculate whether the taxpayer has reached the \$1.6 million limit on superannuation income-stream accounts).<sup>131</sup>

#### 1 *Background to the Introduction of Changes Restricting Non-Concessional Contributions*

The Final Report, in arguing for a reduction in the tax concessions flowing to higher income earners, strongly advocated a reduction in the non-concessional contributions cap as a way to achieve this.<sup>132</sup> In response, the 2016 budget announced a severe limiting of the non-concessional contributions cap. Specifically, it was intended that this cap have a lifetime limit of \$500 000 of non-concessional contributions, and that this limit come into effect from budget eve.<sup>133</sup> Further, it was intended that any previous contributions made from 1 July 2007 be counted towards that limit.<sup>134</sup>

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<sup>126</sup> Explanatory Memorandum, Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) 13.

<sup>127</sup> *Income Tax Assessment Act 1997* (Cth) s 292-85(2)(a).

<sup>128</sup> *Ibid* ss 292-85(3)–(7).

<sup>129</sup> *Income Tax Assessment Act 1997* (Cth) ss 292-85(2)(b), 294-35, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 3.

<sup>130</sup> *Income Tax Assessment Act 1997* (Cth) ss 292-85(2)(b), 294-35.

<sup>131</sup> *Ibid* s 307-230(1).

<sup>132</sup> Murray, Final Report, above n 88, 140.

<sup>133</sup> Commonwealth of Australia, 'Budget 2016–17', 27.

<sup>134</sup> *Ibid*.

However, after sustained protest — some asserting that the limit was too low, others that the implementation was retrospective — the government announced, in September 2016, that it no longer intended to implement the \$500 000 lifetime non-concessional contribution limit.<sup>135</sup> Rather, it announced that from 1 July 2017 no further non-concessional contributions could be made if the taxpayer had a superannuation balance of at least \$1.6 million.<sup>136</sup> Further, from 1 July 2017, the annual non-concessional contribution limit would be lowered from \$180 000 to \$100 000.<sup>137</sup>

## *2 Evaluation of the Changes Regarding Restriction of Non-Concessional Contributions*

Non-concessional contributions benefit from concessional tax treatment on their subsequent earnings. As higher income earners are more likely to make large non-concessional contributions than others,<sup>138</sup> the changes further restricting non-concessional contributions increase vertical equity. Further, as non-concessional contributions lead to increased future superannuation income, restricting such contributions also increases vertical equity in the sense of limiting the amount of future earnings that are tax-preferred, regardless of the salary incomes of the contributors.

The Final Report's comment also made the accurate point that laws aimed at capping contributions will only abate high balances building in the future, and will not affect those who already have high balances.<sup>139</sup> This does not preclude it being good policy, but if the aim is to increase vertical equity due to a reduction of the concessions flowing to higher income earners, then that approach should ideally be accompanied by other policies that target those with money already in the system. Overall, a superannuation tax reform that in one way or another reduces the ability to make non-concessional contributions does contribute to making the system more equitable.

Specifically, concerning the prohibition on contributions once a \$1.6 million balance has been achieved, it could be argued that ultimately, given that a financial year is an arbitrary concept, non-concessional contributions should be limited according to some more policy-relevant principle than annual limits. While this could be achieved, as originally suggested, by a lifetime limit on non-concessional contributions, the legislation has instead utilised a prohibition on further contributions once a superannuation balance exceeds a set amount.<sup>140</sup> Either of these alternatives is likely to increase equity, and both are consistent with superannuation functioning as a retirement tool rather than an inter-generational wealth-building vehicle.

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<sup>135</sup> Morrison and O'Dwyer, above n 113.

<sup>136</sup> Ibid.

<sup>137</sup> Treasury, Australian Government, *Superannuation Reforms* <<https://treasury.gov.au/superannuation-reforms/>>.

<sup>138</sup> Daley, Coates and Wood, above n 76, 42.

<sup>139</sup> Murray, Final Report, above n 88, 142.

<sup>140</sup> *Income Tax Assessment Act 1997* (Cth) ss 292-85(2)(b), 294-35.

On the other hand, while a lifetime cap or prohibition on further deposits once a set balance is achieved should ideally be the main way of limiting non-concessional contributions, the presence of some annual limit to accompany this lifetime mechanism also aids vertical equity. This is because, in the absence of annual caps, wealthy people could deposit large amounts of superannuation early in their working lives, which would maximise their tax benefits to a greater extent than it would if they made deposits in a more staggered manner (since early deposits result in a greater utilisation of concessional earnings). However, as noted in the Final Report, an annual cap potentially removes flexibility from the system and may be to the detriment of those with broken work patterns.<sup>141</sup>

Given that there are arguments for both a non-concessional contributions cap once a certain balance is achieved and for annual limits, the next issue to consider is whether the limits that apply from 1 July 2017 are sound. Since the primary aim of the superannuation system is the provision of an income in retirement, ideally, that lifetime figure would be based on what is necessary for a comfortable retirement. Such a figure can never be devoid of subjectivities, and it will inevitably be partly based on community beliefs about the quantum of a 'reasonable' retirement income, assumptions on longevity, predicted future investment returns, and the degree of expectation that taxpayers should exhaust their capital. With this in mind, the \$1.6 million balance at which taxpayers cannot make any further non-concessional contributions appears to be consistent with the primary role of superannuation, given estimates for what is required for a 'comfortable retirement'.<sup>142</sup> This change goes some way to improving the equity of the current system, albeit at the cost of losing some simplicity, given that previously, members' superannuation balances were irrelevant to their ability to make contributions. In contrast, the initial proposed lifetime cap of \$500 000, in a world where investment returns are increasingly modest, would be unlikely to generate the type of income that is generally regarded by retirees as sufficient for an adequate retirement.<sup>143</sup> This would be exacerbated by the fact that recent changes to the age pension assets test mean that those with superannuation balances of \$500 000 will be ineligible for much of a pension.<sup>144</sup> Some characterised the initial budget

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<sup>141</sup> Murray, Final Report, above n 88, 140.

<sup>142</sup> Australian Securities and Investments Commission, *How Much is Enough?* (as at 8 September 2016) <<https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/super-contributions/how-much-is-enough>>. In the United States, a proposal regarding capping balances in tax-preferred retirement accounts recommended that the cap be set at US\$3.4 million: Jonathan Barry Forman, 'Reconsidering the Tax Treatment of Pensions and Annuities' (2014) 18 *Chapman Law Review* 221, 232.

<sup>143</sup> Australian Securities and Investments Commission, *How Much is Enough?*, above n 142.

<sup>144</sup> *Social Security Act 1991* (Cth) s 1064, as amended by *Social Services Legislation Amendment (Fair and Sustainable Pensions) Act 2015* (Cth) sch 3 pt 1.

changes as retrospective, especially as they affected non-concessional contributions made after 1 July 2007, though this was ultimately a matter of semantics.<sup>145</sup>

However, the government's lowered annual non-concessional contribution cap of \$100 000 will apply to those with lower balances, so it will be a blunt instrument, though the retention of the ability to bring forward three-years of contributions does to some degree alleviate such a concern. In other words, it will no doubt increase equity by discouraging some higher income or higher wealth individuals from disproportionately using the superannuation system to reduce tax. However it will also affect those who might have a low superannuation balance for a number of legitimate reasons — such as broken work patterns or having a relatively low paid job for much of their career — but now have some funds they could deposit in the superannuation system if permitted to do so to help them attain a sufficient superannuation balance. As discussed, while the primary tool for limiting non-concessional contributions should be restrictions on lifetime contributions or a certain superannuation balance being reached, annual caps do have their place. Policy judgments on the size of annual caps always involve trade-offs and subjective assessments, but it is arguable that reducing the annual cap to \$100 000 is not optimal policy.

### C Limiting Tax-Free Earnings

One of the more important July 2017 changes is the limiting of the balance of a member's superannuation income stream that can benefit from tax-free earnings to \$1.6 million.<sup>146</sup> Specifically, division 294 has been inserted in the *Income Tax Assessment Act 1997* (Cth), and in effect deems each superannuation holder with a superannuation income stream to have a transfer balance account which must not exceed \$1.6 million.<sup>147</sup> Amounts in a superannuation income stream exceeding the \$1.6 million cap will be subject to a 15 per cent tax for a first breach, and after 1 July 2018, subject to a 30 per cent tax for a second or subsequent breach.<sup>148</sup> This means that, depending on the breach, account holders would from a tax perspective be no worse off, and in some cases better off, keeping superannuation funds in excess of the cap in their accumulations phase, where earnings would be taxed at 15 per cent.<sup>149</sup>

Further, division 294 states that the transfer balance account is to be credited upon events such as the account holder having a superannuation income stream balance on 1 July 2017, or by transferring money into a superannuation income stream on or

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<sup>145</sup> Australian Broadcasting Commission, *Fact Check: Are the Government's Super Changes 'Not at All' Retrospective?* (27 May 2016) <<http://www.abc.net.au/news/2016-05-26/fact-check--government-super-changes/7422540>>.

<sup>146</sup> *Income Tax Assessment Act 1997* (Cth) s 294-35, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 1 pt 1.

<sup>147</sup> *Income Tax Assessment Act 1997* (Cth) div 294.

<sup>148</sup> *Ibid* s 294-30; *Superannuation (Excess Transfer Balance Tax) Imposition Act 2016* (Cth) s 5.

<sup>149</sup> *Income Tax Rates Act 1986* (Cth) ss 26(1), 27(1), 27A.

after that time.<sup>150</sup> However, earnings that increase the balance of the income stream are not a credit entry.<sup>151</sup> Conversely, this account is to be debited upon the occurrence of certain events such as commuting an income stream back to the accumulation phase or making a lump sum withdrawal.<sup>152</sup> However, it is not debited from normal account-based pension drawdowns that retirees typically use to fund living expenses, including ones that are required by the minimum age-based withdrawals limits.<sup>153</sup> The \$1.6 million limit is indexed to CPI to the nearest \$100 000.<sup>154</sup> For those entitled to a non-commutable, defined-benefit superannuation income stream, only the first \$100 000 paid each year can benefit from a tax offset.<sup>155</sup>

### 1 *Background to Limiting Tax-Free Earnings*

One of the main suggestions of the Final Report regarding the taxation of superannuation was to increase superannuation earnings tax for those with balances over a certain limit.<sup>156</sup>

Previously, the Australian Labor Party ('ALP'), while in government, also had plans to increase the earnings tax payable by wealthier people.<sup>157</sup> Specifically, it planned to introduce a tax on all superannuation income-stream earnings exceeding \$100 000 in any particular financial year, at the rate of 15 per cent (rather than being tax-free).<sup>158</sup> This was not implemented. Subsequently, after losing the election and becoming the opposition party in 2013, the ALP announced its intention to implement a more restrictive version of this policy, whereby income-stream earnings in excess of \$75 000 in a particular year would be subject to a 15 per cent tax.<sup>159</sup>

It should be noted that the Final Report's suggestion was not identical to the one proposed by the ALP. Specifically, the ALP's proposal was aimed at making some tax-free income-stream earnings for targeted taxpayers subject to the same tax rate as earnings on superannuation accumulation funds.<sup>160</sup> The Final Report's proposal,

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<sup>150</sup> *Income Tax Assessment Act 1997* (Cth) s 294-25.

<sup>151</sup> Explanatory Memorandum, Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) [3.57].

<sup>152</sup> *Income Tax Assessment Act 1997* (Cth) s 294-80.

<sup>153</sup> Explanatory Memorandum, Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) [3.100].

<sup>154</sup> *Income Tax Assessment Act 1997* (Cth) s 960-285.

<sup>155</sup> *Ibid* sub-div 294-D.

<sup>156</sup> Murray, Final Report, above n 88, 142.

<sup>157</sup> Bill Shorten and Wayne Swan, 'Reforms to Make the Superannuation System Fairer' (Media Release, 14 September 2010) <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/020.htm&pageID=&min=brs&Year=&DocType=0>>.

<sup>158</sup> *Ibid*.

<sup>159</sup> Australian Labor Party, *Labor's Fairer Super Plan* (as at 13 March 2018) <[https://web.archive.org/web/20180313045750/https://www.alp.org.au/fairer\\_super\\_plan](https://web.archive.org/web/20180313045750/https://www.alp.org.au/fairer_super_plan)>.

<sup>160</sup> Shorten and Swan, above n 157.

on the other hand, was not targeted at increasing tax solely on the earnings of income-stream accounts, but on the earnings of both accumulation and income-stream accounts when the member's total superannuation balance exceeded a certain threshold.<sup>161</sup> A further difference between the Final Report's proposal and that of the ALP is that the Final Report's proposal uses the superannuation fund's balance, rather than its earnings, as the criterion for determining whether the higher earnings rate is applicable.

The current government initially announced, prior to the publication of the Inquiry Reports, that it would not implement a means-tested increase to the superannuation earnings rate.<sup>162</sup> It justified this on the basis that such a change would lead to higher compliance costs for superannuation funds, and avoiding it would help to bring certainty to the superannuation system.<sup>163</sup> However, in the 2016 budget, as a manifestation of the change of direction, the government announced that from 1 July 2017 the maximum amount that could be retained in tax-free earnings mode would be \$1.6 million per taxpayer.<sup>164</sup>

## *2 Evaluation of Law Limiting Tax-Free Earnings*

Putting a limit on the amount that can benefit from tax-free earnings promotes vertical equity, given that earnings are in substance a form of income accruing to the account holder. It is also fiscally positive, as it targets the concessions away from those who are unlikely to utilise the age pension, even though the concept of a transfer balance account comes at some cost to administrative simplicity. However, ultimately, whether the earnings or the balance of the account should be the criterion for a higher level of tax, and at what threshold it should apply, are matters of debate.

The advantage of using earnings as opposed to account balance as the criterion for limiting tax-free earnings is that the long-term returns on assets can change over time, meaning that in a world of unpredictable investment returns, the balance required to support a comfortable requirement today might be inadequate in the future if long-term returns fall. Further, the most targeted way for such a policy to increase vertical equity would be to set earnings as the relevant criterion, since earnings are in essence a form of income.

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<sup>161</sup> Murray, Final Report, above n 88, 141.

<sup>162</sup> Arthur Sinodinos and Joe Hockey, 'Restoring Integrity in the Australian Tax System' (Media Release, 6 November 2013) <<http://axs.ministers.treasury.gov.au/media-release/003-2013/>>.

<sup>163</sup> Murray, Final Report, above n 88, 141. The Final Report did suggest that the compliance issue could be overcome by placing the liability for tax on income stream earnings directly on the taxpayer rather than on their superannuation funds, but that the taxpayer have the option of withdrawing funds from their superannuation account should they wish to access their superannuation money to pay the tax liability (at 141).

<sup>164</sup> Commonwealth of Australia, 'Budget 2016–17', above n 112, 27.

However, given that the legislation uses the account balance as the criterion for the limit of tax-free earnings, it is also important to consider whether \$1.6 million is an appropriate threshold. As discussed, it appears to be a reasonably suitable figure for the balance at which the legislation disallows further non-concessional contributions, given the funds required for a comfortable retirement. Consequently, it is consistent to say that \$1.6 million is a fair figure for the limit to which funds can benefit from tax-free earnings. Further, arguments that it is insufficient<sup>165</sup> ignore the presence of the tax-free threshold,<sup>166</sup> which in many instances enables retirees to withdraw a portion of their superannuation funds and earn tax-free money outside of superannuation.

Overall, the introduction of the transfer balance cap appears to be a positive step in increasing equity, notwithstanding the increased administrative complexity it introduces and that, arguably, earnings would be a more suitable criterion than account balance. It could also be argued that a regime where earnings on superannuation balances in excess of \$1.6 million were subject to non-concessional personal marginal tax rates would even further enhance equity. To avoid arbitrariness, such a hypothetical system would realistically have to be applied to all superannuation balances, not just to income streams. Under such rules, those able to access their superannuation would obtain no tax advantage by retaining excess funds in superannuation. However, such a measure would add complexity, and potentially erode a major aim of superannuation, which is to avoid excessively taxing after-inflation returns.

In terms of efficiency, workforce participation is very unlikely to be negatively affected by the introduction of a transfer balance cap, given that the evidence suggests that mature workers eligible for receiving retirement income while participating in the workforce are more likely to continue to participate if their retirement income is more highly taxed.<sup>167</sup>

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<sup>165</sup> See, eg, Sam Buckingham-Jones, 'Election 2016: Labor Seizes on Peter Costello's Comments about Coalition's Superannuation Policy', *The Australian* (online), 18 May 2016 <<https://www.theaustralian.com.au/federal-election-2016/election-2016-labor-seizes-on-peter-costellos-comments-about-coalitions-superannuation-policy/news-story/d5471f472fe040a43ce3226e75b433e2>>.

<sup>166</sup> *Income Tax Rates Act 1986* (Cth) s 12(1), sch 7 pt 1.

<sup>167</sup> See Timothy F Page and Karen Smith Conway, 'The Labor Supply Effects of Taxing Social Security Benefits' (2015) 43 *Public Finance Review* 291, 313–14 where tax on American social security benefit receipts was linked to a higher work-force participation rate of such recipients.

### D Broadening Income Streams Subject to Earnings Tax Exemptions

On 1 July 2017, both deferred life annuities and ‘innovative income streams’ were characterised as income streams that benefit from tax-free earnings.<sup>168</sup> Specifically, superannuation accounts holding deferred lifetime annuities can now benefit from tax-free earnings, as the legislation now states that these can constitute ‘superannuation income streams’.<sup>169</sup> Deferred lifetime annuities, as their name suggests, are like other life annuities, except that they commence payment only after the retiree reaches a pre-determined age.<sup>170</sup>

Further, the government has also allowed ‘innovative income streams’ (which are income streams that do not necessarily satisfy the conditions of being an annuity or an account-based pension, but do fulfil the four legislative conditions of being an innovative income stream) to constitute superannuation income streams that can benefit from tax-free earnings.<sup>171</sup> This in itself is a radical reform, in that it introduces a whole new category of superannuation income streams. Specifically, for an income stream product to constitute an ‘innovative income stream’ four conditions need to be fulfilled. First, the taxpayer must have satisfied a condition of release, such as reaching preservation age and retiring, before being entitled to any benefits.<sup>172</sup> Second, once commenced, the payments must be payable to the holder for the rest of their life.<sup>173</sup> Third, there cannot be an unreasonable deferral of payments from the instrument after payments have commenced.<sup>174</sup> Fourth, the instrument cannot

<sup>168</sup> *Income Tax Assessment Act 1997* (Cth) ss 307-75, 307-80, 995-1 as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 11; *Income Tax Assessment Act 1997* (Cth) s 295-385, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 8; *Income Tax Assessment Regulations 1997* (Cth) sub-reg 995-1.01(1), as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 items 7–9; *Superannuation Industry (Supervision) Regulations 1994* (Cth) regs 1.03, 1.06, 1.06A, 1.06B, as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 items 11, 16, 20.

<sup>169</sup> *Income Tax Assessment Act 1997* (Cth) ss 307-75, 307-80, 995-1; *Income Tax Assessment Regulations 1997* (Cth) sub-reg 995-1.01(1), as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 items 7–9; *Superannuation Industry (Supervision) Regulations 1994* (Cth) regs 1.03, 1.06, 1.06A, 1.06B, as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 items 11, 16, 20.

<sup>170</sup> Murray, Final Report, above n 88, 125.

<sup>171</sup> *Income Tax Assessment Regulations 1997* (Cth) sub-reg 995-1.01(1), as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 item 9; *Superannuation Industry (Supervision) Regulations 1994* (Cth) regs 1.03, 1.06, 1.06A, 1.06B, as amended by *Treasury Laws Amendment (2017 Measures No 1) Regulations 2017* (Cth) sch 1 items 11, 16, 20.

<sup>172</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth) sub-regs 1.06(1)(a), 1.06A(3)(a).

<sup>173</sup> *Ibid* sub-reg 1.06A(3)(b).

<sup>174</sup> *Ibid* sub-reg 1.06A(3)(c).



provide for more than a maximum amount to be commuted to a lump sum.<sup>175</sup> This maximum amount is based on a straight-line, sliding scale, calculated from the date on which the instrument commences until the actuarially estimated life expectancy of the holder of the instrument.<sup>176</sup> For instance, if a taxpayer starts receiving an innovative income stream payment at 70 and their expected life expectancy is 82, then at half way through that point, at 76, the instrument must not allow them to be refunded anything more than half of the capital used to purchase the instrument. Clearly, an instrument that did not allow any capital commutation would fulfil this requirement.

### 1 *Background of Laws that Broaden Superannuation Income Streams*

The Final Report recommended legislative changes to bring deferred lifetime annuities and pooled products under the tax-free earnings net.<sup>177</sup> Specifically, pooled products allow contributors to pool assets in return for each being entitled to a regular income stream for life.<sup>178</sup> Although such pooled products protect against individual longevity risk, unlike traditional life annuities, they do not protect against systematic longevity risk, and they do carry investment risk.<sup>179</sup> As far as systematic longevity risk is concerned, any rise in community-wide life expectancies that exceeded predicted levels would lead to lower annuity payments under such a scheme.<sup>180</sup> The government's response stated that it would take action on this recommendation.<sup>181</sup>

Also in 2014, a separate document, the Retirement Income Stream Regulation discussion paper addressed the issue of widening the range of instruments that could benefit from tax-free earnings, and invited public submissions on that issue.<sup>182</sup> In 2016 this was followed by the final paper on Retirement Income Stream Regulation, which recommended the expansion of superannuation income streams.<sup>183</sup> Specifically, it recommended that the legislation be changed to allow deferred lifetime annuities and innovative income streams (the latter of which would include pooled products).<sup>184</sup>

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<sup>175</sup> Ibid sub-reg 1.06A(3)(d), reg 1.06B.

<sup>176</sup> Ibid.

<sup>177</sup> Murray, Final Report, above n 88, 125.

<sup>178</sup> Ibid.

<sup>179</sup> Ibid.

<sup>180</sup> Ibid.

<sup>181</sup> Commonwealth of Australia, 'Improving Australia's Financial System: Government Response to the Financial System Inquiry', above n 98, 13.

<sup>182</sup> Commonwealth of Australia, 'Review of Retirement Income Stream Regulation' (Discussion Paper, Treasury, July 2014) <[https://static.treasury.gov.au/uploads/sites/1/2017/06/C2014-037\\_Dicussion-paper.pdf](https://static.treasury.gov.au/uploads/sites/1/2017/06/C2014-037_Dicussion-paper.pdf)>.

<sup>183</sup> Commonwealth of Australia 'Retirement Income Streams Review' (Treasury, May 2016) 2, 10–15 <<https://static.treasury.gov.au/uploads/sites/1/2017/06/Review-of-Retirement-Income-Streams.pdf>>.

<sup>184</sup> Ibid 15.

## 2 *Evaluation of Changes regarding Laws Broadening Superannuation Income Streams*

Traditional lifetime annuities provide a regular, reliable income stream for the rest of the holder's life that is safe from investment and longevity risk.<sup>185</sup> A related point is that these annuities can theoretically provide a higher retirement income than an account-based pension.<sup>186</sup> This is because choosing a rate of spending with an account-based pension requires a trade-off between the risk of outliving one's savings (by consuming resources too fast, on the assumption of dying at the actuarially predicted age) and being risk averse (under-consuming, on the assumption that one might materially outlive one's predicted life expectancy).<sup>187</sup> Despite their benefits, for a variety of reasons, lifetime annuities are unpopular internationally.<sup>188</sup> As annuities and annuity-like instruments can enhance the security and size of retirement incomes, widening the variety of forms they are available in is consistent with the primary purpose of superannuation.

Specifically, extending the earnings tax exemption to deferred life annuities will in some cases result in annuitisation becoming a more attractive option. Deferred life annuities are characterised by a deferred start time, as compared with immediate lifetime annuities.<sup>189</sup> Since annuities have in-built fees, deferred life annuities provide better value for money, in the sense that less money needs to be spent on them because their commencement date is delayed.<sup>190</sup> In other words, because they only provide a secure income for the later part of life, where longevity is relatively uncertain, less money needs to be spent on their purchase, so that less is lost on the annuity fee loading. As such annuities provide a greater opportunity for providing a reliable retirement income stream, there is good reason for including their earnings under the tax-free umbrella of other superannuation income streams.

Similarly, changing the definition of 'superannuation income streams' to include innovative income streams (including eligible pooled annuities) that potentially hold many of the benefits of traditional lifetime annuities, though with greater risk,<sup>191</sup> is a positive policy move. Pooled annuity products are cheaper and offer higher incomes than traditional life annuities.<sup>192</sup> There are behavioural reasons why people might

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<sup>185</sup> Mulvey and Purcell, above n 41, 2–4.

<sup>186</sup> Jeffrey R Brown, 'Rational and Behavioral Perspectives on the Role of Annuities in Retirement Planning' (Working Paper No 13537, National Bureau of Economic Research, October 2007) 4–6, 35.

<sup>187</sup> *Ibid.*

<sup>188</sup> Jeffrey R Brown, 'Financial Education and Annuities' [2008] (3) *OECD Journal: General Papers* 173, 181–2.

<sup>189</sup> Murray, Final Report, above n 88, 317.

<sup>190</sup> Shlomo Benartzi, Alessandro Previtro and Richard H Thaler, 'Annuitization Puzzles' (2011) 25(4) *Journal of Economic Perspectives* 143, 157.

<sup>191</sup> Murray, Final Report, above n 88, 125.

<sup>192</sup> Murray, Interim Report, above n 96, 4–27.

prefer such annuities.<sup>193</sup> Consequently, as such instruments will assist some retirees to enjoy a higher retirement income, it is consistent with the aims of superannuation that such instruments should also fall under the tax-free net applying to other superannuation income streams. Although widening the range of eligible income streams does add some complexity to the legislation, such impact is limited, because compliance will for the most part fall on superannuation funds, who are already well-equipped in dealing with complex legislative frameworks.

### *E Deductible Personal Concessional Contributions*

One of the announcements made in the 2016 budget, and now legislated to apply from 1 July 2017, concerns making it possible for salary earners to make concessional contributions together with an accompanying tax deduction.<sup>194</sup> Until 1 July 2017, taxpayers could only make concessional contributions individually if they earned less than 10 per cent of their income from their salary.<sup>195</sup> This means that the typical salary earner could in the past only make what was in effect additional concessional contributions if their employers agreed to a ‘salary sacrifice arrangement’. This change, effective from 1 July 2017, allows salary earners to arrive at the same tax and economic outcome by making their own contributions as if they had entered into salary sacrifice arrangements. This change was not based on any recommendations or suggestions by the Inquiry Reports.

This appears to be a very positive change in the law, as it frees employees from having to rely on their employer’s willingness to make additional concessional contributions to increase their superannuation balance. Further, it enhances simplicity, as it reduces the administrative complexity of having to enter into salary sacrifice arrangements.

### *F Changes to Concessional Contributions Cap*

It was announced in the 2016 budget,<sup>196</sup> and subsequently legislated,<sup>197</sup> that from 1 July 2017 the concessional contribution cap for all age groups would be reduced to \$25 000. The legislation reduced the pre-July 2017 limits of \$35 000 (for those

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<sup>193</sup> See generally Wei-Yin Hu and Jason S Scott, ‘Behavioral Obstacles in the Annuity Market’ (2007) 63(6) *Financial Analysts Journal* 71.

<sup>194</sup> *Income Tax Assessment Act 1997* (Cth) s 290-150, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 5.

<sup>195</sup> *Income Tax Assessment Act 1997* (Cth) ss 280-10, 290-150, 290-160, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 5.

<sup>196</sup> Commonwealth of Australia, ‘Budget 2016–17’, above n 112, 28–9.

<sup>197</sup> *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 2 pt 1.

at least 50 years of age) and \$30 000 (for others).<sup>198</sup> Further, also announced in the 2016 budget<sup>199</sup> and now legislated,<sup>200</sup> from 1 July 2018 unused concessional cap amounts can be rolled over for up to five years (meaning that the ability to utilise previously unused caps will only be available from 1 July 2019).

While these changes were not specifically raised by either of the Inquiry Reports, they are consistent with the general arguments made in the Final Report that superannuation taxation benefits are excessively geared to wealthier members of our community.<sup>201</sup>

### 1 *Evaluation of Reduction in Concessional Contribution Cap and Ability to Rollover Unused Concessional Contribution Caps*

Given that higher income earners are more likely to use a higher concessional contribution cap, having it lowered to an annual limit of \$25 000 will increase vertical equity,<sup>202</sup> especially given that the previous cap appeared generous by some measures.<sup>203</sup> As discussed, limiting non-concessional contributions also increases vertical equity, and preventing such further contributions once a certain superannuation balance has been obtained, as opposed to an over-reliance on annual limits, is fairer in that it does not rely on the arbitrary concept of a financial year. However, with concessional contributions there is a stronger argument for exclusive reliance on annual caps. This is because a substantial proportion of concessional contributions are compulsory employer contributions,<sup>204</sup> and differentially disallowing these would be administratively complex (for example, the existence of a lifetime concessional contributions cap would mean some employees would not be entitled to receive any mandatory contributions).

On the other hand, the scrapping of a larger limit for older workers is suboptimal in some cases, since older workers have had a limited amount of time to participate in a mature mandatory superannuation system, given that compulsory superannuation

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<sup>198</sup> *Income Tax Assessment Act 1997* (Cth) s 291-20, later amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 2 pt 1; *Income Tax (Transitional Provisions) Act 1997* (Cth) s 291-20.

<sup>199</sup> Commonwealth of Australia, ‘Budget 2016–17’, above n 112, 24.

<sup>200</sup> *Income Tax Assessment Act 1997* (Cth) s 291-20(3)–(7), as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 6.

<sup>201</sup> Murray, Final Report, above n 88, 137–8.

<sup>202</sup> David Ingles, Emily Millane and Miranda Stewart, Submission to Treasury, *Superannuation Reform Package*, 15 September 2016 [4] <[https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies\\_crawford\\_anu\\_edu\\_au/2016-10/ttpt\\_submission\\_superannuation\\_changes\\_15.09\\_16\\_tranche\\_i.pdf](https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies_crawford_anu_edu_au/2016-10/ttpt_submission_superannuation_changes_15.09_16_tranche_i.pdf)>.

<sup>203</sup> Christopher Strano and Dale Pinto, ‘A Comparative Analysis of Australian and Hong Kong Retirement Systems’ (2016) 14(1) *eJournal of Tax Research* 34, 51–2.

<sup>204</sup> Daley, Coates and Wood, above n 76, 40.

was introduced in the early 1990s and was initially set at a low contribution rate.<sup>205</sup> Consequently, there is an argument for older workers being able to participate at a higher cap level to assist them to provide for an adequate retirement income. The precise level of the higher cap could partly be based on an actuarial analysis of the extent to which mature workers have been disadvantaged by their limited participation in a mature superannuation system. Such a higher cap could be limited to mature workers who have a superannuation balance below a certain threshold, as was proposed by the previous government but never implemented.<sup>206</sup> In the alternative, a higher annual cap could be allowed for people of all ages until they reach a certain superannuation balance threshold. This would recognise that there may be legitimate reasons other than mature age to have insufficiently participated in the superannuation system, such as the broken work patterns of those raising a family.<sup>207</sup> However, this would have the disadvantage of a greater loss in tax revenue.

The lower concessional contribution cap is unlikely to have any impact on efficiency as far as workforce participation is concerned, given its size<sup>208</sup> and the fact that tax increases on retirement contributions have less of an impact on work incentives than tax increases on take-home pay.<sup>209</sup>

The related change that allows rollovers of unused concessional contributions caps has much merit. Allowing rollovers for up to five years for unused concessional contributions is a good step towards taking a longer-term view. As discussed, broken work patterns, especially for women,<sup>210</sup> can compromise a person's ability to fully utilise their concessional contribution limits to help build an adequate superannuation balance, and this to some extent allows such people more flexibility. This means that such a policy will abate, and in some cases have a benefit that exceeds, the reduction in the annual concessional contributions caps. While anyone seeking to take advantage of the rollover will need to access their contribution records for previous years, leading to some loss of simplicity, this is likely to have a limited impact, given that modern technology would allow members to access the relevant

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<sup>205</sup> Leslie Nielson and Barbara Harris, *Chronology of Superannuation and Retirement Income in Australia* (1 June 2010) <[https://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/BN/0910/ChronSuperannuation](https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/0910/ChronSuperannuation)>.

<sup>206</sup> Ness Super, *Government Proposed Changes to Concessional Contributions and Co-Contributions* (16 February 2012) <<https://web.archive.org/web/20180907194246/http://nesssuper.com.au/government-proposed-changes-concessional-contributions-co-contributions/>>.

<sup>207</sup> See generally Senate Economics References Committee, Parliament of Australia, *'A Husband is Not a Retirement Plan' – Achieving Economic Security for Women in Retirement* (2016).

<sup>208</sup> For example, for someone on the top tax rate the inability to no longer use the \$30 000 cap results in an increase in tax of  $(\$30\,000 - \$25\,000) \times (47\% - 15\%) = \$1600$ . For those previously able to use the \$35 000 cap the amount would be double this, \$3200.

<sup>209</sup> McClelland and Mok, above n 124, 22–3.

<sup>210</sup> Senate Economics References Committee, above n 207.

government website holding such records. However, while any limit to the rollover period will by its nature be arbitrary, arguably it should be more than five years to allow those whose superannuation has fallen behind a greater chance to catch up, though this needs to be balanced against potential government tax revenue loss and administrative complexity. Further, it could be argued that limiting the right to exercise the use of this rollover to those with balances up to \$500 000 sets it at too low a threshold, given current low returns, and that \$500 000 falls drastically short of what is required for a comfortable retirement.<sup>211</sup> On the other hand, there are arguments for making this threshold lower than the \$1.6 million fund balance limit after which further non-concessional contributions are disallowed,<sup>212</sup> given that concessional contributions have a substantially higher fiscal cost compared with non-concessional contributions.<sup>213</sup>

Overall, while there are arguments for a higher concessional contributions cap for those with lower balances, especially older workers, the introduction of the ability to rollover unused concessional contribution caps is a positive policy move that offers a greater number of people an opportunity to build up a higher superannuation balance.

### G Spouse Contribution Offset

A further July 2017 change announced in the 2016 budget,<sup>214</sup> and now legislated,<sup>215</sup> involved increasing the threshold income of the recipient at which the spouse contribution offset is applicable. The pre-July 2017 threshold for the full offset was \$10 000, with a shading-out for higher amounts and no entitlement at income levels of \$13 000 or over.<sup>216</sup> From 1 July 2017 these thresholds were raised to \$37 000 and \$40 000 respectively.<sup>217</sup> As this change will cost the government very little from a fiscal point of view and allow a greater number of spouses to build up their superannuation balances, it appears to be a positive measure.<sup>218</sup> On the other hand, the fact that revenue loss is estimated to be very limited means that the offset is unlikely to be utilised to any substantially greater degree than is currently the case.

<sup>211</sup> Australian Securities and Investments Commission, *How Much is Enough?*, above n 142.

<sup>212</sup> *Income Tax Assessment Act 1997* (Cth) s 292-85(2)(b), s 294-35.

<sup>213</sup> Commonwealth of Australia, *Tax Expenditures Statement 2017* (Treasury, January 2018) 77–8 <<https://static.treasury.gov.au/uploads/sites/1/2018/01/2017-TES.pdf>>.

<sup>214</sup> Commonwealth of Australia, ‘Budget 2016–17’, above n 112, 25.

<sup>215</sup> *Income Tax Assessment Act 1997* (Cth) ss 290-230, 290-235, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 7.

<sup>216</sup> *Income Tax Assessment Act 1997* (Cth) ss 290-230, 290-235.

<sup>217</sup> *Ibid* ss 290-230, 290-235, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 7.

<sup>218</sup> Commonwealth of Australia, Budget Paper No 2, above n 112, 25.

## H *Transition to Retirement Income Streams Changes*

Another of the superannuation tax changes announced in the 2016 Budget<sup>219</sup> and now legislated concerns earnings made from transition to retirement income streams no longer being tax-free as of 1 July 2017.<sup>220</sup>

While changing the taxation of transition to retirement income streams was not an issue specifically covered in the Inquiry Reports, these changes are consistent with its comments to the effect that superannuation tax concessions could benefit from improved targeting.<sup>221</sup>

### I *Evaluation of Reduction in Concessional Contribution Cap and Ability to Rollover Unused Concessional Contribution Caps*

Transition to retirement income streams were originally intended to be used by taxpayers transitioning from full to part-time work, and in doing so, dipping into their superannuation to make up for their lower income.<sup>222</sup> However, in reality, their predominant use has turned out to be by full-time workers who use it as a tax minimisation strategy.<sup>223</sup> Subsequently, the policy of making transition to retirement income stream earnings subject to the same rate of tax as those of accumulation funds will reduce their effectiveness as a tax minimisation vehicle while leaving it possible for those who use them for legitimate purposes to continue to do so. As the ability for full-time workers to effectively gain a tax benefit from utilising a transition to retirement income stream strategy was dependent on a reasonable superannuation balance,<sup>224</sup> and such balances correlate to higher incomes,<sup>225</sup> these changes increase vertical equity. Further, the evidence suggests that the changes are unlikely to have any negative impact on workforce participation of mature workers, given that the introduction of the transition to retirement provisions in their original form did not increase mature worker participation.<sup>226</sup>

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<sup>219</sup> Ibid, 30.

<sup>220</sup> *Income Tax Assessment Act 1997* (Cth) s 307-80, as amended by *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (Cth) sch 11.

<sup>221</sup> Murray, Final Report, above n 88, 137–8.

<sup>222</sup> Commonwealth of Australia, ‘Transition to Retirement’ (Consultation Paper, Treasury, November 2004) 3–4 <[http://archive.treasury.gov.au/documents/928/PDF/Transition\\_to\\_retirement\\_Consultation.pdf](http://archive.treasury.gov.au/documents/928/PDF/Transition_to_retirement_Consultation.pdf)>.

<sup>223</sup> Explanatory Memorandum, *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* (Cth) [10.12].

<sup>224</sup> Under *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 6.01(2), a transition to retirement income stream can only distribute a maximum of 10 per cent of its balance, meaning that someone utilising it as a tax minimisation strategy to replace concessionally contributed funds requires a reasonable superannuation balance.

<sup>225</sup> Daley, Coates and Wood, above n 76, 61.

<sup>226</sup> Rami Hanegbi, ‘The Transition to Retirement Provisions: A Critical Analysis and a Consideration of Policy Alternatives’ (2013) 23 *Revenue Law Journal* 1, 7–8.

One consequence of this new law is that the few part-time workers who legitimately used such income streams for retirement purposes are treated the same as the full-time workers who utilised them to minimise their tax. In contrast, an alternative theoretical policy of quarantining the utilisation of the transition to retirement income stream tax concessions to those who work part-time would have the advantage of enabling the few who use them legitimately to continue to benefit from their concessional tax treatment.

## VI CONCLUSION

A superannuation system free from taxes would provide retirees with substantially higher retirement balances and incomes. However, for the purposes of equity and revenue raising, some degree of superannuation taxation is desirable. This means that a consideration of superannuation taxation raises many complex issues and involves value judgments.

Specifically, lowering the division 293 threshold, maintaining the offset for lower income earner contributions, limiting tax-free earnings, and placing extra limitations on contribution caps, all increase the equity of the system. The other changes, involving broadening the range of income streams that can benefit from superannuation tax concessions and increasing the spouse contribution offset, while not aimed at increasing vertical equity, are consistent with the superannuation system's purpose of providing retirees with a reasonable retirement income. While some of the changes — mainly the introduction of the transfer balance cap and limitation of non-concessional contributions — do increase complexity in managing superannuation funds, they will only affect those with higher balances, who are likely in most cases to have the resources to comply with the new laws. Further, there is no indication of substantial economic distortions caused by these changes.

The Australian superannuation system is a never-ending work-in-progress, and policy debate relating to its taxation is likely to continue indefinitely. This article has found that as a whole, the latest round of changes — while far from ideal — make the system more sustainable and fair.