AIST briefing paper

November 2010

The benefits of an SG rate of 12 per cent

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Background

Australia's retirement system is based on a three-pillar approach of age pensions, compulsory super contributions and voluntary private savings.

When the Keating government introduced the superannuation guarantee ("SG") in 1992, the ultimate target was 15 per cent. However the enacting legislation specified a schedule of increases to only 9 per cent, which was reached in 2002.

While the super system has fallen short in delivering an SG rate of 15 per cent, Australia's retirement income architecture is widely recognised as world's best practice.

Today, employees have nearly $1.3 trillion of assets in superannuation and the Australian economy is the world's largest per capita for investment in managed funds. These savings acted as a buffer for Australian business against the turmoil of the Global Financial Crisis.

The Government's proposal

In May 2010, the Federal Government proposed to gradually increase the SG rate to 12 per cent by 2019. The Government's proposal provides three years before the SG rate starts to rise – first by 0.25 per cent in 2013-14 and 2014-15, and then by 0.5 per cent every year until it reaches 12 per cent in 2019. It also includes measures to improve the equity of the tax treatment of super, and provision for a 'low-income' rebate equal to the 15 per cent contributions tax on the SG rate of 9 per cent – up to $500 to workers earning up to $37,000 per annum.

Since pre-tax contributions to superannuation are taxed concessionally at 15 per cent, high-income earners with a marginal tax rate of up to 46.5 per cent[1] have a significant incentive to put more income into superannuation and reduce their overall taxable income. By contrast, Australian residents with annual taxable income between $6,000 and $37,000 have a marginal tax rate of 16.5 per cent, and therefore little financial incentive to lock wealth into superannuation investments until they retire. Rebating low-income earners for contribution tax would ensure that they do not pay any tax on SG contributions and provide a substantial incentive to invest in superannuation and save towards retirement.

Why 9 per cent is not adequate

There is broad consensus that the current SG rate of 9 per cent is insufficient to provide an adequate retirement income for the majority of working Australians. This is particularly true for workers who earn less than the average wage and for whom retirement income adequacy will still be very much linked to age pension adequacy even when the compulsory super system fully matures.

While there is no universally agreed target for the adequacy of retirement incomes, one common measure is current retirement income expressed as a percentage of pre-retirement earnings. An 'adequate' retirement income is typically considered to be between 60 and 65 per cent of gross pre-retirement earnings, after taking into account any age pension entitlements.[2]

[1] Including the Medicare levy.
[2] Rice Warner/IFSA 2010; Senate Select Committee on Superannuation and Financial Services

Applying this standard to our modelling detailed in the case studies below, a single male on average income who spends 40 years in the paid workforce would not achieve an 'adequate' retirement income with an SG rate of 9 per cent but would with an SG rate of 12 per cent.

While 9 per cent SG provides those with lower incomes in working life with a more 'adequate' replacement rate than would be provided solely by the age pension, a large proportion of the expenditures of low-income earners are fixed and therefore a replacement rate of 60-70 per cent would be 'inadequate' for meeting these fixed expenditures.

Another way of measuring adequacy is to consider the amount of income needed in retirement to achieve a certain lifestyle. The Westpac-ASFA Retirement Standard says that singles seeking a 'modest' lifestyle will have an annual expenditure of $20,973 in retirement, while singles seeking a 'comfortable' lifestyle will have an annual expenditure of $39,081 in retirement. Annual expenditure for a retired couple is $30,382 for a 'modest' lifestyle and $53,456 for a 'comfortable' lifestyle.

Applying this standard to our modelling detailed in the case studies below, a single male on an average annual income of $62,000 who spends 40 years in the paid workforce would have a below 'comfortable' retirement lifestyle with an SG rate of 9 per cent but would have an above 'comfortable' lifestyle with an SG rate of 12 per cent.

The challenge of adequacy is obviously greater for the two-thirds of working Australians who earn less than $62,000 per annum.

An SG rate of 9 per cent will not deliver sufficient retirement income for most Australians, according to widely-used measures of adequacy.

Impact of workforce participation on retirement income levels

The amount of time spent in the paid workforce is arguably just as critical a factor as salary level when it comes to achieving 'adequacy' in retirement. While many of the calculations relating to the SG rate and retirement income adequacy are based on 40 years in full-time employment, current estimates suggest the reality is considerably different for many Australian workers. Indeed, an examination of the workforce participation rates in Australia suggests a story of the 'haves' and 'have-nots' in terms of ability to accrue an adequate level of superannuation savings.

The latest available published Productivity Commission data shows that while Australia's overall participation rates for males and females were above the OECD average in 2005, relatively low participation rates were recorded for:

- Prime aged males (25 to 54 years), where Australia ranked 6th lowest among 30 OECD countries;
- Child-bearing aged women (25 to 44 years), where Australia ranked 8th lowest; and
- Older men and women (55 to 64 years), where Australia ranked 13th within the OECD.

Taken together, these segments represented almost 70 per cent of Australia's labour force. Moreover there was a marked decline in participation from age 55, well before the age pension eligibility of 65 years for men and 63 for women.

A study completed in 2001 by UNSW School of Economics and Actuarial Studies estimated that the average number of expected years in full-time equivalent employment was 30.7 years. At the time, this figure was predicted to fall to just 28 years by 2030.[3]

Workforce participation rates in Australia suggest a story of the 'haves' and 'have-nots' in terms of ability to accrue an adequate level of superannuation savings.

Impact of career break

Lower average earnings and time spent out of the paid workforce to care for families means that the typical Australian woman will retire with considerably less super than her male counterpart. Based on the modelling in the case studies below, it has been estimated that a seven-year career break would reduce a women's superannuation savings at retirement age by 23 per cent.[4]

Moreover, women have a longer life expectancy meaning that their retirement savings have to spread over more years. According to the Australian Life Tables, a 65-year-old woman today is expected to live around 21.6 years, compared with 18.5 years for men.

Increasing the SG rate to 12 per cent would be particularly beneficial for women and other part-time workers

Life expectancy

Today's workers will live longer than previous generations and will require a higher income to support a more active, healthier lifestyle than their parents. Over the next 40 years, life expectancy at age 60 is projected to increase from 22.6 to 27.7 years for males and 26.1 to 30.8 years for females. With average life expectancies growing at the rate of about one year every decade, fiscal budgets are likely to come under severe pressure. The 2009 Intergenerational Report forecasts that the dependence ratio (of working-age population to the over-sixties) will halve from 5 to 2.7 by 2050.

The report also forecasts that even after the superannuation system has reached maturity (i.e. when most Australian workers have had the benefit of a working lifetime of an SG rate of 9 per cent), 80 per cent of retirees will still be either partially or fully reliant on the age pension. Currently about 80 per cent of retirees receive an age pension, with about 55 per cent of these people receiving the full age pension.

As a result of the heavy reliance on the age pension by older Australians, the Government will become the effective underwriter of longevity insurance for most Australians. Age pension costs will increase as baby boomers reach retirement and the ratio of workers to retirees continues to reduce.[5]

The OECD Pensions at a Glance report recently ranked Australia as the fourth highest out of 30 countries on old-age income poverty. Despite our retirement income architecture being arguably world's best practice, Australia appears to be trailing on the issue of adequacy.

[3] Rather than full-time equivalent employment, the four case studies below assume 40 actual years in a combination of full-time and part-time employment.
[4] $259,688 versus $201,258 at age 65 (today's dollars)
[5] Institute of Actuaries Retirement Incomes Taskforce 2008

The benefits of an SG rate of 12 per cent

As the costs of an ageing population continue to escalate, AIST believes it is critical that we raise the SG rate to a minimum of 12 per cent to ensure that our nation is less vulnerable to a blowout in age pension costs, and that our individual retirement savings last longer.

Raising the SG and reducing the number of retirees receiving the age pension will allow the Government to focus pension policy on those retirees in greatest need, as well as addressing its own longer-term fiscal requirements.

The case for 12 per cent

Based on the modelling in the case studies below, under an SG rate of 12 per cent, a male who earned $62,000 per year over 40 years would increase his superannuation savings at retirement by $132,241 and be $105 per week better off in retirement than with 9 per cent, while a female retiree who earned $42,000 per year for 33 years would increase her balance at retirement by $69,384 and be around $63 per week better off.

The Government forecasts that increasing the SG rate to 12 per cent will grow the savings pool, and lead to $85 billion of additional superannuation being invested over the next ten years and at least an extra $500 billion by 2036. This will further nation-building and strengthen the Australian economy against future economic shocks.

The SG increase will help alleviate longevity risk associated with insufficient superannuation savings, and the pressure likely to be imposed on the age pension through a rapidly ageing population.

Impact on Government Budget

In Australia superannuation income attracts concessions and is taxed at lower level than normal income. When the SG rate is increased, there is a significant cost to the Federal Budget in the form of reduced tax revenue as wages which would normally be taxed at an individual's marginal tax rate are instead taxed at the concessional 15 per cent tax rate. Moreover once this money is invested in the superannuation system, investment earnings are taxed at the concessional rate of 15 per cent.

The recent election debate highlighted a fundamental lack of understanding among many commentators and politicians about the "cost" to government revenue of raising the rate of SG. During the debate, Shadow Treasurer Joe Hockey repeatedly claimed that the increase in the SG rate would not cost the Government. Similarly, Australian Chamber of Commerce and Industry CEO Peter Anderson claimed it was a "furphy" that the Government told the community that the resource tax was necessary to fund higher super payments, insisting that the payments were going to be paid for by employers.

It has been estimated that every one per cent rise in the SG rate costs Treasury about $1 billion per year. Increasing the SG rate to 12 per cent will reduce the projected pension costs for future governments as fewer retirees take up the age pension. AIST has estimated (in today's dollars) that:

- In 2019-20, the first year with an SG rate of 12 per cent, an additional $24.7 billion will be delivered into Australian superannuation accounts.
- Total additional superannuation savings due to the rise in the SG rate for all years from 2013-14 (the initial SG rate increase to 9.25 per cent) to 2049-50 will deliver an additional $1.22 trillion into accounts.
- If this additional $1.22 trillion of superannuation was used in lieu of the forecasted government spending on age and service pensions, it would cover 38 per cent of the $3.23 trillion of age and service pension payments

to individuals from 2009-10 to 2049-50 as forecasted in the Intergenerational Report 2010 ("IGR 2010").[6] An SG rate of 12 per cent would make significant inroads into relieving pressure on the government's long-term fiscal gap. However over the next 40 years, payments from the government for its total expected age and service pension liabilities would still exceed the additional savings in superannuation by an average of $49 billion per year.

	SG rate	Working Population	Effect of 12% SG to aggregate superannuation balances (cumulative)	Cost of age and service pensions (cumulative)
2009-10	9%	11.72 million	Nil	$35 billion
2019-20	12%	13.54 million	$84 billion	$465 billion
2029-30	12%	15.02 million	$371 billion	$1,088 billion
2039-40	12%	16.63 million	$743 billion	$1,989 billion
2049-50	12%	18.00 million	$1,219 billion	$3,226 billion

These estimates rely on a number of assumptions and projections (see Appendix A) from the IGR 2010.[7]

Impact on employers and employees

Many employer groups, particularly small business, frequently describe the SG as a "tax" on business that will force businesses to close their doors and lead to higher unemployment. However history shows that this was not the case when the compulsory super was introduced in 1992. Almost ten years later, company profits had risen and unemployment had fallen. SG rate rises were largely paid for from productivity gains in the form of the foregone wage rises.

Annual price inflation, measured from growth in the Consumer Price Index (CPI), has averaged 2.77 per cent since 1994, while annual wage inflation, measured from growth in average weekly ordinary time earnings (AWOTE), has grown at 4.56 per cent. In other words, 'real' wages have grown annually by 1.74 per cent for more than 15 years. If this scenario is repeated in the next decade, employees absorbing the full impact of the SG rate increase up until 2019 would still experience real wage rises of more than 1 per cent a year.

It is therefore hard to argue that the proposed incremental SG rate rises from 2013 to 2019 are likely to be a significant impost to either employers (in terms of wage costs) or employees (in terms of a reduction in their take-home pay).

Raising the SG rate is only one of many factors that will affect wage negotiation between employees, unions and employers. The impact of the rise will depend on the outcome of these wage negotiations and could vary across industries, employees and employers.

Importantly, the long lead-in time for SG rate increases, which is much longer than the previous timetable for SG rate rises from 3 to 9 per cent, should give businesses plenty of time to include the SG rate in their wage negotiations and business planning. Also note that an estimated one in four employers already pays an SG rate of

[6] Table A4 of the IGR 2010 projects government spending of $1,570 per person on age and service pension payments for a national population of 22.2 million people in 2009-10, $1,930 per person for 25.7 million people in 2019-20, and so forth, rising to $3,890 per person for 35.9 million people in 2049-50. The sum of all years from 2009-10 to 2049-50 (using linear interpolation for years excluded from Table A4) equals $3.226 trillion.

[7] www.treasury.gov.au/igr/igr2010

at least 10 per cent. These employers will not have to adjust their contribution until at least 2016 when they would need to pay SG at the rate of 10.5 per cent.

Henry and adequacy

The final report of Australia's Future Tax System Review, commonly known as the Henry Tax Review, was released by the Government in May 2010. The Review recommended changes to Australia's tax and transfer policy to help deal with future demographic, social, economic and environmental issues. Its key recommendations concerning adequacy of retirement incomes included:

- Removing contributions tax and income tests for income support, and instead taxing employer contributions at marginal personal income tax rates and providing a 20 per cent tax offset,
- Halving the 15 per cent tax rate on super fund earnings to 7.5 per cent, however this new rate would be introduced to earnings from income streams in the retirement phase.
- Developing a private longevity insurance market, and
- Removing the restriction on superannuation contributions for those aged over 75.

As part of the Review, Ken Henry considered whether to increase the SG rate to 12 per cent. Assuming his package of recommendations was accepted, he considered an SG rate of 9 per cent to be adequate for striking an appropriate balance between working-life consumption and compulsory saving for retirement. In the lead up to the recent election, the Coalition has indicated it would not lift the SG rate to 12 per cent and would instead consider Henry's proposal.

Henry's recommendations for the SG rate to remain at 9 per cent assume that net contributions under the above tax proposal would be similar to those achieved by a straightforward lift in the SG to 12 per cent, under current policy settings. This would be due to the removal of the current 15 per cent contribution tax and the introduction of refundable flat rate tax offset which would mean that only higher income workers would pay more than 15 per cent tax.

AIST has modelled the Henry Review recommendations on personal tax rates, see Appendix E for details.

AIST has the following concerns with Henry's package of reforms:

- The rebate/marginal tax proposal for contributions would require wholesale changes to the way super funds currently operate. By contrast, raising the SG is straightforward, less complex and would not require additional resourcing.
- The Henry Review made a number of assumptions including using the average level of voluntary contributions which is in fact heavily skewed to high-income earners.
- Taxing SG at marginal personal income tax rates would reduce the take-home pay of many individuals (see Appendix E). This makes the proposal very difficult to sell to the Australian public, particularly in light of so many changes to our super system in the past decade. Continual changes to the tax concessions of super create uncertainty and confusion.
- Taxing super at marginal tax rates is complex from an administrative point of view, for both funds and the ATO. Under such a proposal, the ATO would need to issue assessments and match each individual's SG contribution with their tax return in order to determine the individual's super contribution tax rate. Such data matching requirements would necessitate a significant boost to ATO resources.
- Tax rebates are not cast in stone and history shows that they are vulnerable to tinkering by successive governments – witness the changes to the Government's co-contribution scheme.

- The new tax on pension-paying funds, which currently do not pay any tax, is likely to be unpopular among retirees, especially for those who have made decisions based on existing rules.
- Taxing super at marginal tax rates would substantially lessen the attraction of 'salary sacrificing' super and could see more retirement savings end up in less-regulated, high-risk investments.

Conclusion

The demographic challenges facing Australia mean that it is vital that our nation's retirement policy settings are such that all working Australians are able to retire with dignity.

This paper demonstrates that if the Superannuation Guarantee remains at its current rate of 9 per cent, many Australians will not achieve a comfortable retirement, even after a full working lifetime of compulsory superannuation contributions.

AIST believes that the Government's proposed reform agenda to raise the Superannuation Guarantee to 12 per cent, together with tax equity measures such as the low-income rebate, is the right way forward. This landmark package of reforms will not only ensure that most Australians have adequate retirement savings but it will also help alleviate future pressure on the age pension through our rapidly ageing population that is living much longer than ever before.

Case Study 1: average retirement income for a male

The size of the SG rate will have a significant effect on how much Australians receive in their retirements. Consider the example of a single male who owns his own home and earns a gross annual salary of $62,000 (in today's dollars) plus superannuation from age 25 to 65.[8] He selects a balanced investment option, which provides an annual investment earnings rate of 8 per cent before management fees and tax. The following table of superannuation savings and retirement income is based on the assumptions in Appendix B.

SG rate	Superannuation savings balance at retirement	Annual income during retirement	Weekly income during retirement
12%	$519,905	$44,179	$847
9%	$387,664	$37,675	$722
0%	nil	$17,625	$338

Hence he would increase his superannuation savings at retirement by $132,241 and be $125 per week better off in retirement with a mature SG rate of 12 per cent.

Based on his annual retirement income, he would have a below 'comfortable' retirement lifestyle with an SG rate of 9 per cent, or an above 'comfortable' lifestyle with an SG rate of 12 per cent according to the Westpac Retirement Standard. Further his retirement income would not be 'adequate' with an SG rate of 9 per cent, but would be 'adequate' with an SG rate of 12 per cent according to the Rice Warner definition of between 60 and 65 percent of pre-retirement earnings.

Case Study 2: average retirement income for a female without a career break

Contrast this with the example of a single female who owns her own home and earns a gross annual salary of $42,000 (in today's dollars) plus superannuation from age 25 to 65.[9] She also selects a balanced investment option. The following table of superannuation savings and retirement income is based on the assumptions in Appendix C.

SG rate	Superannuation savings balance at retirement	Annual income during retirement	Weekly income during retirement
12%	$349,271	$34,086	$653
9%	$259,688	$30,140	$578
0%	nil	$17,625	$338

Hence she would increase her superannuation savings at retirement by $89,583 and be $75 per week better off in retirement with a mature SG rate of 12 per cent.

Based on her annual retirement income, she would have an above 'modest' but below 'comfortable' retirement lifestyle with an SG rate of 9 per cent, or an almost 'comfortable' lifestyle with an SG rate of 12 per cent according to the Westpac Retirement Standard. Further her retirement income would be 'adequate' with an SG rate of 9 per cent, and very 'adequate' with an SG rate of 12 per cent according to the Rice Warner definition of between 60 and 65 percent of pre-retirement earnings.

[8] In 2009, working males (full-time and part-time) in Australia earned an average of $1,181 per week, which is $61,623 per year (6310.0 - Employee Earnings, Benefits and Trade Union Membership, Australia, Aug 2009, ABS).
[9] In 2009, working females (full-time and part-time) in Australia earned an average of $789 per week, which is $41,169 per year (6310.0 - Employee Earnings, Benefits and Trade Union Membership, Australia, Aug 2009, ABS).

Case Study 3: average retirement income for a female with a career break

Contrast the female in Case Study 2 with an identical female except that she takes a seven-year break from work starting at age 30. The following table is her superannuation savings and retirement income.

SG rate	Superannuation savings balance at retirement	Annual income during retirement	Weekly income during retirement
12%	$270,642	$30,624	$587
9%	$201,258	$27,561	$528
0%	nil	$17,625	$338

Hence she would increase her superannuation savings at retirement by $69,384 and be $59 per week better off in retirement with a mature SG rate of 12 per cent.

Based on her annual retirement income, she would have an above 'modest' but below 'comfortable' retirement lifestyle with an SG rate of 9 per cent, or an almost 'comfortable' lifestyle with an SG rate of 12 per cent according to the Westpac Retirement Standard. Further her retirement income would be just 'adequate' with an SG rate of 9 per cent, and very 'adequate' with an SG rate of 12 per cent according to the Rice Warner definition of between 60 and 65 percent of pre-retirement earnings.

Case Study 4: average retirement income for a married couple

Now consider the example of a married couple (combining the Case Study 1 male with the Case 3 female who takes a seven-year career break starting at age 30) who are the same age. They own their own home and earn a gross annual salary of $104,000 (in today's dollars) plus superannuation from age 25 to 65. Again they select a balanced investment option. The following table of superannuation savings and retirement income is based on the assumptions in Appendix C.

SG rate	Superannuation savings balance at retirement	Annual income during retirement	Weekly income during retirement
12%	$790,703	$67,084	$1,286
9%	$589,077	$57,561	$1,103
0%	nil	$26,494	$508

Hence they would increase their superannuation savings at retirement by $201,626 and be $183 per week better off in retirement with a mature SG rate of 12 per cent.

Based on their annual retirement income, they would have a just above 'comfortable' retirement lifestyle with an SG rate of 9 per cent, or a very 'comfortable' lifestyle with an SG rate of 12 per cent according to the Westpac Retirement Standard. Further their retirement income would be below 'adequate' with an SG rate of 9 per cent, and 'adequate' with an SG rate of 12 per cent according to the Rice Warner definition of between 60 and 65 percent of pre-retirement earnings.

Appendix A: Impact on the age pension of an SG rate of 12 per cent: assumptions and projections

The Government is proposing to increase in the SG rate from 9 to 12 per cent between 2013 and 2019.

Productivity measures GDP per total number of hours worked, and is the primary contributor to enhancing Australia's future economic growth and reducing the economic and fiscal pressures of an ageing population. Assuming the labour share and corporate profit share of business income revert to long run averages, there will be a strong correlation between productivity and real wages. However it is very difficult to forecast in the long run due to historical variation in the factors driving productivity growth.

- Real wages are therefore forecast to grow at an average of 1.6 per cent per year, based on the IGR 2010's projection of productivity growth which used the 30-year historical average.
- The population, participation rate and pension payment forecasts are Treasury projections in IGR 2010 (Tables A1, A2 and A4, with linear interpolation used for years not presented in those Tables).
- ABS data shows that the mean annual earnings for full-time and part-time employees are $51,882.[10]

[10] Employee Earnings, Benefits and Trade Union Membership, 6310.0, August 2009.

Appendix B: Case Study 1 male: assumptions

The case study estimates are calculated using ASIC's FIDO retirement planner. This planner calculates how much superannuation could be saved before retirement, and then how much can be drawn out and how much of the age pension will be received in retirement. The annual income in retirement is then compared with an SG rate of 0, 9 and 12 per cent.

For this case study, it is assumed that he:

- Is eligible for the age pension, a homeowner and does not have a spouse,
- Is in work from age 25 to 65 and does not have a career break,
    - Pension age is age 67, preservation age is age 60,
- Has not accumulated any superannuation before starting work at age 25,
- Does not make any salary sacrifice or after-tax contributions,
- Does not take out a lump sum at retirement,
- Retires for 20 years from age 65 to 85,[11]
- Selects a fund which charges low fees (management cost 0.55 per cent of accumulation, management fee $55 per year, insurance premiums $78 per year, no contribution or adviser service fees),
- Selects the Balanced investment option, which provides an annual investment earnings rate before management fees and tax of:
    - 8 per cent (nominal rate, no adjustment for inflation and rise in community living standards),
    - 4.3 per cent (real rate, adjusted for inflation of 2.5 per cent per annum and rise in community living standards of 1 per cent per annum),
- Earnings tax 6 per cent (nominally 15 per cent, but offset by imputation credits and tax deductions), tax on contributions 15 per cent,
- Current contributions limits and co-contribution eligibility, and
- Full age pension of $671.90 per fortnight and current income test, assets test and pharmaceutical allowance.

Appendix C: Case Study 2 female without break: assumptions

This case study is identical to Appendix B except that she retires for 22 years from age 65 to 87.[12]

Appendix D: Case Study 4 married couple: assumptions

This case study is identical to Appendices B and C except that they retire for 21 years from age 65 to 86.[13]

[11] If he maintains the previously mentioned annual income and then lives past age 85, he will be solely reliant on the age pension (currently $17,625 per annum); according to an ABS lifetable (3302.0 - Deaths, Australia, 2008), an Australian male at age 65 in 2006-08 would expect to live on average for a further 18.6 years.

[12] If she maintains the previously mentioned annual income and then lives past age 87, she will be solely reliant on the age pension (currently $17,625 per annum); according to an ABS lifetable (3302.0 - Deaths, Australia, 2008), an Australian female at age 65 in 2006-08 would expect to live on average for a further 21.6 years.

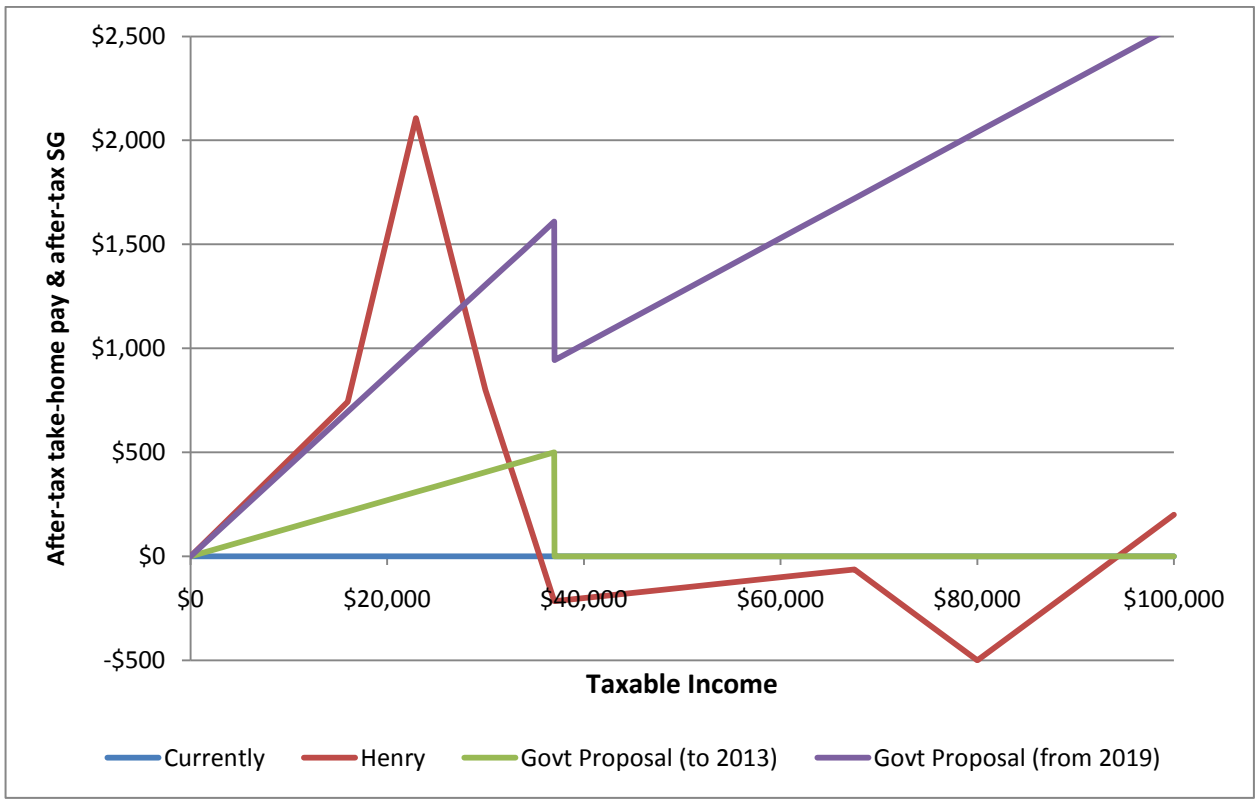
[13] If either individual maintains the previously mentioned annual income and then lives past age 86, they will be solely reliant on the age pension (currently $26,494 per annum).

Appendix E: Modelling the Henry Review recommendations on personal tax rates

AIST has modelled the Henry Review recommendations on personal tax rates, such as:

- To tax superannuation at the marginal tax rate less a 20 per cent rebate, and
- To provide a personal tax-free threshold of $25,000, then a 35 per cent tax rate up to $180,000 and 45 per cent above $180,000.

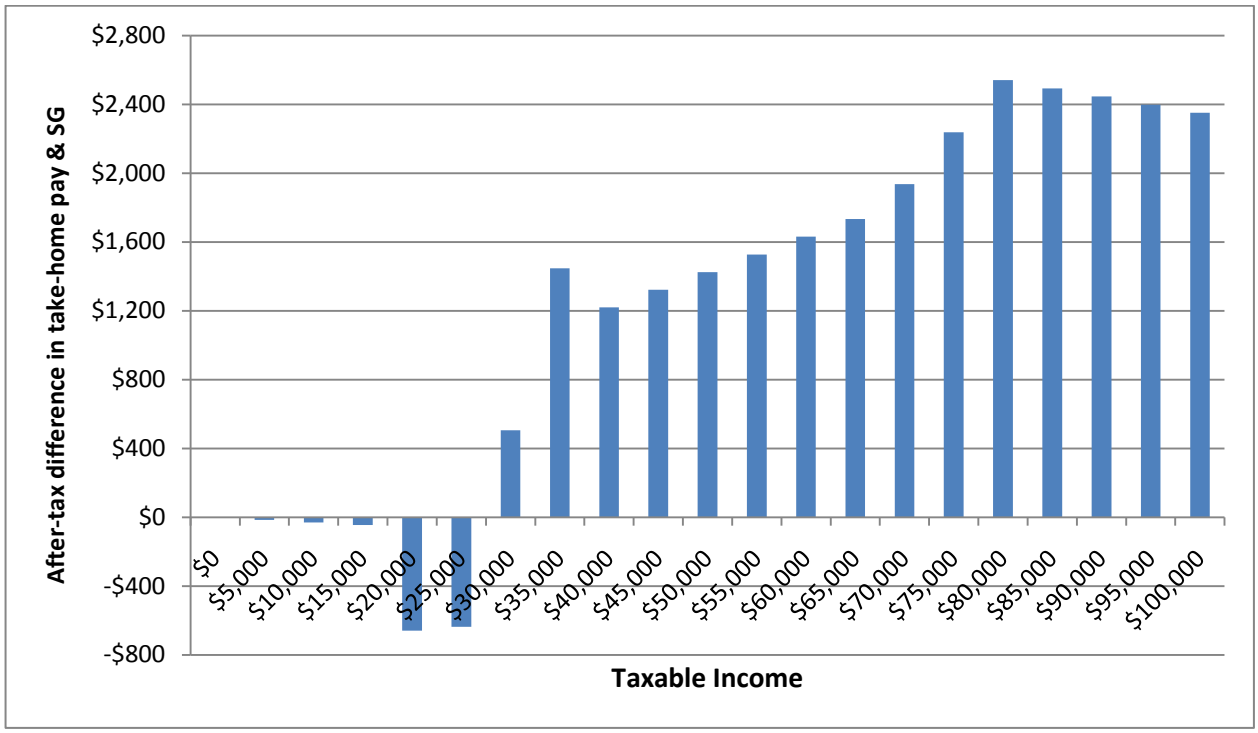
Effect of reviews on after-tax take-home pay and after-tax superannuation, by level of taxable income



With the current superannuation and taxation regimes set as the $0 baseline, the red line in the graph above shows how much better off taxpayers at different levels of income would be under Henry's recommendations. The green line shows the benefit of the rebate for low income earners with annual taxable income up to $37,000, while the purple line combines this with the benefit of more superannuation for taxpayers as the SG rate increases to 12 per cent under the Government's proposal. The largest benefits occur as the green line migrates up to the purple line between 2013 and 2019, based on the assumption that real income levels excluding SG are maintained and employers incur the entire burden for the SG rate increase.

The graph shows that everybody with an annual taxable income of at least $27,790 who receives the full benefit of the 12 per cent SG rate will be better off under the Government's proposal, compared with the recommendations of the Henry Review. However note that the burden of a higher SG will likely be shared between employers and employees. Even in the hypothetical scenario where employee take-home pay was reduced by the same amount as the SG increase, individuals with an annual taxable income between $32,492 and $94,286 will still be better off under the Government's proposal due to Henry's higher effective tax rates.

After-tax benefit for taxpayer in take-home pay and superannuation: 12 per cent SG compared with the Henry Review recommendations, by level of taxable income



The bar chart above shows that, consistent with the previous graph, individuals with annual taxable income of at least $27,790 who receive the full benefit of the 12 per cent SG rate will be better off compared with the Henry Review.

The benefits of an SG rate of 12 per cent

If the Henry Review recommendations were applied, there would be five factors that contributed to whether individual taxpayers were better off:

- Alternative income tax rate regime
- Removal of the Low Income Tax Offset ("LITO")
- Removal of the Medicare levy
- Marginal tax rate ("MTR") (rather than 15 per cent) on SG contributions
- 20 per cent rebate on SG contributions

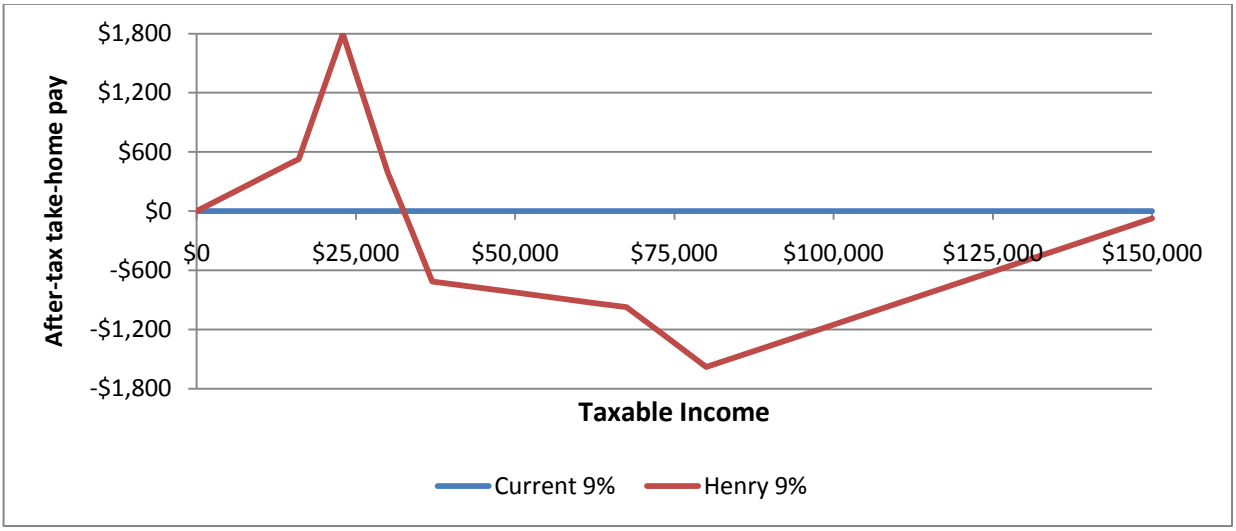
This table shows the amount that each factor determines whether individuals are better off at different levels of taxable income:

Taxable income	$5,500	$22,936	$37,000	$80,000	$150,000
Income tax	$0	$2,540	$450	–$1,700	–$300
LITO	$0	–$1,500	–$1,220	$0	$0
Medicare levy	$83	$344	$555	$1,200	$2,250
SG contributions tax	$74	$310	–$666	–$1,440	–$2,700
20% rebate on SG contributions	$99	$413	$666	$1,440	$2,700
BENEFIT OF HENRY OVER CURRENT REGIME	**$256**	**$2,107**	**–$215**	**–$500**	**$1,950**

The big spike in benefit under Henry for those taxpayers earning around $22,936 is due to the different MTRs. The current MTR for an annual taxable income of $22,936 is 15 per cent, while Henry has proposed $22,936 ($25,000 including 9 per cent SG) as the tax-free threshold – above which the benefit for individuals under Henry declines rapidly as they are taxed at 35 per cent. Nearly all of the benefit in this spike is received as take-home pay.

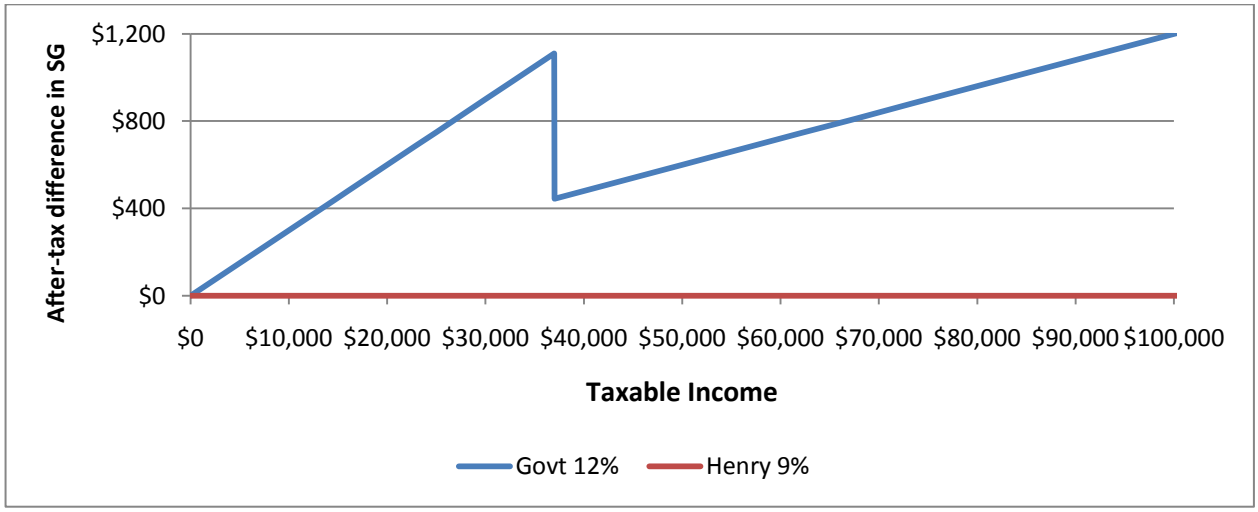
The MTR for taxable incomes between $25,000 and $180,000 (including SG contributions) is 35 per cent. Such taxpayers are worse off under Henry since this rate is also applicable to SG contributions and is higher than current SG contributions tax rate of 15 per cent. However they are fully compensated for this under Henry by the 20 per cent rebate on SG contributions – which is why the figures in these two rows above cancel each other out. Also note that as income increases, the impact of removing the Medicare levy increases.

Effect of Henry review on after-tax take-home pay, by level of taxable income



This graph considers take-home pay: the red line shows that individuals with annual taxable income up to $32,492 will receive more take-home pay under Henry (up to $1,797 per annum), while those with annual taxable income of between $32,492 and 153,488 will receive less take-home pay under Henry (up to $1,580 per annum).

Effect of 12 per cent SG on after-tax SG, by level of taxable income



This graph shows that SG contributions after tax will be higher at all income levels under the Government's proposed 12 per cent SG rate, particularly for those who benefit from the low income earners rebate. An SG rate of 12 per cent will ensure that Australian workers save more and have greater confidence of enjoying an adequate and comfortable retirement.