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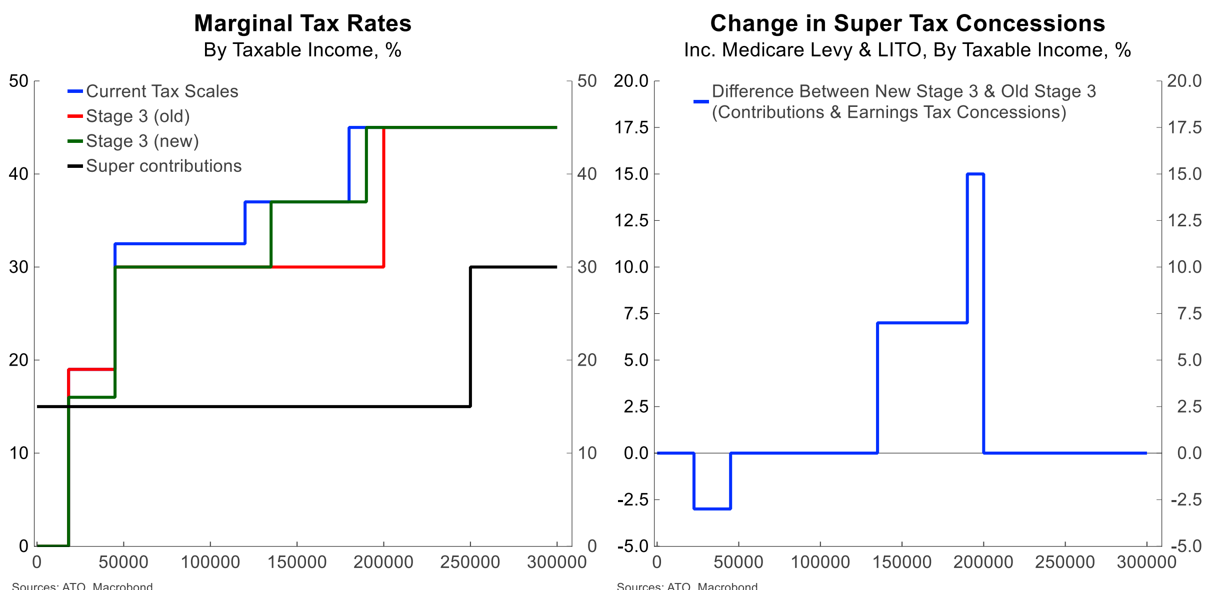
Tax Insights

Super Incentive Tweaks Post Tax Change

- **Much has been said about the Government's changes in January to the previously legislated stage 3 tax cuts. One area that has received less attention is the interaction between the changes to the tax scales and the superannuation system.**
- **Superannuation is taxed concessionally. There is a lower tax rate applied to contributions and earnings inside the super system compared to taxes paid outside of super. This is to encourage people to save for their own retirement and compensate for the money being locked away until they retire – with some limited exceptions.**
- **The size of the incentive, determined by the tax rates within and outside of super, is an important driver of how widely super concessions are used and who receives the biggest benefits. This also helps to understand potential behavioural responses from policy changes.**
- **The updated stage 3 tax package makes superannuation relatively more concessional for higher income earners (between $135k and $200k) and relatively less concessional for lower income earners (between around $22.5k and $45k) compared to the previously legislated package.**
- **The macro impact of these changes is small. However, at the margins, they provide relatively larger incentives for higher income earners to increase super contributions to reduce their tax and regain some of the benefits lost (compared to the previously legislated stage 3 changes).**
- **Super tax concessions are heavily skewed towards higher-income earners. People in the top two taxable income deciles (above $95k) receive around 55% of these benefits. These changes are likely to further entrench this into the future, potentially adding to growing discussion around the sustainability of Australia's tax and transfer system, including superannuation tax settings.**



Much has been said about the Government's changes in January to the previously legislated stage 3 tax cuts. The changes are aimed at redistributing more of the benefit to low- and middle-income earners to help with elevated cost-of-living challenges. These changes have passed through Parliament and will be effective from July 2024.

2023-24 income year		Previous stage 3 tax rates		Newly legislated tax rates	
Taxable Income ($)	Marginal Rate (%)	Taxable Income ($)	Marginal Rate (%)	Taxable Income ($)	Marginal Rate (%)
0 - 18,200	0	0 - 18,200	0	0 - 18,200	0
18,201 – 45,000	19	18,201 – 45,000	19	18,201 – 45,000	16
45,001 – 120,000	32.5	45,001 – 200,000	30	45,001 – 135,000	30
120,001 – 180,000	37	200,000 +	45	135,001 – 190,000	37
180,001 +	45			190,001 +	45

Australia's tax and transfer system is complex. It is important not just to think about the tax scales but to also consider the many interactions between the marginal tax scales and other aspects of the system. These interactions increase complexity significantly.

Policy authorities consider interactions from the perspective of trying to achieve a particular policy outcome and to predict what behaviour may be induced by policy changes. Other agents in the tax system, including individuals, tax planners and advisors, consider interactions to optimise outcomes for their and their clients' circumstances.

One of the interactions that hasn't received much attention is the changes to the tax scales and the superannuation system.

Relatively greater incentives for higher-income earners to add to super

The updated stage 3 tax package makes superannuation relatively more concessional for higher income earners (between $135k and $200k) and relatively less concessional for lower income earners (between around $22.5k and $45k) compared to the previously legislated package.

These changes may to lead to some behavioural effects. Higher income earners will become more incentivised to contribute to superannuation to reduce their tax bill than under the old package. However, this comes with the drawback of locking more money away until retirement. Individuals who are closer to retirement or who are not as liquidity constrained and can wait to access the money may be more likely to do so. Depending on the contributions made, this can go a long way to regaining the tax cuts that would have been provided under the old stage 3 package.

Additionally, the increase in the concessional contributions cap to $30k (from $27.5k) in the 2024-25 financial year will provide additional cap space to make these contributions.

Individuals can also access up to five years' worth of unused concessional contributions if their super balance was below $500k on 30 June in the prior financial year.

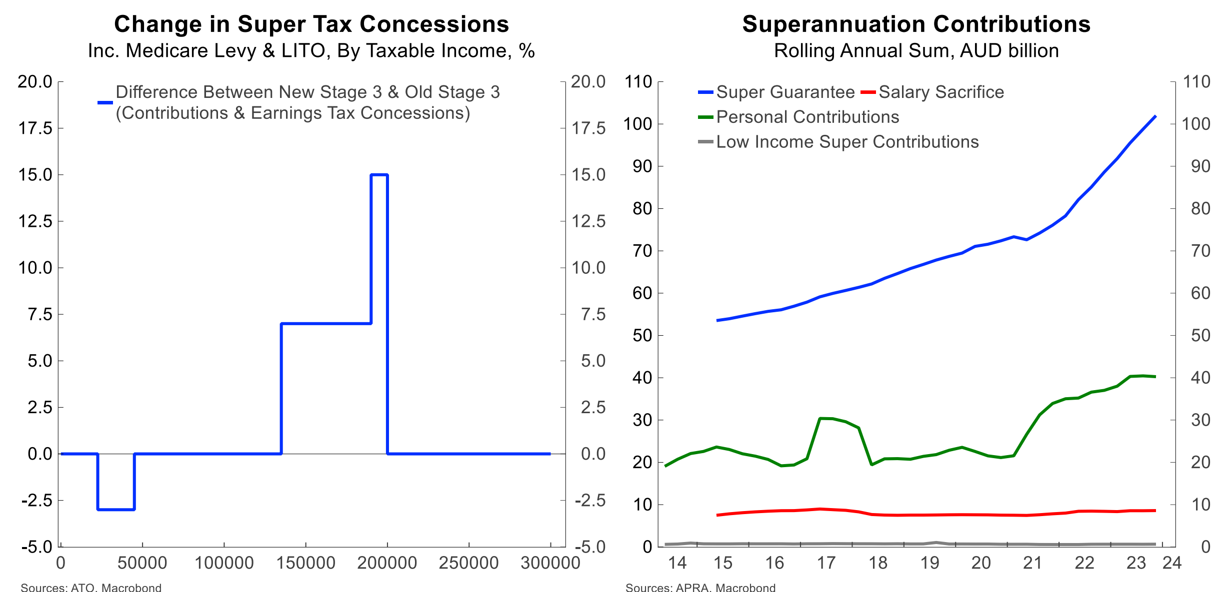
Financial advisors are well equipped to speak with their clients about their individual circumstances and the pros and cons of such an approach to optimise their tax position.

Conversely, contributing to super has become less concessional for lower income earners compared to the previously legislated package and current settings. This increases their opportunity cost and reduces the benefit from super guarantee contributions (i.e. compulsory employer contributions). It also reduces their incentives to make voluntary contributions.

At a macro level, these changes are not large enough to move the needle on total contributions, which are heavily skewed to compulsory employer contributions in any event. However, they may lead to the benefits of superannuation tax concessions becoming even more skewed to higher

income earners than is currently the case or would have been the case under the previously legislated package.

This may also add to growing discussion in the community about the sustainability of Australia's tax and transfer system. This includes the reliance on income taxes and the balance between taxing income versus other sources, such as consumption, savings and land.



Superannuation tax settings

The superannuation system is also incredibly complex, but the key point is that superannuation is concessionally taxed. This means that money within the super system is typically taxed in a more preferred way than had it been invested outside of the super system. There are also nuances including a range of contribution and balance thresholds that exist to limit the amount of money that people can get into this concessional environment.

Concessional super contributions (i.e. pre-tax contributions) are taxed at a rate of 15% rather than at marginal rates. This is typically lower than people's marginal rate, resulting in a tax saving for individuals when income is directed towards super.

Individuals with income over $250,000 pay an additional 15%, lifting their total rate on concessional contributions to 30% and lowering the relative benefit they receive compared to their marginal rate.

Earnings inside the accumulation phase are taxed at a rate of 15%, irrespective of the income of the individual. Capital gains on assets held for over 12 months receive a one third discount (in contrast to the 50% discount for capital gains on assets held for over 12 months by individuals and trusts). This results in an effective tax rate of 10% for capital gains on assets held for over a year.

After moving assets into the retirement phase, earnings become tax free for balances up to an individual's transfer balance cap (currently up to $1.9 million).

Considering these concessional tax settings, super can provide substantial tax savings for individuals over their working life and into retirement.

The government provides concessions to incentivise saving and compensate individuals for locking money away for decades. This helps people grow their investments to a larger balance than would have been possible had they invested outside of super.

Concessions are expensive and unevenly distributed

This concession comes at a significant cost and most of the benefit flows to higher-income individuals. The 2023-24 Tax Expenditures and Insights Statement showed that collectively, superannuation tax concessions are worth around $50 billion in 2024-25 ($28.1 billion for contributions and $21.3 for earnings). This will rise in both nominal terms and as a share of GDP as the super system continues to mature.

To put that into context, $51.1 billion was spent on the Age Pension in 2021-22. Looking further out, the Government's 2023 Intergenerational Report estimates that the value of superannuation tax concessions will overtake Age Pension expenditure in the 2040s.

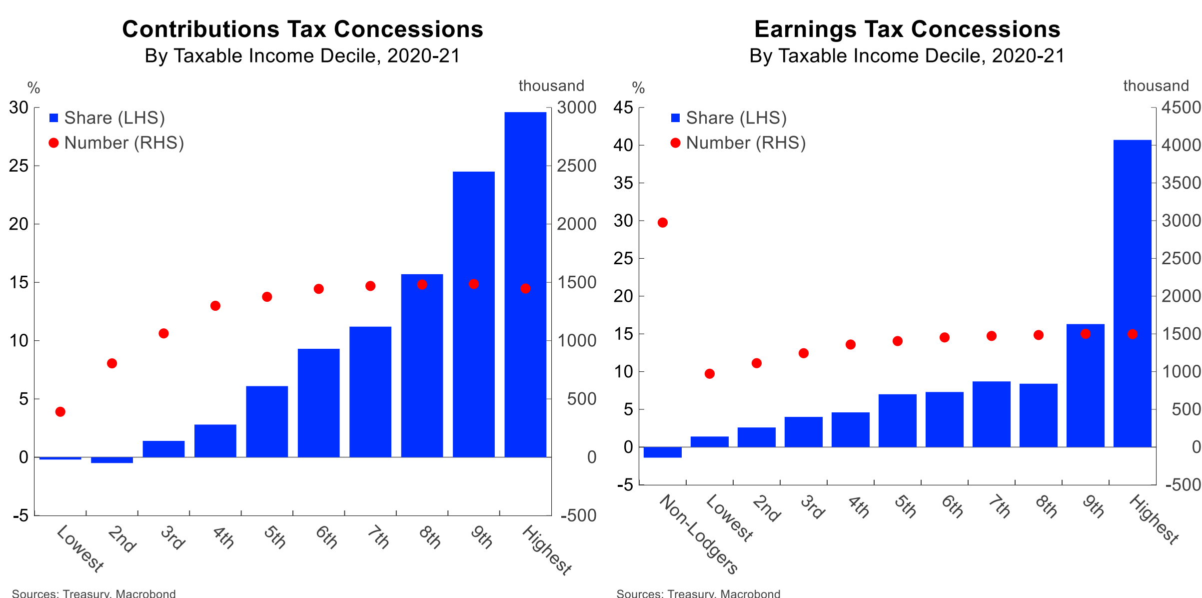
There is an important catch. Money contributed cannot be accessed until an individual hits their preservation age (60 from July 2024), except in some exceptional circumstances. For young people, this means that their money will be locked away for several decades.

Additionally, the value of concessions is not equal for individuals – neither at the point of contributing, nor when earnings are generated. Indeed, the benefits are heavily skewed towards high income earners, while lower income earners either receive very little benefit, or can be worse off in certain situations.

People in the highest taxable income decile (above $128.1k in 2020-21) received around 30% and 40% of the benefit from the concessional taxation of contributions and earnings, respectively, in 2020-21. That figure rises to around 55% when looking at the top two taxable income deciles (above $95k in 2020-21). Meaning that over half of the benefit of superannuation tax concessions flows to the top two taxable income cohorts.

Part of this reflects the fact that higher income people contribute more and have more money in superannuation. They are, therefore, expected to receive a greater benefit. While another part reflects the size of the tax concession typically being larger for higher income people.

The latter point is important to consider for tax planning, as the immediate benefit received – and thereby the opportunity cost of investing outside super versus contributing to super – varies depending on an individual's income. In short, higher income people have a much greater incentive to maximise the use of the superannuation system, for saving and tax planning purposes.



Changes to stage 3 likely to exacerbate the skew in concessional super tax benefits

Changes in the tax rates in super or outside super alter the relative costs and benefits of making additional contributions to super.

Specifically, marginal tax rates have changed under the new stage 3 package, while superannuation tax rates remain the same. This will lead to some relative shifts in the concessionally of super at different income levels.

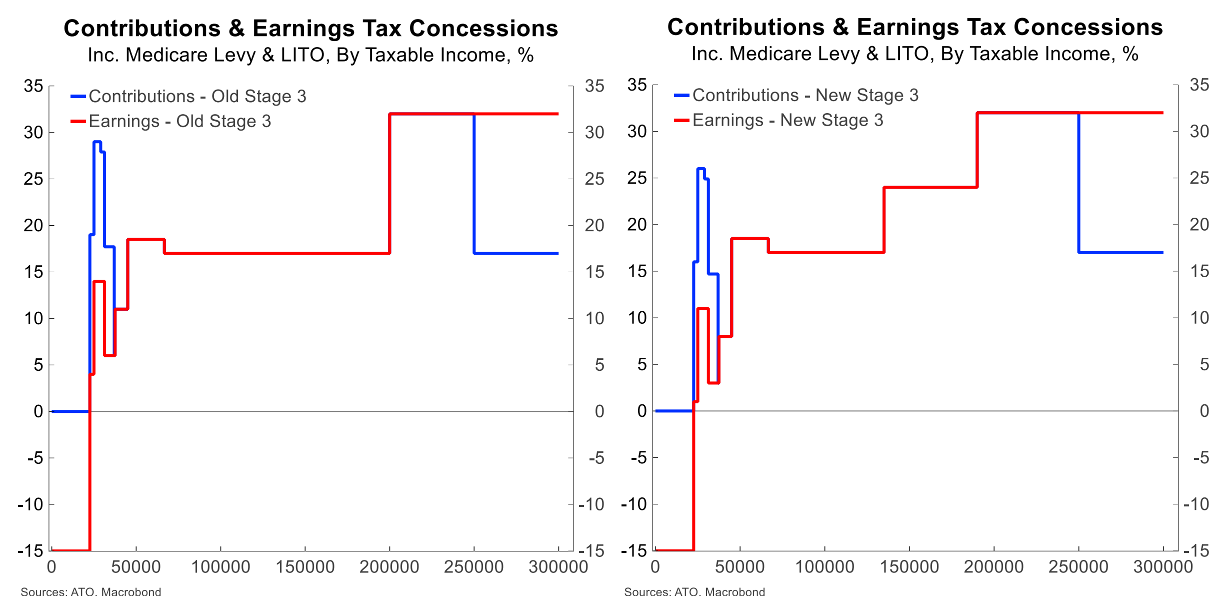
After adjusting for the tapering in of the Medicare Levy, the tapering out of the Low Income Tax Offset, and the Low Income Super Tax Offset (see Appendix for additional detail), the new stage 3 tax cuts make super more concessional for higher income earners and less concessional for lower income earners than under the old stage 3 package.

Specifically, compared to the old stage 3 approach, super becomes more concessional at income levels between $135,001 and $200,000, by 7 or 15 percentage points. In contrast, the changes lower the concession by 3 percentage points for income between around $22,500 and $45,000.

Compared to the current system, super becomes less concessional for most earners up to $135,000, marginally reducing their incentive to contribute. Above this, the concession remains broadly unchanged compared to current rates.

The earnings tax concession is negative for people on very low incomes as they pay 15% tax on earnings while they would have paid no tax had they been made outside of the super system. However, this treatment is already in place and remains unchanged in either scenario.

Of note, this excludes a range of other interactions across the tax and transfer systems, such as family tax benefits. These are specific to each individual and family.



Community discussion around broader review of tax and transfer system growing

At a macro level, these changes are marginal. They are unlikely to have an impact on the economy or the adequacy of the superannuation system.

However, they may lead to superannuation concessions being even more skewed towards higher income earners, as they increasingly look for ways to reduce their tax burden as bracket creep and the lack of indexation of tax brackets leads to increases in average tax rates.

Discussion around the value of superannuation for lower income earners – who earn smaller concessions which will also reduce going forward, and receive a lower Age Pension entitlement later in life than they otherwise would due to means testing – may also increase.

More broadly, a large-scale review of Australia's tax and transfer system, or even of just the taxation of superannuation and savings could examine whether current tax settings are appropriate. For example, there are three potential taxing points within a retirement income system – contributions, earnings, and withdrawals. A broad review could include comparing the current approach of taxing concessions, earnings and withdrawals to other approaches.

The current approach is often referred to as a ttE system. This acronym refers to the fact that contributions are concessionally taxed (t), earnings are concessionally taxed (t), and withdrawals are tax exempt (E).

A common approach internationally is an EET system, where contributions are tax exempt (E), earnings are tax exempt (E), and withdrawals are fully taxable (T). Such an approach is more common in the US, UK and many European countries.

There are pros and cons of each approach and there are also other options to explore as well. A holistic review could consider what would be best practice and what policy changes could be made to help move the Australian system closer to an optimal approach.

One thing these changes may do is add to the growing discussion in the community around the sustainability of Australia's tax and transfer system, including superannuation tax settings.

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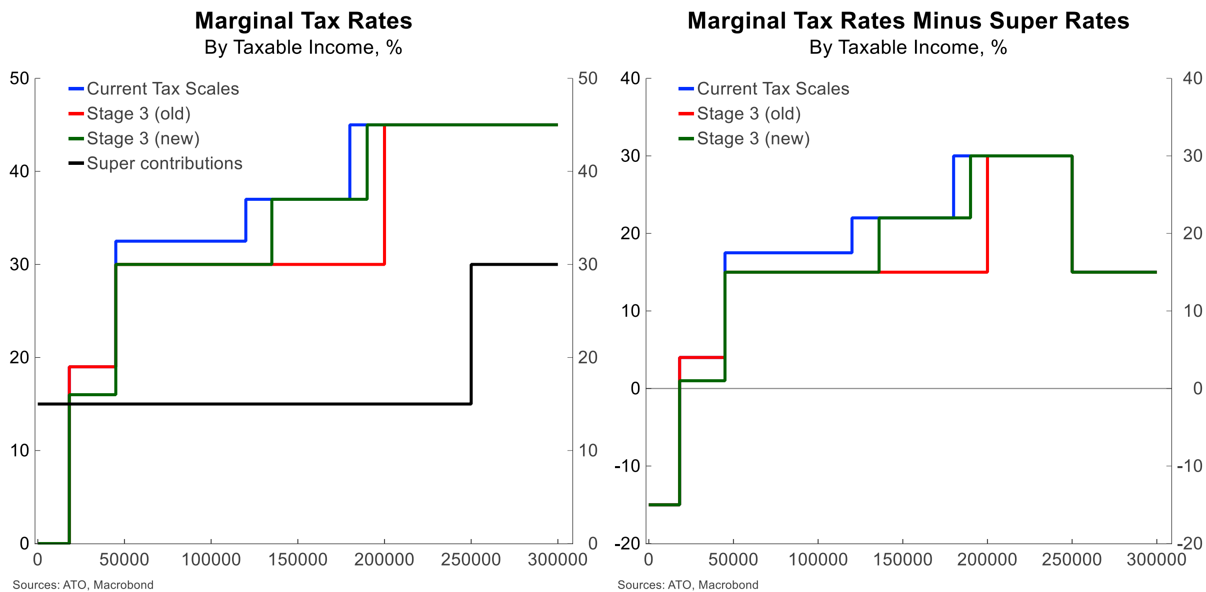
Appendix: Marginal tax rates compared to superannuation tax rates

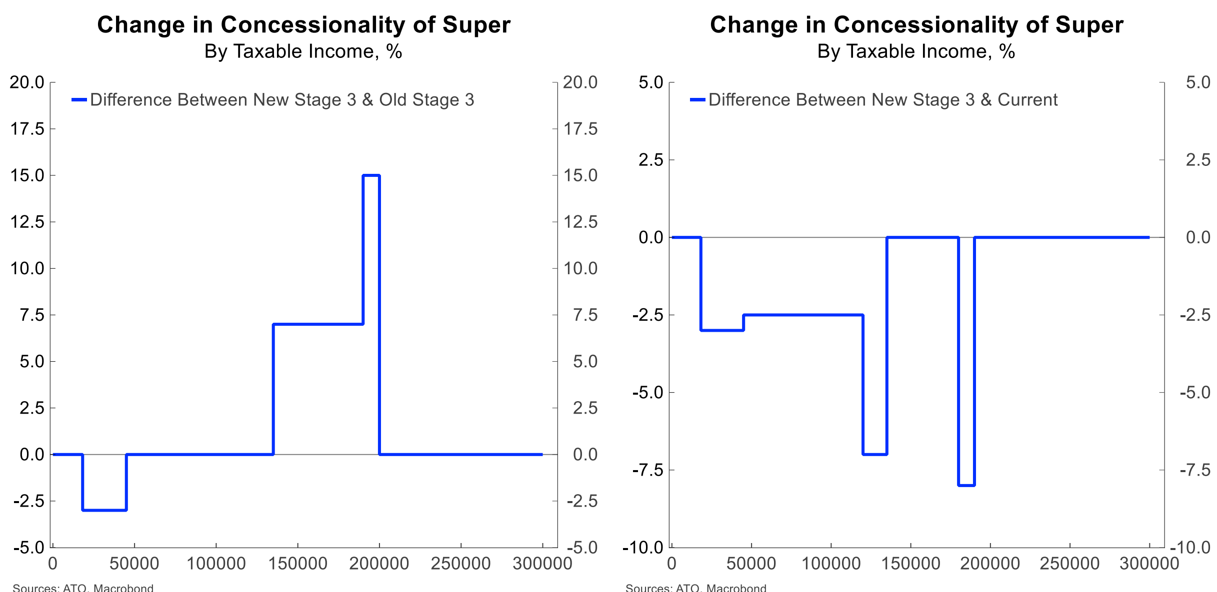
The tax changes make superannuation less concessional for lower income earners that fall into the new 16% tax bracket than the current system or the old stage 3 package. Compared to the current system, super becomes less concessional for most earners up to $135k. For higher income earners, the changes make super more concessional compared to the old stage 3 package, but broadly unchanged compared to current rates. This reflects differences between new tax rates and the 15% tax on superannuation.



Compared to the old stage 3, super becomes 7 or 15 percentage points more concessional at taxable income between $135,001 and $200,000. In contrast, the changes appear to lower the concession by 3 percentage points for taxable income between $18,201 and $45,000 – the new 16% bracket.

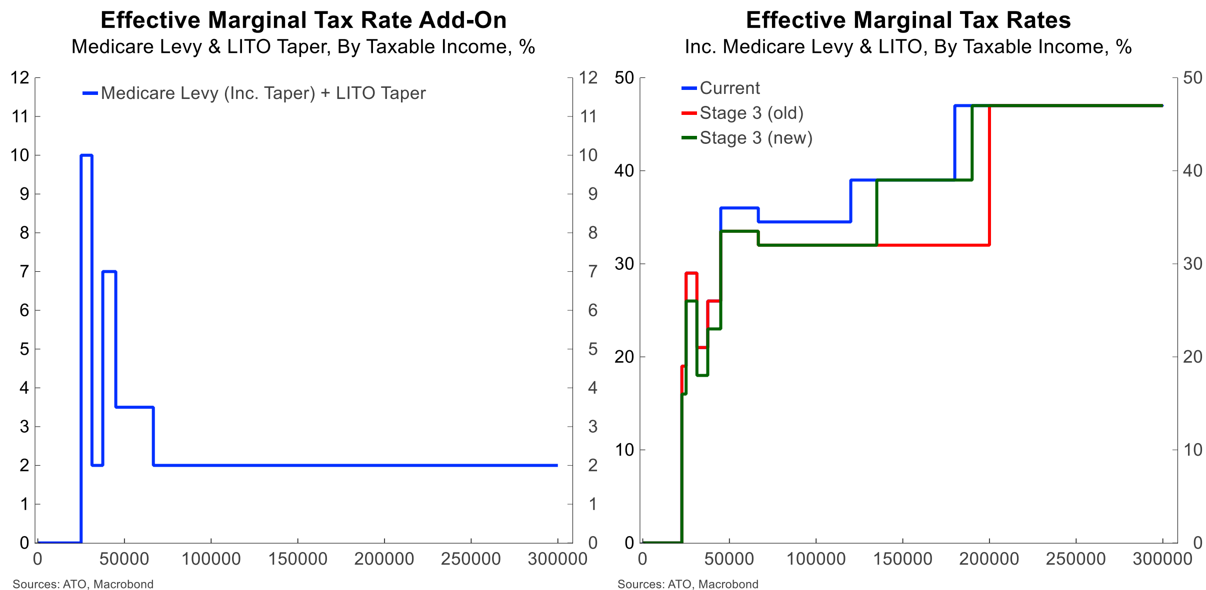
It appears that people in this range will only receive a 1% tax concession when contributing to superannuation – a tiny benefit when that money needs to be locked away until retirement.

However, that isn't the full story. The picture is more complicated as there are additional elements of the tax system that need to be accounted for.



Medicare Levy & LITO taper increase total concession for low-income earners

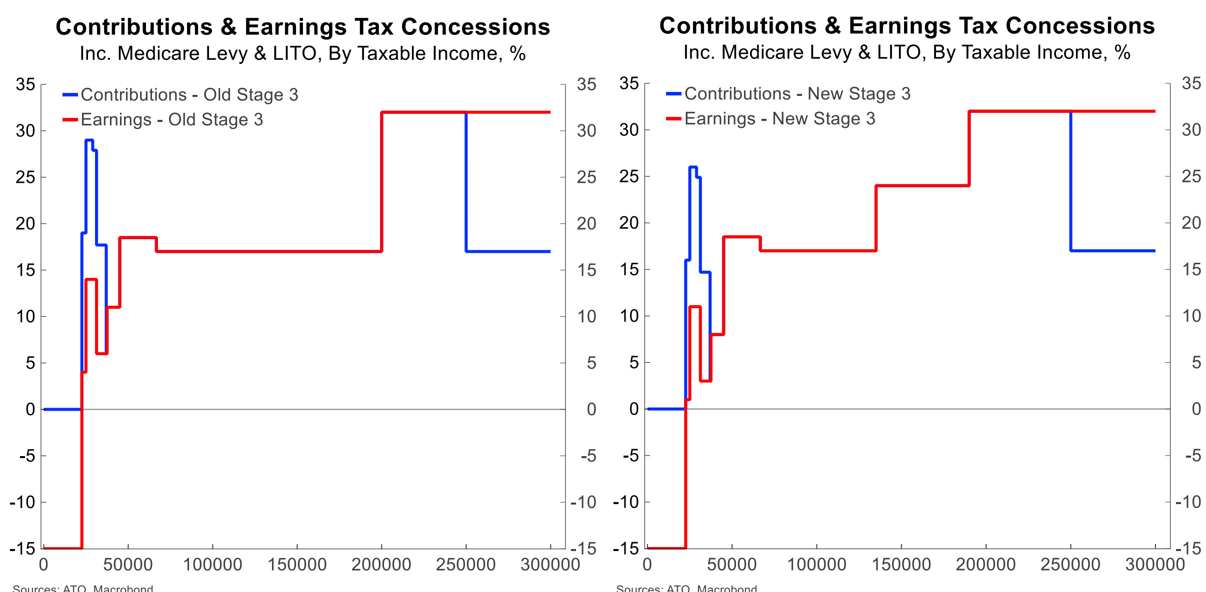
Effective marginal tax rates are higher than implied by statutory tax scales. The is because certain benefits provided to low-income earners are clawed back as income rises.



A $700 Low Income Tax Offset (LITO) is available on income below $37,500. This is reduced by 5 cents per dollar between $37,501 and $45,000, and 1.5 cents per dollar between $45,001 and $66,667. The Medicare Levy (2%) is not applied on incomes below a lower threshold and tapers in at a rate of 10 cents per dollar until incomes rise to an upper threshold.

A Low Income Super Tax Offset (LISTO) of up to $500 is available on income below $37,000. This avoids a situation where low-income earners would pay more tax (i.e. 15%) on super contributions than had they received that money as income. However, this only removes the negative concession, it doesn't create a benefit. Additionally, this is only provided on contributions. Earnings are still taxed at 15% while they may have been tax free if they were received as income.

Even after making these adjustments, higher income earners continue to receive the greatest benefit from superannuation tax concessions relative to their marginal tax rates. However, the benefit for lower income earners is higher than if these interactions were not considered.



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