Topic 1: Purpose and History of Australian Superannuation Regime

Introduction

Superannuation is a regime where individuals have funds invested for their retirement. These accounts are referred to as superannuation accounts (only called this in Australia).

*These accounts get larger over time due to more money being put in them, and also due to them earning a return whilst in the superannuation account. This is because money in their superannuation accounts are invested by the superannuation fund. Money can be invested in many ways, usually it is a mix of equities (shares) and bonds.

*In general, you can only access your superannuation once you reach the preservation age (currently this age is 56, however over time it will rise to 60). This rise in the preservation age will benefit the super funds as the money will be there for longer and they will receive additional funds through fees. As such, they are pushing for the age to increase even above 60.

In many cases the employer has to contribute money into the employee's superannuation account. Currently, the minimum employer contribution is 9.5% of the employee's salary. So for instance, if an employee has a salary of $60,000, the employer must contribute $5,700 ($60,000*.095) into the employee's superannuation account.

The previous government (Labor party) has legislated this to increase to 12% in a staggered manner till 2019/20. *However the current government (Liberal) has changed this so that it will remain at 9.5% until 30 June 2021 and then increase by 0.5 percentage points each year until it reaches 12% (the Labor impact is still legislated; however, the Liberal party has delayed it).

*Employees can increase their superannuation contributions above this. The most tax effective way they can do this is through a 'salary sacrifice' – for instance if on a salary of $70,000, say to their employer 'please reduce my salary to $65,000 and pay an extra $5,000 into my super account. So they will now get their 9.5% of $70,000 ($6,650) plus the extra $5,000 = $11,650. *The limitation on this is that the employer has to agree to this. Most of them will as it doesn't affect them, however if they like they have the option to say no.

Employees can also directly contribute into their superannuation accounts out of their money (i.e. out of their savings our out of their after-tax salary). *As we will learn, later, this currently does not have the same tax advantages as employer contributions (although the government is working to change this).

*Self-employed people do not have to contribute to their superannuation accounts. However, they can if they wish to do so. The rationale for why self-employed people may not have to contribute is because both their business is their retirement vehicle (they can sell their business when they are about to retire and use this to fund their retirement), and also the additional money is often vital to the continuation and growth of the business (it is important that the money is kept in the business so they can continue to grow and earn greater profits).

*Under 65's can make contributions into their fund without a test. *Someone who is 65-74, need to pass a 'work test' to make contributions. *People who are 75+ can only have contributions in the form of the mandated employer contributions (what the employer has to give them). The rationale for the additional tests on these older people on the contribution of super accounts is that the main purpose of super is to spend the money while you are alive rather than using it as an estate tool. If we allow people to make keep contributing just before they die, they are doing this not to build a super account for when they retire, but rather to build up their estate for their beneficiaries to inherent (which is not the purpose of the super fund).

*In general superannuation is a highly concessional tax. For example, employer contributions into superannuation accounts is taxed at 15%, as compared to salary, which is taxed at marginal tax rate that are substantially higher for full time workers (in effect, 15% tax is far lower than the tax rate you would be paying on your current job). Further, earnings (such as interest earned, rent revenue etc.) that superannuation funds make are also taxed at 15% (rather than your marginal tax rate – thus a lower rate). In the 2016 budget, some changes to the taxation of superannuation were announced, yet to be legislated. These will be covered; they will not commence until mid-2017.

*Superannuation funds are run as a trust structure:

- They will have a trustee who runs the fund (though some of the activities might be outsourced). In larger funds the trustee is typically a corporate entity. In Self-Managed Super Funds (4 or less people), the trustee can be a natural person/s or corporation.
- There will be the members, who are beneficiaries of this trust.
- There will be a trust deed that has the 'governing rules' of the fund.
- The trust property will be the funds invested.

The trustee (usually a company) will sometimes utilize:

- Investment manager – an entity that is appointed by the trustee. The trustee is the one that must formulate the investment strategy and has the ultimate responsibility for investment performance. The trustee is held as a fiduciary and is therefore responsible for the investment. However, investment decisions are often outsourced to an investment manager.
- Administrator – Carries out day to day administrative tasks of funds. Larger funds, especially industry funds are more likely to utilize these.

APRA is the overseeing body for the prudential supervision of super funds. However, in the case of Self-Managed Super Funds, the ATO is the relevant body.

There are a number of pieces of relevant legislation. The *Superannuation Industry (Supervision) Act 1993* ('SISA') is the major one.

History

Note: It appears that the initial purpose of superannuation was completely different to its current purpose.

*In the 1980's inflation was a problem (often up around 8%). Consequently, many industrial awards traded off smaller wage rises for the inclusion of superannuation. For example, instead of 8% pay rise, get 5% pay rise and 3% of superannuation. This was thought that with less money in the pocket individuals would not have such high demand, reducing inflation.

By 1990, about 80% of workers were entitled to superannuation under industrial agreements.

*In 1992 legislation enacted that mandated that employers pay 3% superannuation into employees' superannuation accounts. This was legislated to increase to 9% by July 2002.

*This is now legislated to increase to 12%. The first part of this increase came into effect 1 July 2013. It is now 9.5%. it will remain at 9.5% until 30 June 2021 and then increase by 0.5 percentage points each year until it reaches 12% (due to the Liberal government – some argue that the government may legislate to even delay this further).

Justifications and counter-arguments for superannuation

Argument 1: To protect us from ageing population crisis due to higher future dependency rates.

Facts: "The number of people aged 15 to 64 (typically the age of people in the work force) for every person aged 65 and over has fallen from 7.3 people in 1975 to an estimated 4.5 people today. By 2054-55, this is projected to nearly halve again to 2.7 people" (Intergenerational Report 2015). This is what is known as the 'dependency ratio', i.e. the proportion of those of retirement age as compared to those of working age.

It is argued that this will put pressure on the government's fiscal position. *A lower proportion of people working means less tax revenues. *Further, the more elderly people means greater spending on pensions, aged care and health. To combat these two issues, we will need a higher tax burden to pay for this.

*The good news (and converse argument) in this respect is that the annual GDP/capita growth is predicted to be 1.5% for the next 40 years, which compounds to around 80%. This means the average income per person in 40 years' time will increase from the current $66,400 to $117,300 in today's dollars (Intergenerational Report 2015).

*It has been argued that the higher incomes "trumps" the impact of higher taxes – in other words, since incomes in after-inflation terms will be so much higher, even with taxes that are higher than today, the net effect is much higher average incomes (so the higher tax doesn't matter because we will still be earning much more than we are taking into account inflation). - Creina Day and Steve Dowrick, 'Ageing Economics: Human Capital, Productivity and Fertility' (2004)

Using the predictions of the 2015 Intergenerational Report this theory very much still applies.

*Another counter argument not on the slides but which the lecturer discussed was that despite over the past 40 years the population has aged, the GDP per capita taking into account the cost of living (the best measure of the wealth in Australia) has increased significantly over the past 40 years. It may be argued that this demonstrates that the continuance of our ageing population will not impact on our wealth.

These counter arguments may be further countered as they only reflect past results and estimates for the future, which may not turn out to be true.

Argument 2: To Save Rising Pension Costs due to an Ageing Population

In Australia we have a means tested age pension (different to the US where everyone gets their benefits regardless of their financial position – we look at their savings and income). *If people have greater retirements savings & income, people are more likely to not be eligible for pension, or only be eligible for part pension.

**However, there is another side to this: Superannuation as we know is concessionally taxed. So because it is concessionally taxed, this is in a sense a cost – because in a "parallel universe" that has no superannuation, that money would be taxed at normal higher rates, so tax revenue would be higher.