Parliamentary
Budget Office

How is super taxed?

PBO budget explainer, 27 April 2023

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The contents of this explainer are the sole responsibility of the Parliamentary Budget Office (PBO).

Overview

This explainer is the first in a 2-part series about taxes on superannuation (or *super*). Unlike most OECD countries, in Australia taxes apply as fund members' balances increase during their working lives rather than as pensions are drawn out of the fund after retirement. This means that the timing of contributions matters for how much tax is paid. Contributions made earlier in a person's accumulation phase are more affected by taxes than those made closer to retirement. In addition, amounts entering funds are largely all taxed at the same rate, in contrast to the progressive rates of the personal income tax system.

Super is a long-term savings vehicle that contributes to 2 of the 3 pillars of Australia's retirement income system: compulsory and voluntary savings. The other pillar is the Age Pension.

The super guarantee (SG), introduced in 1992, greatly expanded the number of people with access to super, to virtually all employees now. The expansion in coverage, combined with tax incentives for voluntary contributions, has built a sector with total assets worth $3.4 trillion (150% of GDP) as at December 2022 – a pool of savings that supports Australians in retirement.

From a fiscal perspective, super is an important source of Australian Government revenue, accounting for around 5% of total tax revenue in 2021-22. This is the fifth largest source behind personal income tax, company tax, goods and services tax (GST) – which is passed to the states and territories – and customs and excise duties. Super is taxed concessionally, which means that it is taxed less than many other forms of income. The tax treatment of super has undergone a number of changes over the last 40 years, often to limit the availability of tax concessions.

How super is taxed

In general there are 3 points at which super can be taxed: contributions, investment returns on super assets (earnings), and withdrawals. The current system taxes most SG contributions and voluntary (before tax) concessional contributions at a flat rate of 15% up to the *concessional contributions cap* ($27,500 in 2022-23). Non-concessional contributions are made after an individual has already paid personal income tax. Earnings are also taxed at a flat rate of 15%. In retirement, earnings (if they are held in a retirement-phase account) and withdrawals (since 2007) are untaxed.

The tax concessions on super aim to encourage individuals to save for retirement, but higher-income earners typically benefit from these concessions more than lower-income earners. This is because the difference between an individual's marginal tax rate and the flat tax rate on super increases as their income increases. In 2019-20, around 30% of the value of tax concessions on super contributions were received by the highest 10% of earners.

In contrast to Australia, many other OECD countries do not tax contributions or earnings in their equivalent retirement-income schemes. Instead, these countries only tax withdrawals. When the SG was introduced in 1992, taxing contributions and earnings had the effect of raising revenue sooner than taxing withdrawals.

The trade-off, however, is that taxing contributions and earnings at the same rate for most taxpayers can make the super system less progressive. In addition, the compounding impact of taxes on earnings is larger for contributions made early in an individual's accumulation phase than for those made for an individual close to retirement.

The second explainer in this series (forthcoming) will explore the longer-term fiscal impacts of the super system, in particular its interactions with the Age Pension and integration into the retirement-income system as a whole.

Introduction

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Australia's retirement income system is built on 3 pillars: the Age Pension, compulsory savings, and all forms of voluntary savings, including housing. Super directly contributes to 2 of these pillars through compulsory contributions under the super guarantee (SG) and voluntary contributions. The super system plays an important role in ensuring that Australians have sufficient income to meet their financial needs in retirement.

Super is a system where regular contributions are made into a super *accumulation fund (or super fund)* throughout individuals' working lives, from which withdrawals are made in retirement.[1] The SG, introduced in 1992, greatly expanded the number of people with access to super, from around 40% in the mid-1980s[2] to virtually all employees in 2022[3] (Figure 2). There has also been a shift from defined benefit funds towards defined contribution funds.[4] Box 1 provides some context around the introduction of the SG.

This expansion in coverage has resulted in a large pool of savings that supports Australians in retirement. The value of assets held in super funds has increased from $83 billion in the late 1980s (around 25% of GDP) to $3.4 trillion by December 2022 (around 150% of GDP).[5] Around two-thirds of these assets are held in funds regulated by the Australian Prudential Regulation Authority (APRA), and around a quarter are held in self-managed super funds (SMSFs).[6] The remainder, less than 10%, are mostly held in defined benefit funds.

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1 Individuals can sometimes access their super before retirement if they meet a condition of release. For simplicity, this paper only discusses those who access their super in retirement.

2 Department of the Treasury (2002) *Treasury submission to the inquiry into superannuation and standards of living in retirement*.

3 The Association of Superannuation Funds of Australia (ASFA) notes that 'superannuation coverage is now more or less universal'. See ASFA (2022) *The Australian superannuation industry, September 2022*.

4 This explainer focuses on the tax treatment of defined contribution funds, where individuals and employers make regular contributions to a fund, which is invested for an individual to withdraw from in retirement. Defined benefit funds, in which employers are required to provide for their former employees in retirement, are largely untaxed, with benefit pensions tax free up to $106,250 in 2022-23. Historically, defined benefit funds were common among public service employees, but only account for around 3% of super fund members today. Public sector defined benefits funds are usually unfunded, which means the government (state or Commonwealth) employer doesn't pay contributions to a fund, but only contributes when the retirement benefits are paid out.

5 PBO analysis of Australian Bureau of Statistics (2023) *Managed Funds, Australia, December 2022*.

6 Australian Prudential Regulatory Authority (2023) *APRA releases superannuation statistics for December 2022*, accessed 21 April 2023.

Box 1: The super guarantee – national savings, retirement incomes and wages

While super funds have existed in Australia since the late 1800s, the system of compulsory super, known as the super guarantee (SG), was not introduced until 1 July 1992. Under the SG, employers are required to make contributions to a super fund on behalf of their employees. If contributions are not made or are made late, employers must pay the *super guarantee charge*.

The groundwork for the SG included the then Australian Government's Prices and Incomes Accord with the Australian Council of Trade Unions (ACTU) in 1985. The agreement included a requirement for employers to pay a 3% super contribution on behalf of employees on award wages in lieu of a wage rise.

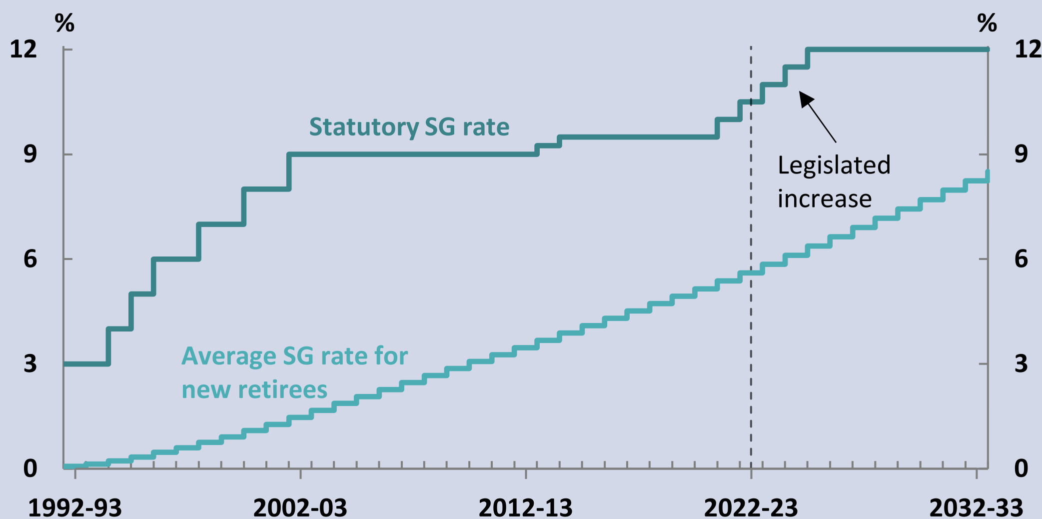
At the time, Australia was relying heavily on foreign savings to finance national investment, such that low national savings was considered to have left Australia paying a premium on borrowing through high interest rates and more exposure to commodity price changes and global economic shocks.[7]

The agreement aimed to both boost the long-term national savings rate and help improve retirement incomes. Paying super instead of a wage rise was also intended to contain high inflation and unemployment.

The coverage of mandatory super contributions was expanded to nearly all employees in 1992 (the SG), and the SG rate was increased to 9% over the next decade (Figure 1). The SG rate was further increased to 10% in 2021-22, 10.5% in 2022-23 and is legislated to rise to 12% by 2025-26.

The super system in Australia is still some years away from approaching full *maturity*. People entering retirement in 2022-23 will have received low or zero SG payments for around half of their working lives, an average rate of around 6%. Figure 1 also shows the average SG rate received by people retiring in each year, assuming they had worked for 45 years before. On the current policy trajectory, the average SG rate received by retiring employees over their career will reach 9% by 2035-36.

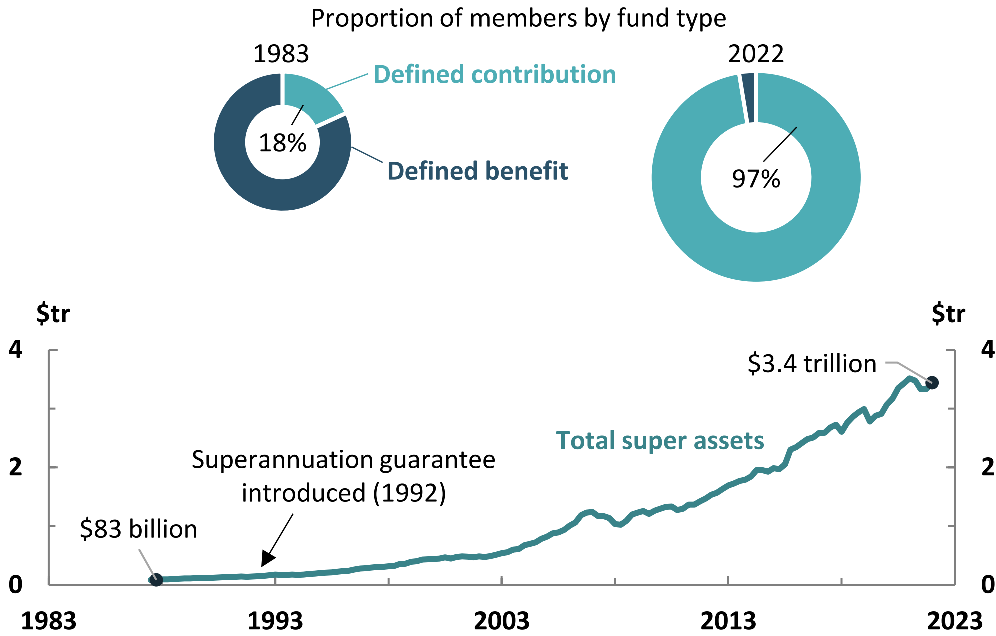
Figure 1: The super guarantee rate since 1992-93



Source: Australian Taxation Office (ATO) (2023) *Super guarantee percentage*, accessed 21 April 2023; and PBO analysis.

[7] See, for instance, FitzGerald, V.W. (1993) *National Saving: A report to the Treasurer*, Australian Government Publishing Service.

Figure 2: Super coverage by fund type and total super assets, 1983 to 2022



Note: The size of each circle is proportional to the coverage of employees at the time, around 39% in 1983 and almost 100% in 2022.
Source: Australian Government (2001) *Towards higher retirement incomes for Australians: a history of the Australian retirement income system since Federation*; Department of the Treasury (2002) *Treasury submission to the inquiry into superannuation and standards of living in retirement*; Australian Prudential Regulatory Authority (APRA) (2022) *Annual fund-level superannuation statistics, June 2022*; Australian Bureau of Statistics (ABS) (2023) *Managed Funds, Australia, December 2022*; and PBO analysis.

Australia's super system is taxed concessionally, which means that it is generally taxed at a lower rate than other forms of taxable incomes. Super can be taxed at 3 points: when contributions are made, when super assets earn investment returns (earnings), and when withdrawals are made. Most contributions and earnings are taxed at a flat rate of 15%, while withdrawals in retirement are generally untaxed. These are considered *concessional* tax rates, because the rates are lower in each case than the taxes that apply to other forms of income, particularly income earned by individuals.

Taxes on super are paid to the government by the individuals' super funds, rather than by their employers or directly from the individuals themselves.[8] Super funds were liable for taxes totalling nearly $27 billion in 2021-22, equal to around 5% of government tax revenue.[9]

Many OECD countries do not tax contributions or earnings at all in their equivalent schemes, instead only taxing withdrawals.[10] While Australia's system of taxing contributions and earnings can be shown to have a similar impact on average retirement incomes, there are costs and benefits to Australia's approach.[11] For instance, taxing contributions and earnings raises revenue sooner, but the flat tax rate means the tax concessions are distributed towards high-income earners. The tax settings also create incentives for additional contributions, but these are stronger for those closer to retirement, even though contributions made earlier would have a greater impact on retirement incomes.

[8] The tax on super fund earnings in the form of dividends is mostly paid by the issuing company.

[9] Australian Government (2022) *2022-23 October Budget, Budget Paper No. 1*, Note 3, page 341.

[10] Organisation for Economic Co-operation and Development (2022) *Annual survey on financial incentives for retirement savings, OECD country profiles 2022*.

[11] A 2022 working paper from the Tax and Transfer Policy Institute found that Australia's tax concessions on super were close to the median across OECD countries when measured on a comparable basis. See Pincus J. (2022) *Superannuation tax concessions are overestimated*(revised)*, Tax and Transfer Policy Institute Working paper 1/2022.

Super can be taxed at 3 different points

The 3 points where super can be taxed are:

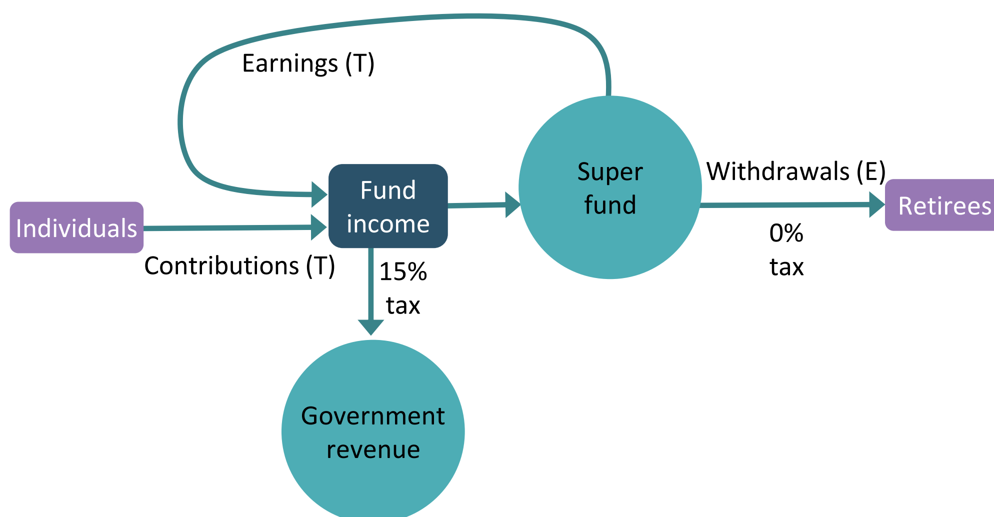
(1) when contributions are made into a super fund

(2) when super fund assets earn investment returns (earnings)

(3) when withdrawals are made from a super fund.

If each taxing point is denoted as either 'T' for taxed or 'E' for exempt, Australia is said to have a 'TTE' super tax system.[12] This means that contributions (1) and earnings (2) are taxed, while withdrawals (3) are mostly untaxed (Figure 3). The nomenclature can be helpful in comparing different tax systems. The tax treatment at each point is explained in more detail below.

Figure 3: How super funds are taxed



Note: This is a simplified diagram of how super funds are taxed and excludes more complex elements, for instance that earnings are untaxed for account holders in the retirement phase, and that withdrawals to individuals who are not retired are usually taxed.
Source: PBO.

Most super contributions are taxed at a low rate

Super contributions can be categorised into 3 groups:

- super guarantee (SG) contributions, made by employers
- voluntary concessional contributions, made by employers or individuals
- non-concessional contributions, made by individuals.

The tax treatment of contributions is summarised in Table 1 and explained in more detail below.

SG contributions

The most common form of contributions are SG contributions, which form part of an employee's total remuneration. SG contributions are made by employers on behalf of their employees. Super funds pay 15% tax on these contributions on behalf of their members (individuals who contribute to a super fund are considered *members* of that fund), which is paid from their account balances. Box 2 provides more information on how super funds are assessed for tax.

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[12] Sometimes Australia's super tax system is denoted with lower case Ts, i.e. 'ttE', to reflect that the usual tax rate on contributions and earnings is relatively low compared to other forms of income.

Table 1: Tax treatment of super contributions, 2022-23

Contribution	Who pays	Tax rate	Maximum allowable contribution
Compulsory contributions (super guarantee)	Employers	15%	$27,500[(a)]
Voluntary concessional contributions	Employers or individuals (before tax)	15%	Same cap as above (both compulsory and voluntary concessional contributions count towards the cap)
Voluntary non-concessional contributions	Individuals (after tax)	Marginal tax rates	$110,000[(b)]

(a) Eligible account holders can carry forward unused contributions for up to 5 years.
(b) Individuals cannot make non-concessional contributions if their super balance is greater than or equal to the transfer balance cap (the maximum amount an individual can transfer into a retirement-phase account) at the end of the previous financial year. Individuals may bring forward 2 years of contributions.
Source: Australian Taxation Office (ATO) (2022) *Contribution caps*, accessed 21 April 2023; and PBO analysis.

SG contributions count towards the *concessional contributions cap*, which is the limit on contributions that can be made at the concessional rate of 15%. The concessional contributions cap was $27,500 in 2022-23.[13]

Some individuals pay higher or lower effective tax rates on their SG contributions. For instance, those earning below $37,000 are eligible for the *low income super tax offset* (LISTO), which refunds the tax paid on their contributions up to $500 per financial year.[14] Those earning more than $250,000 (inclusive of their contributions) pay the *Division 293 tax*, an additional 15% on any contributions for which an individual's income exceeds the threshold.[15] This additional tax can either be paid by the individual or released from their super fund.

The tax rate on SG contributions is considered concessional, even for those who pay the Division 293 tax, because it is lower than the rate that most taxpayers would face if their SG contributions were instead paid as salary or wages.

Voluntary concessional contributions

Individuals can elect to make additional contributions from their pre-tax income. These are known as *voluntary concessional contributions* because they are also taxed at a concessional rate of 15%.[16] Voluntary concessional contributions are also included in the concessional contributions cap, along with SG contributions. Figure 5 shows that the concessional contributions cap has changed significantly over time.

Self-employed individuals are not required to pay themselves SG contributions, but they can make voluntary concessional contributions up to the same concessional contributions cap. This ensures that super contributions from self-employed individuals are subject to the same tax treatment as those from employees.

[13] Australian Taxation Office (2023) *Concessional contributions cap*, accessed 21 April 2023.
[14] Australian Taxation Office (2019) *Low income super tax offset*, accessed 21 April 2023.
[15] Australian Taxation Office (2021) *Additional tax on concessional contributions (Division 293) – for individuals*, accessed 21 April 2023.
[16] Typically, voluntary concessional contributions are made either through a salary sacrifice arrangement with an employer or via a personal tax-deductible contribution. The Division 293 tax still applies for individuals with incomes greater than $250,000.

Box 2: The super fund income tax return

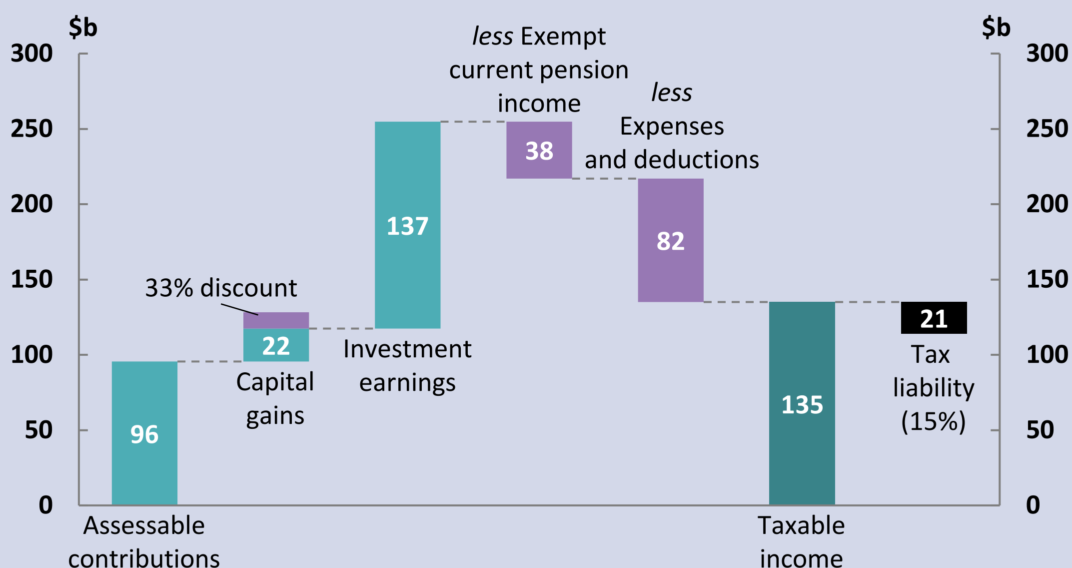
Super funds submit an annual tax return detailing the income and expenses for funds they manage on behalf of their members.[17] Major items on these tax returns are shown in Figure 4. Table 2 shows the relative sizes of the different forms of super fund income (contributions and earnings) and expenses.

The super fund's tax return includes all fund earnings and then subtracts the earnings from retirement-phase accounts, which are tax free. This is referred to as *exempt current pension income* and typically accounts for around one quarter of earnings in aggregate. This may increase in the future as a greater share of fund assets enter the retirement phase.

Historically, the most volatile sources of earnings have been capital gains and foreign exchange gains and losses. Dividends and franking credits are usually less volatile but were unusually high in 2018-19 due to large share buybacks in that period.

Amounts for *net capital gains* are after the application of a 33% discount for gains on assets held for at least 12 months. For example, if a fund sold an asset after 12 months, making a $90 capital gain, it would write only $60 on its tax return. While the tax rate on these discounted capital gains is 15%, the effective rate on the full amount is only 10%.

Figure 4: Contributions of key items to the aggregate of all super tax returns, 2019-20



Note: The tax liability is slightly higher than 15% of taxable income. This reflects that aggregate taxable income includes a small amount of funds that made a taxable income loss. Taxable income is around $141 billion when loss-making funds are excluded, and the $21 billion liability is 15% of this.
Source: Australian Taxation Office (ATO) (2022) *Taxation statistics 2019*-20; and PBO analysis.

In total, super funds were liable for just over $20 billion of tax revenue for each of 2017-18, 2018-19 and 2019-20. However, the net amount of tax super funds remitted themselves was around $11 billion in 2019-20. This is because around half of their tax liability was effectively paid in advance by companies, credited to the funds as franking credits (see rows *Tax at 15%, Less: franking credits* and *Tax payable* in Table 2).

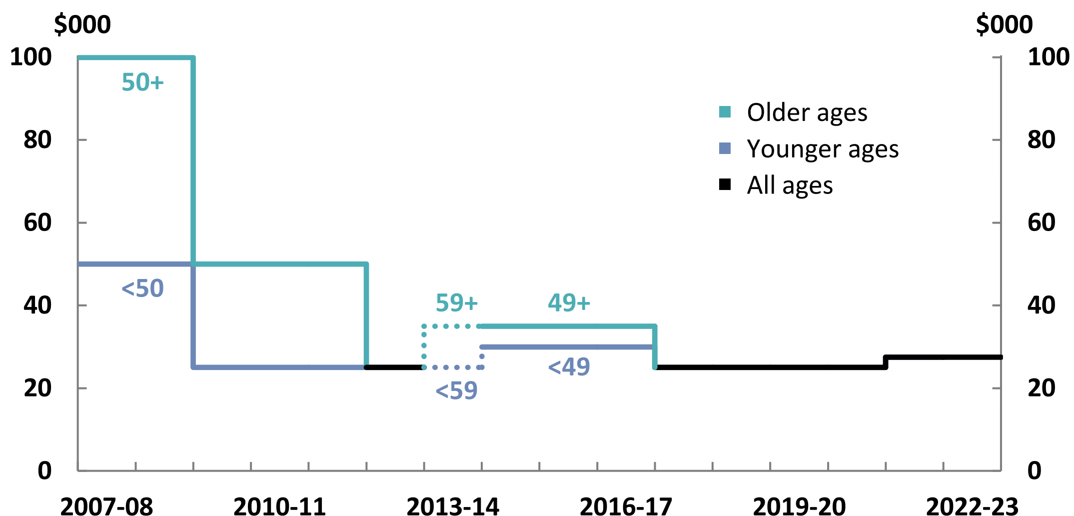
[17] Like most businesses, super funds also submit a tax return on their own behalf, detailing their income (such as management fees) and expenses (such as employee wages). When this explainer refers to taxation of super funds, it refers to tax paid by the fund on behalf of its members.

Table 2: What did super funds report on their tax returns? 2017-18 to 2019-20

	2017-18 $b	2018-19 $b	2019-20 $b
Assessable contributions			
Employer	90.1	93.2	99.8
Personal (self-employed and other)	7.2	8.4	8.7
Less: transfers to life insurance funds	-12.1	-11.4	-12.9
Investment earnings			
Net capital gain[a]	30.6	21.8	21.8
Gross rent and other leasing and hiring	7.6	7.9	7.4
Gross interest	5.9	5.9	4.8
Net foreign income	20.4	22.9	28.2
Gross franked dividends	31.2	51.4	29.4
Foreign exchange gains	29.7	21.8	46.7
Trust distributions (unfranked)	8.7	8.3	9.9
Other income	5.9	6.3	10.9
Less: exempt current pension income	-33.6	-38.0	-37.7
% of earnings	*-24.0*	*-26.0*	*-23.7*
Less: expenses and deductions			
Death or disability insurance premiums	-10.2	-10.5	-9.8
Investment expenses	-4.0	-4.1	-4.4
Management and administration expenses	-5.6	-5.6	-5.7
Foreign exchange losses	-26.5	-29.1	-55.8
Other expenses	-5.6	-4.8	-6.3
Taxable income or loss	139.6	144.5	135.0
Taxable income	144.5	150.5	140.6
Tax @ 15%	21.7	22.6	21.1
Less: franking credits	-9.3	-15.4	-8.8
Less: other credits	-0.9	-0.9	-0.9
Tax payable	11.5	6.3	11.4

(a) After the application of the 33% discount for gains on assets held for at least 12 months.
Source: Australian Taxation Office (ATO) (2022) *Taxation statistics 2019-20*; and PBO analysis.

Figure 5: Concessional contributions cap, 2007-08 to 2022-23



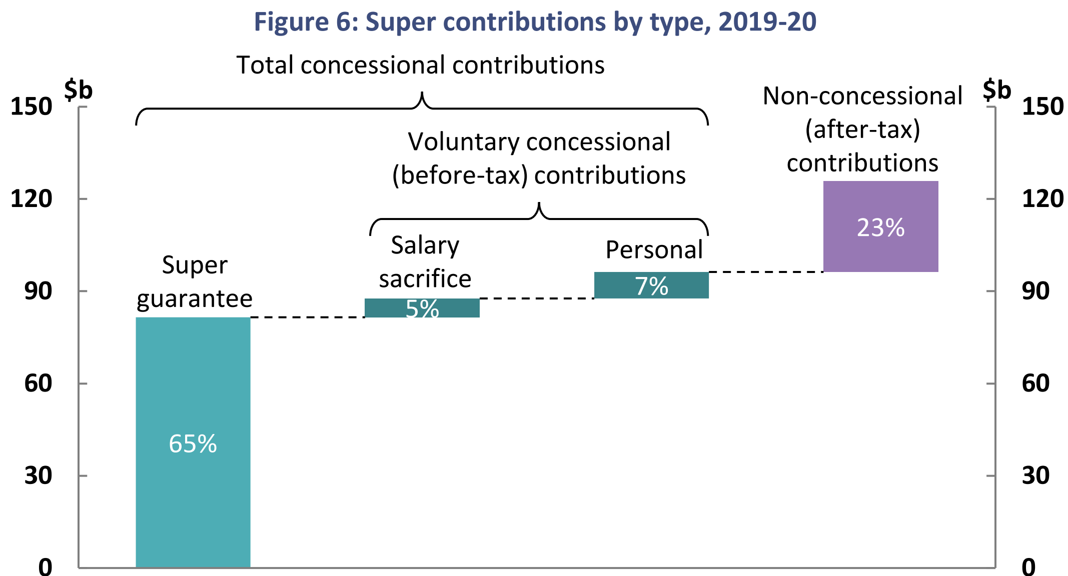
Notes: The dotted lines represent the change in eligible ages in 2013-14. From 2019-20, some individuals can contribute more than the cap in a given year by using previous concessional caps that were not fully utilised. This has been omitted for simplicity.
Source: Australian Taxation Office (ATO) (2023) *Concessional contributions cap*, accessed 21 April 2023.

Non-concessional contributions

Contributions into super can continue to be made after the concessional contributions cap is reached, but they must be made from post-tax income.[18] These are known as *non-concessional contributions* because they have already been taxed at an individual's marginal tax rate. Super funds do not need to pay the 15% contributions tax on non-concessional contributions.

Like concessional contributions, there is a limit on the value of non-concessional contributions that can be made in a given financial year. This limit, known as the *non-concessional contributions cap*, was $110,000 in 2022-23[19], though the cap is reduced to zero for individuals with balances above the *transfer balance cap*, which was $1.7 million in 2022-23.[20] Non-concessional contributions accounted for nearly a quarter of all contributions in 2019-20 (Figure 6).

Figure 6: Super contributions by type, 2019-20



Note: Excludes contributions to defined benefit funds.
Source: Australian Prudential Regulation Authority (APRA) (2023) *Annual superannuation bulletin, June 2022*; Australian Taxation Office (ATO) (2022) *Taxation statistics 2019-20*; and PBO analysis.

Super earnings are also taxed at a low rate

Super funds invest the contributions they receive on behalf of their members, earning investment returns. These earnings are also taxed, but only in an individual's *accumulation phase* – the phase in their working life when they are building their super balance for retirement.

Earnings in an accumulation-phase account are taxed at a rate of 15%, paid by super funds on behalf of their members. This is concessional because it is lower than the tax rate that most taxpayers would face if they earned investment income outside of super.

After an individual has reached the preservation age (60 for most individuals) and retires, they may transfer some or all their super from an accumulation-phase account into a *retirement-phase account*. Retirement-phase accounts require a minimum percentage to be withdrawn each year, which is not the case for accumulation-phase accounts.[21]

[18] If the concessional contributions cap is exceeded, the excess contributions are included in the individual's assessable income and taxed at their marginal tax rate. The ATO applies a 15% tax offset to account for the contributions tax already paid. See Australian Taxation Office (2022) *If you exceed your concessional contributions cap*, accessed 19 April 2023.

[19] Australian Taxation Office (ATO) (2022) *Contribution caps*, accessed 21 April 2023.

[20] Australian Taxation Office (ATO) (2022) *Transfer balance cap*, accessed 21 April 2023.

[21] Individuals who have retired or are transitioning to retirement are still able to make contributions up to the age of 74 (inclusive) but cannot make these contributions into a retirement-phase account. They must maintain an accumulation-

Earnings in a retirement-phase account have always been untaxed, though reforms brought in from 2017-18 introduced a limit, known as the *transfer balance cap*, on how much can be transferred into a retirement-phase account. The transfer balance cap was $1.7 million in 2022-23 but is expected to increase to $1.9 million in 2023-24, as it is indexed to inflation (the consumer price index). Super assets held above this limit must be in an accumulation-phase account where earnings are taxed at 15%.[22] While the transfer balance cap does not affect the tax rate applied on super earnings for those not yet in retirement, individuals with account balances that exceed the cap are restricted from making non-concessional contributions.

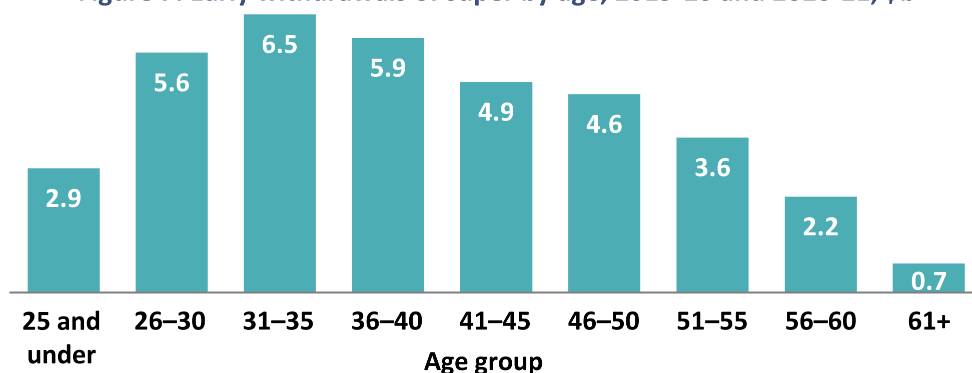
Super withdrawals are generally untaxed

After an individual has reached the preservation age and is in retirement, they can withdraw money from super untaxed as either a *lump sum* or *income stream*. A lump sum is when money is withdrawn in a single payment, while an income stream is a series of regular payments. Prior to 2007, both forms of withdrawal were taxed at a concessional rate up to a *reasonable benefit limit* and were taxed at marginal rates above this limit.

Withdrawals may be taxed in some circumstances. For instance, withdrawals can sometimes be made by individuals below the preservation age on compassionate grounds, such as paying for medical expenses or palliative care for a dependent. Tax usually applies to these withdrawals. Similarly, if a person dies, their super fund will normally pay their remaining super to their nominated beneficiary. This may be subject to tax depending on who receives the benefit, the age of the beneficiary and of the deceased person, as well as how contributions were originally made to the fund.

In 2019-20 and 2020-21, the Australian Government made early super withdrawals temporarily tax free up to $10,000 in each financial year for eligible individuals aged under 60. This was part of the response to the COVID-19 pandemic. There were around 4.5 million withdrawals totalling $38 billion, with younger people being more likely to withdraw than those closer to retirement (Figure 7).[23] As discussed later, withdrawals earlier in a person's accumulation phase have a larger impact on final retirement balances because of the compounding effect of earnings.

Figure 7: Early withdrawals of super by age, 2019-20 and 2020-21, $b



Source: PBO analysis of data provided by the Australian Taxation Office.

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phase account (in addition to a retirement-phase account) for these contributions. The earnings from the accumulation-phase account are still taxed at 15%.

[22] An individual may transfer the transfer balance cap amount into a retirement-phase account. However, if the value of these assets increases above the cap, they do not need to transfer the excess back to an accumulation-phase account.

[23] It is unclear whether withdrawals were distributed towards lower age groups because these people were more likely to have their incomes reduced or lose their job due to pandemic-related lockdowns and other restrictions, or because people closer to retirement place a higher value on their super relative to today's consumption.

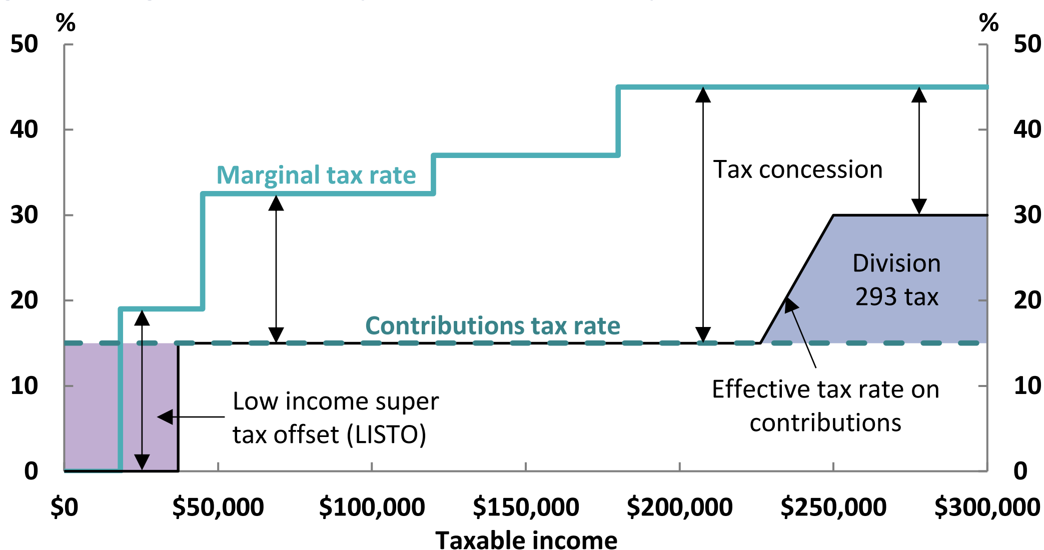
Super is taxed differently to other forms of income

The tax rates applying to super contributions and earnings are concessional. The benefits of these concessions flow more towards higher-income earners because these people would otherwise pay higher marginal tax rates if their super was paid directly to them as personal income. Taxing super earnings at personal income marginal rates, however, would greatly reduce retirement balances, as the impact of earnings taxes compounds over many years. Successive governments have tweaked tax policies on super over the last 40 years, often with the aim of limiting the availability of tax concessions.

Super tax concessions on contributions are distributed towards higher-income earners

All individuals with taxable incomes between $37,000 and around $225,000 pay the same tax rate of 15% on their concessional super contributions (both SG contributions and voluntary concessional contributions)[24], but higher-income earners – especially those earning between $180,000 and $225,000 – receive more of a tax concession. This is because they face higher marginal tax rates on their salary and wages compared to low-income earners within the same range (Figure 8).

Figure 8: Marginal tax rates on personal income and super contributions tax rate, 2022-23



Note: Marginal tax rate excludes levies and offsets. While contributions from individuals earning below $37,000 are taxed at 15%, they are eligible for the low-income super tax offset (LISTO) on their SG contributions, as well as a government co-contribution of up to $500 on any voluntary after-tax contributions. As such, the effective tax rate on contributions can be zero for low-income earners. Individuals earning more than $250,000 (including contributions) pay an additional 15% tax on their contributions exceeding this amount – for salary and wage earners, this effectively phases in from around $225,000 (assuming an SG contribution of $25,000) such that the effective tax rate on contributions is 30% for those with a taxable income above $250,000.
Source: Australian Taxation Office (ATO) (2019) *Low income super tax offset*, accessed 21 April 2023; Australian Taxation Office (ATO) (2021) *Additional tax on concessional contributions (Division 293) – for individuals*, accessed 21 April 2023; and PBO analysis.

Individuals usually prefer consumption today over consumption in the future. Tax concessions on super contributions provide some compensation to individuals for forgoing today's consumption. But the tax concessions on contributions do not compensate individuals equally.

For instance, an individual who earns $200,000 in 2022-23 faces a marginal tax rate of 47% (including the Medicare levy). If a dollar is paid to this individual's super fund, the super fund pays 15c of tax on

[24] The Division 293 tax applies an additional 15% on concessional contributions for individuals whose taxable income plus concessional contributions exceeds $250,000 – the tax only applies to the amount of contributions for which this total income exceeds $250,000. For an individual earning $225,000 with concessional contributions of $25,000, their Division 293 income would be assessed as $250,000, meaning they would start to pay Division 293 tax on their next dollar of income.

their behalf. If that dollar was instead paid to the individual directly, they would pay 47c of tax. This means that for every dollar contributed to super the individual forgoes 53c in post-tax consumption while their super balance increases by 85c. The ratio of these (85c/53c) shows that, for each dollar of post-tax consumption forgone, this individual's super balance will increase by $1.60.

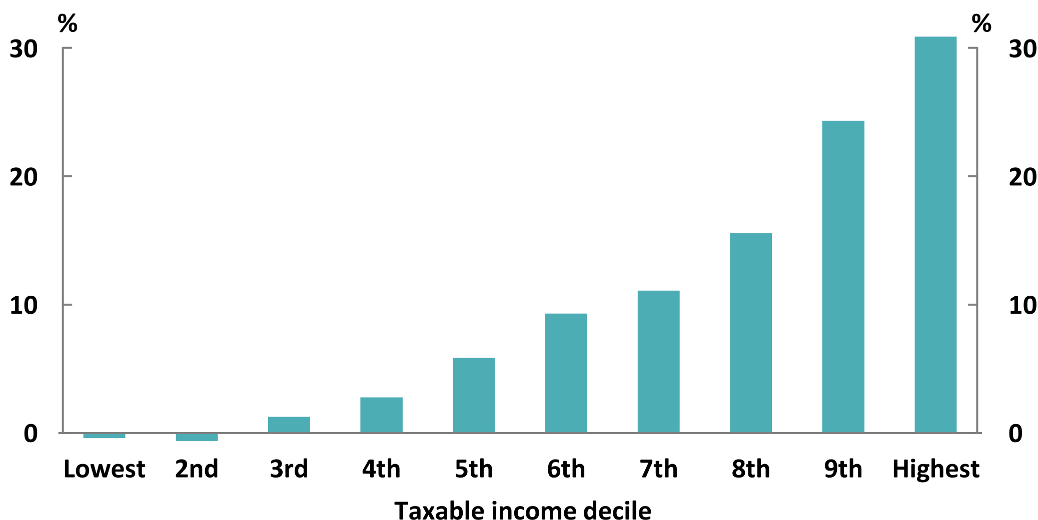
In contrast, an individual who earns $100,000 in 2022-23 faces a marginal tax rate of 34.5% (including the Medicare levy). Applying a similar calculation, this individual forgoes 65.5c in post-tax consumption for each dollar contributed to super, while their super balance increases by 85c. For every dollar of post-tax consumption forgone, their super balance will increase by $1.30. The individual is still compensated for forgoing consumption, but by less than the higher-income earner.

Because the benefit that high-income earners receive is greater than the benefit that low-income earners receive (on average), super tax concessions are often said to be *regressive*. Figure 9 shows that around 30% of the $20 billion in super tax concessions on contributions in 2019-20 were received by those in the highest 10% of income earners, those who earned more than $121,700.[25]

There are 3 factors behind this distribution:

1. For each dollar contributed to super, high-income earners receive a higher tax benefit than low-income earners, on average, because they face a higher marginal tax rate.
2. Higher salary and wage earners are more likely to receive higher SG contributions through their employer.
3. Higher-income earners are more likely to have capacity to make voluntary contributions than lower-income earners.

Figure 9: Share of super tax concessions on contributions by income decile, 2019-20



Note: The share is negative for the lowest 2 deciles because on average they face a marginal personal income tax rate below 15%. The impact does not incorporate the low income super tax offset.
Source: The Department of the Treasury (Treasury) (2023) *2022-23 Tax Expenditures and Insights Statement*.

Taxes on super earnings compound over a working life

As discussed above, the flat tax rate of 15% on super earnings is considered concessional because it is lower than the tax rate that would apply to other forms of investment income. The total value of tax concessions on super earnings was estimated at around $16 billion in 2019-20.[26] However, over a

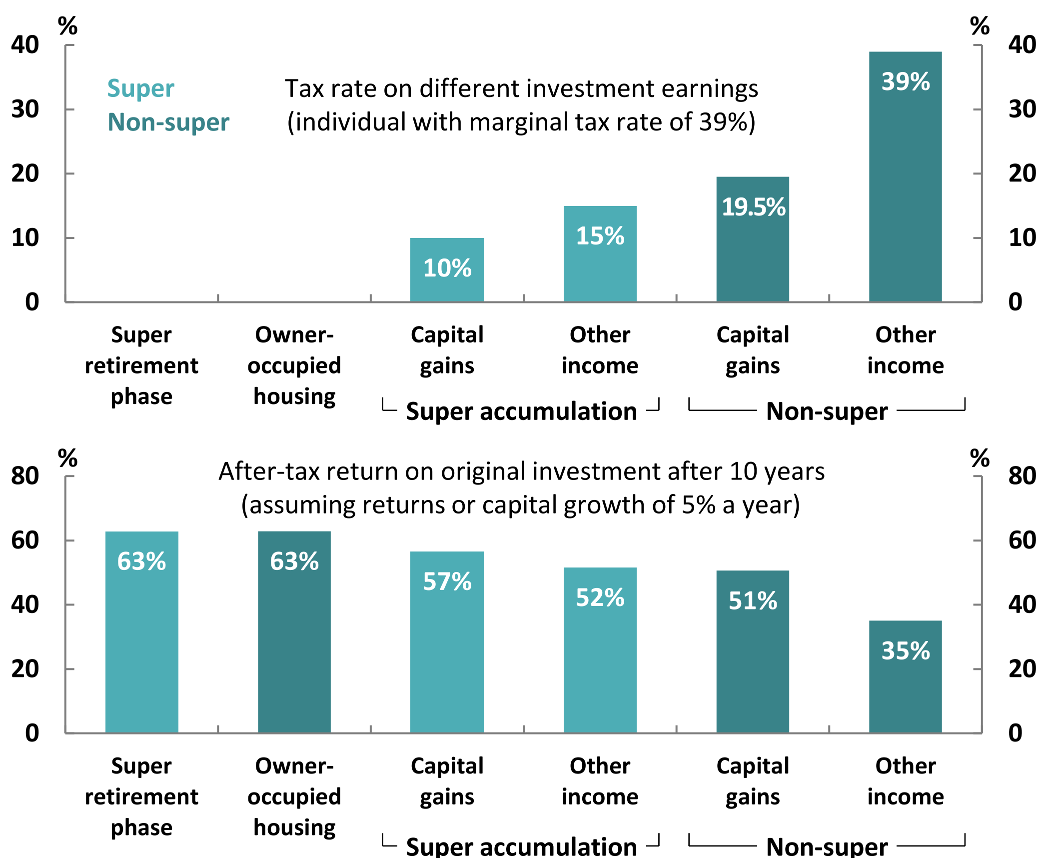
[25] See Department of the Treasury (2023) *2022-23 Tax Expenditures and Insights Statement*, page 15 and 206.
[26] Department of the Treasury (2023) *2022-23 Tax Expenditures and Insights Statement*, page 17.

working life of 45 years, taxes on super earnings compound such that the impact on retirement balances exceeds the 15% tax rate. Taxing earnings at marginal rates would reduce final retirement balances by even more.

Other investments outside of super are often taxed at concessional rates as well. This is shown in Figure 10, which compares the tax treatment of a number of investments both inside and outside of super, as well as how the tax treatment affects returns over a 10-year period. For simplicity, the examples are based on an individual who pays the second-highest marginal tax rate of 39% in 2022-23, which includes the Medicare levy, and that all investments earn either a 5% return or 5% capital growth each year.[27]

Over a 10-year period, super earnings in the accumulation phase make a slightly higher after-tax return than capital gains outside of super, but a much higher return than investments outside of super that are taxed at a marginal rate of 39%. Owner-occupied housing, for which no tax is payable on the capital gains, makes a higher return, equivalent to the tax-free earnings in the super retirement phase (the tax concession on capital gains from owner-occupied housing was estimated at around $40 billion in 2019-20)[28].

Figure 10: Comparison of super earnings and taxes against other investment options



Note: The after-tax return on the original investment does not incorporate any tax paid before the investment, such as personal income tax or super contributions tax, nor does it incorporate other taxes such as stamp duty for owner-occupied housing (or other capital gains assets), nor fees in super funds. The differences in the after-tax returns are based on differences in the tax on the earnings or capital gains only. The chart does not include investments with both a yield and capital growth component. A more detailed analysis of the effective marginal tax rates on different investments can be found in Varela, P., Breunig, R., and Sobeck, K. (2020), *The Taxation of savings in Australia: Theory, current practice and future policy directions,* Tax and Transfer Policy Institute (TTPI) Policy Report No. 01-2020.
Source: PBO analysis.

[27] In this example, the returns are set to be equal across different investment types to demonstrate the impact of different tax rates. Typically, however, the rate of return on investments will adjust to changes in the tax rate.

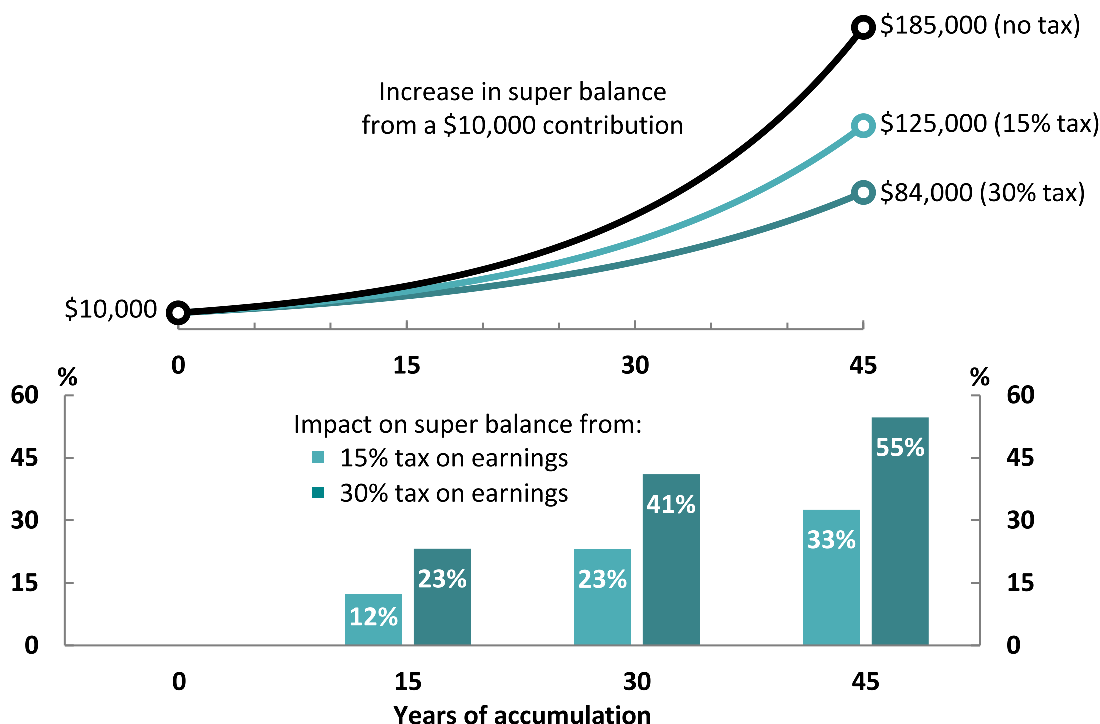
[28] Department of the Treasury (2023) *2022-23 Tax Expenditures and Insights Statement*, pages 158 and 159.

Capital gains for assets held for more than 12 months, both inside and outside of super, receive a discount. Inside the super accumulation phase this discount is 33%, which means capital gains are taxed at an effective rate of 10%. Outside of super, capital gains made by individuals receive a 50% discount. For an individual facing a marginal rate of 39%, this means that the effective tax rate is 19.5%. Capital gains are also only taxed on realisation, which means that they are able to accrue faster than investments that pay an annual return and reinvest the after-tax earnings.[29]

Compounding occurs when earnings are reinvested to generate additional earnings over time. This effect can be large over an individual's working life, potentially 45 years or more. When an individual is first contributing to super, growth in their super balance will primarily occur from contributions, while earnings are more likely to be the main source of growth as individuals approach retirement.

The tax rate on earnings also has a significant impact on the degree of compounding that occurs over a long period of time. For instance, consider an individual who makes a $10,000 post-tax contribution at the age of 22. If this individual retires at age 67 (45 years later), that $10,000 contribution would increase their final retirement balance by $125,000 (based on an average return of 5.2% plus net capital gains of 1%, taxed at 15%), or $41,000 adjusted for purchasing power.[30] If, instead, earnings were taxed at 30% (close to the marginal tax rate for the average taxpayer), the increase in their final retirement balance would only be $84,000 ($28,000 adjusted for purchasing power), around a third lower. If their earnings were not taxed at all, their $10,000 contribution would increase their final retirement balance by $185,000 ($61,000 adjusted for purchasing power), nearly 50% higher than under a 15% tax and more than double the balance under a 30% tax. This is illustrated in Figure 11.

Figure 11: Comparison of super balances subject to different tax rates on earnings over 45 years



Note: Values are presented in nominal terms only and modelled based on earnings of 5.2% plus net capital gains of 1%. Contribution is assumed to be post tax – no contributions tax is incorporated into the impact.
Source: PBO analysis.

[29] In making investment decisions, investors are more likely to consider the rate of return on investment (after tax) than the tax rate itself. They will also consider cash flow and the liquidity of the investment.

[30] The same calculation would apply to an individual withdrawing $10,000 from their super, in terms of the reduction in their final balance. The purchasing power adjustment assumes an inflation rate of 2.5% a year.

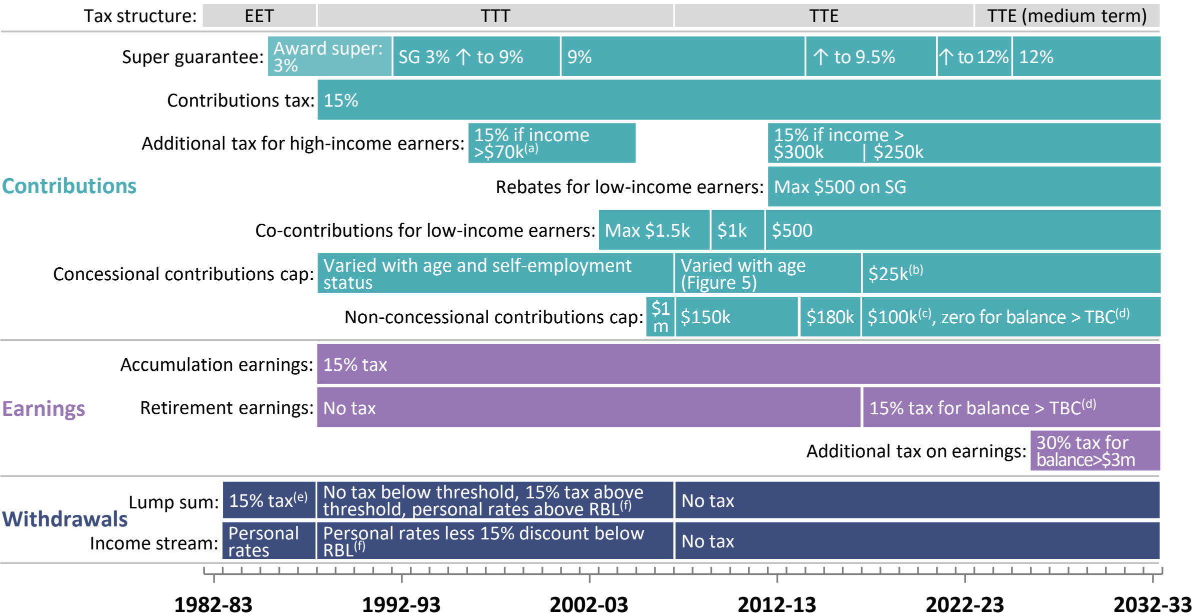
The example shows that contributions made further from retirement are more affected by taxes on investment returns than those made closer to retirement. This may largely balance out for an individual who makes regular contributions under the SG, but individuals who make additional voluntary contributions as they approach retirement will reduce the impact of taxes on their final retirement balances.

There have been many changes to super taxation over the past 40 years

The tax treatment of super has changed significantly since the early 1980s. Some of the most significant reforms have included the removal of tax on withdrawals, the introduction and changes to caps on contributions, and measures to incentivise lower-income earners to contribute to their super.

Prior to 1988, withdrawals were the only point at which super was taxed, meaning that Australia had an EET super tax system. Australia then moved to a TTT system from the 1990s to today's TTE system from 2007-08 when withdrawals were made tax free. Figure 12 shows a timeline of these and other super tax changes, including the recently announced 30% tax on earnings for the proportion of balances in excess of $3 million from 2025-26.

Figure 12: Key changes to super taxation since 1982-83

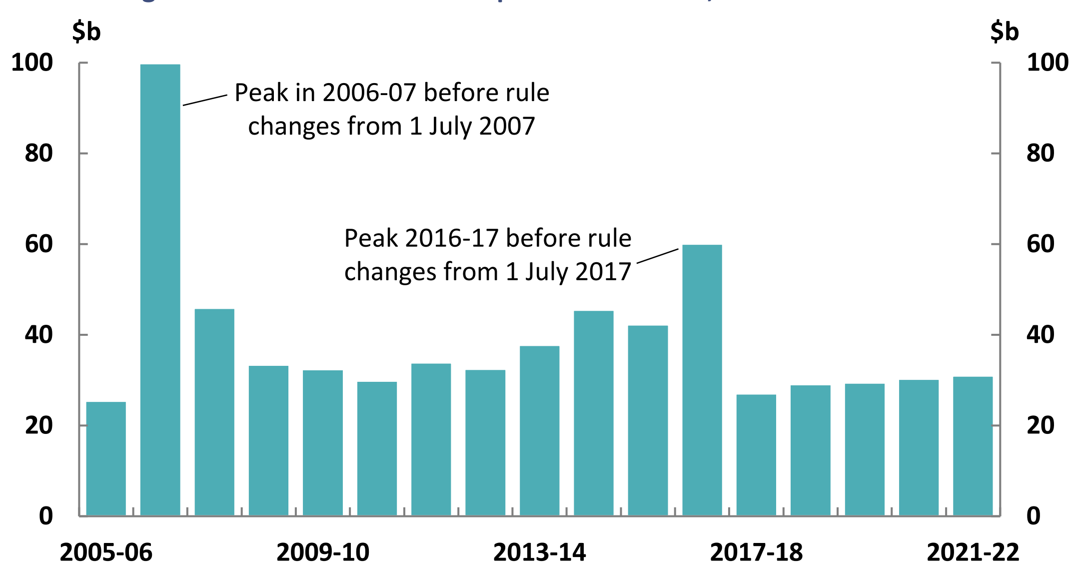


(a) This threshold was indexed annually.
(b) Indexed to average weekly ordinary time earnings in increments of $2,500 (2022-23 cap was $27,500). From 2019-20, unused amounts in an individual's concessional contributions cap can be carried forward over a maximum of 5 years.
(c) Indexed to average weekly ordinary time earnings in increments of $10,000 (2022-23 cap was $110,000). Individuals can bring forward up to 2 years of their cap from future years.
(d) TBC: Transfer balance cap. This was $1.6 million in 2017-18, indexed to the consumer price index in increments of $100,000 (2022-23 cap was $1.7 million).
(e) The 15% tax rate was available to individuals aged over 55 on withdrawals below a specified threshold. Other lump sum withdrawals were taxed at 30%.
(f) RBL: Reasonable benefit limits. These amounts were the maximum an individual could withdraw at concessional tax rates over their lifetime. The RBL was twice as high for income streams than for lump sums.
Note: This chart is not exhaustive – it excludes more technical elements relating to the taxation of super. The medium-term period includes announced changes to super taxes, specifically the 30% earnings tax for balances over $3 million.
Source: S. Reinhardt and L. Steel (2006) *A brief history of Australia's tax system*, Department of the Treasury; K. Swoboda (2014) *Major superannuation and retirement income changes in Australia: a chronology*, Parliamentary Library; M. Pascoe (1997) *Superannuation Surcharge*, The Education Network, accessed 21 April 2023; R. Stephens (2001) *DIY Funds and Reasonable Benefit Limits*, The Education Network; accessed 21 April 2023; Australian Taxation Office; and PBO analysis.

Making withdrawals tax free from 2007-08 was the most significant change to the super tax system since the introduction of the SG in 1992. This change made accumulating large super balances more attractive, but it was balanced by limits placed on how much could be contributed.[31]

Non-concessional contributions peaked before the changes on withdrawal taxes came into effect from 1 July 2007. From May 2006 to June 2007, the non-concessional contributions cap was introduced at $1 million per financial year. This was reduced to $150,000 from 1 July 2007 and has since been reduced to $110,000 for 2022-23. The policy changes created an incentive for individuals to top up their super in the short window before the non-concessional contributions cap was reduced. Figure 13 shows a significant spike in non-concessional contributions in 2007. A smaller spike can also be seen in 2016-17 in response to a reduction in the non-concessional contributions cap and the introduction of the transfer balance cap from 1 July 2017, which meant that those with a balance above $1.6 million in 2017-18 would no longer be able to make non-concessional contributions. Following this, non-concessional contributions have remained relatively stable.

Figure 13: Non-concessional super contributions, 2005-06 to 2021-22



Source: Australian Prudential Regulatory Authority (APRA) (2023) *Annual superannuation bulletin, June* 2022; Australian Taxation Office (ATO) (2022) *Taxation statistics 2019-20*; and PBO analysis.

From a fiscal perspective, taxes on super are an important source of government revenue. In 2021-22, super taxes accounted for around 5% of total tax revenue[32], fifth behind income tax, company tax, goods and services tax (GST), and customs and excise duties (Table 3).

Table 3: Australian Government tax receipts, 2021-22

Tax receipt	$m	Share of total
Individuals and other withholding tax	259,052	48%
Company tax	123,308	23%
Goods and services tax	73,498	14%
Excise and customs duty	39,126	7%
Superannuation fund taxes	*26,546*	*5%*
Other tax receipts	15,056	3%
Total tax receipts	**536,586**	**100%**

Source: Australian Government (2022) *Budget October 2022-23, Budget Paper No. 1*, Table 5.8, page 164.

[31] Prior to 1 July 2007, withdrawals were taxed concessionally up to a *reasonable benefit limit*. This meant that the incentive to accumulate a very high super balance was low. Nonetheless, some individuals have accumulated very large balances that would not be possible under the caps on contributions that apply today.

[32] The percentage would be higher if the tax on funds' dividend income was attributed to the funds rather than companies.

There are costs and benefits to Australia's super tax system

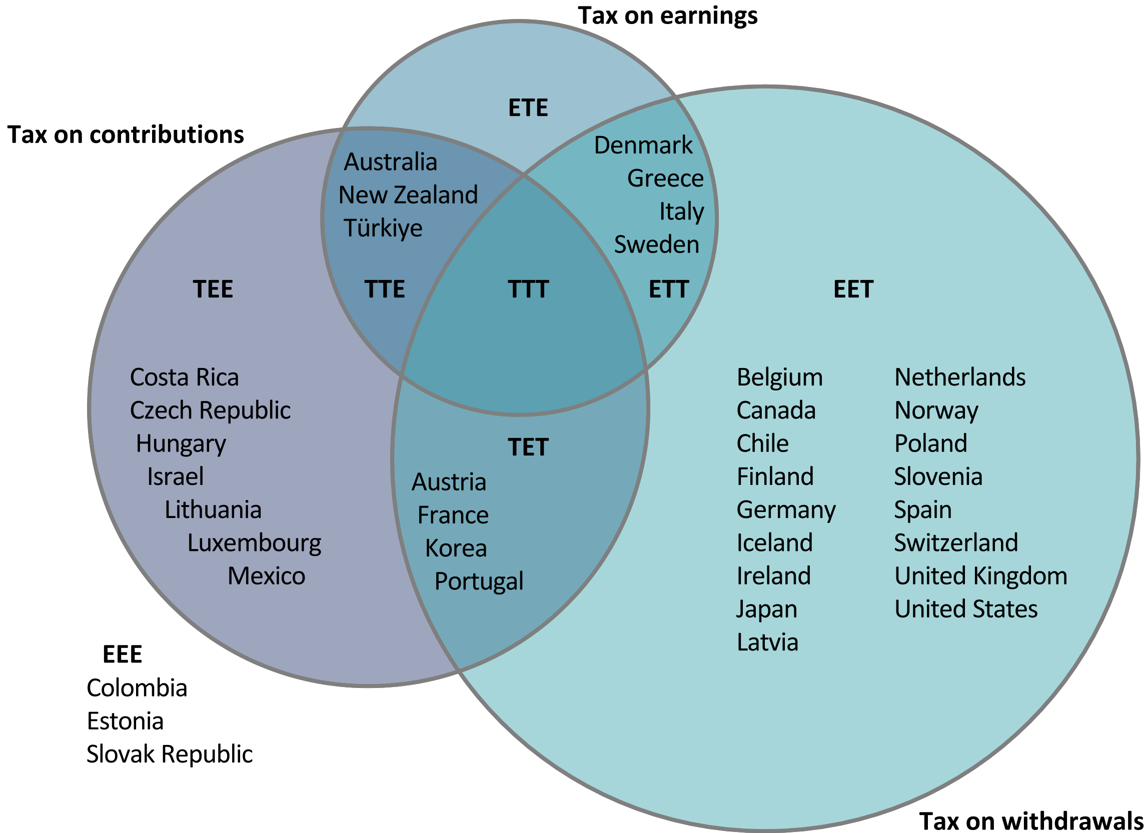
Australia's system of taxing contributions and earnings is relatively uncommon across the OECD. The more common system is to have contributions and earnings untaxed, with a tax applying to withdrawals. One advantage of Australia's system is that taxing super during the accumulation phase raises revenue earlier than just taxing withdrawals in retirement. There are also downsides to Australia's super tax system. In particular, it is difficult to achieve a similar level of progressivity for taxes on super than that which exists for personal income tax. In addition, taxes on earnings have a greater impact on contributions made earlier in a person's accumulation phase.

Many OECD countries tax withdrawals instead of contributions and earnings

Funded contribution schemes for retirement savings, similar to Australia's super system, operate in most OECD countries. These schemes vary in terms of their coverage, the degree to which contributions are mandatory or voluntary, and how the schemes are managed.

These schemes also vary in how they are taxed at the 3 main taxing points: contributions, earnings, and withdrawals. As noted earlier, Australia's super system can be denoted as TTE because it taxes contributions and earnings but not withdrawals.[33] TTE systems like Australia's are relatively uncommon, with only 2 other OECD countries taxing their schemes a similar way: New Zealand and Türkiye. In contrast, 17 of 38 OECD countries have an EET taxing scheme, meaning that contributions and earnings are untaxed, but withdrawals are taxed (Figure 14). A further 3 countries have an EEE scheme. No country has a TTT scheme and only 7 countries tax earnings.

Figure 14: Tax treatment of retirement-income systems, OECD countries, 2022



Source: PBO presentation of Organisation for Economic Co-operation and Development (OECD) (2022) *Annual survey on financial incentives for retirement savings, OECD country profiles 2022*.

[33] Or 'ttE', reflecting that contributions and earnings are taxed at a concessional rate.

In terms of their impact on retirement balances, taxes on contributions are equivalent to taxes on withdrawals, provided they are set to the same rate. As such, TEE and TET schemes are broadly equivalent to EET. Similarly, TTE and ETT are broadly equivalent in their impact on retirement balances.

With the introduction of the SG in 1992, taxing contributions and earnings had the effect of raising revenue sooner than an EET model. Because the super system was still maturing, the pool of withdrawals was much smaller relative to the pool of contributions. As the system has matured over the last 30 years, the pool of earnings has grown substantially, while the pool of withdrawals will continue to grow relative to contributions and earnings as the system matures further.

Under an EET model, the government would not raise any super revenue from a young individual entering the workforce until they retire, potentially several decades later. In contrast, even with relatively low tax rates under the TTE model, the government collects revenue from this individual's super income throughout their working life.

There are, however, some costs to Australia's TTE model. These are explored in more detail in the following sections.

The impact of super taxes depends on when contributions are made

As discussed in previous sections, taxes on super earnings compound over time. This has a greater impact on super balances for contributions made earlier in a person's accumulation phase. Relative to a scheme that does not tax earnings (EET, TEE or TET), earnings taxes favour contributions closer to retirement, even though contributions made earlier have a greater impact on retirement incomes.

Figure 15 shows that a contribution made 45 years before an individual retires is effectively taxed at a rate of 43% (assuming a 15% tax on both contributions and earnings) – that is, the contribution's impact on an individual's final retirement balance is 43% lower than it would be if contributions and earnings were untaxed, as they would be under an EET model.

As an individual gets closer to retirement, the impact of super taxes reduces. For an individual only a year away from retirement, for instance, the impact of super taxes on a contribution is only slightly higher than the 15% contributions tax. As such, the incentive for individuals to make voluntary concessional contributions is stronger in the lead-up to their retirement – not only will taxes have a smaller impact on their contributions, these individuals delay their consumption by a shorter period.

Figure 15: Total impact of super taxes on final balance by timing of contribution

Note: Assumes that super assets earn 5.2% per annum with 1% net capital gain. Both contributions and earnings are taxed at 15%.
Source: PBO analysis.

Super taxes are less progressive than personal income taxes

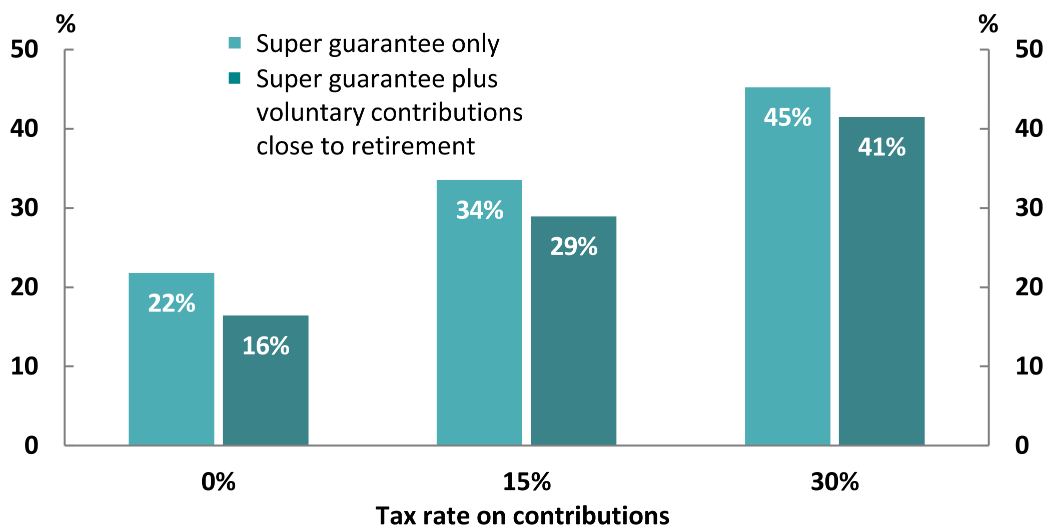
In terms of the overall impact of taxes on final retirement balances across a working life, Australia's TTE scheme is broadly equivalent to an EET scheme. For an individual making regular contributions over a 45-year working life, where all contributions and earnings are taxed at 15%, their retirement balance would be 34% lower than it would be in a scheme that did not tax contributions and earnings. For this person, Australia's TTE scheme is equivalent to an EET scheme with a 34% tax on withdrawals (or a TEE scheme with a 34% tax on contributions).[34] This *effective tax rate* will be higher or lower depending on the tax rate paid on contributions.

Individuals who receive the low income super tax offset (LISTO) or a government co-contribution on some or all of their contributions effectively have a lower equivalent tax rate on their withdrawals. Similarly, individuals who pay the Division 293 tax on some or all of their concessional contributions, or who make non-concessional contributions, would have a higher equivalent tax rate on their withdrawals. Figure 16 shows that even in extreme cases where all of an individual's SG contributions are either untaxed or taxed at 30% over a 45-year working life, the effective tax rate varies between 22% and 45%.

For individuals earning between $37,000 and around $225,000 for the majority of their working lives, the impact of super taxes as a proportion of their final retirement balance will be broadly similar, even though they may have a wide range of final retirement balances. In this way, super is taxed less progressively than personal income tax (though the Age Pension adds progressivity to the broader retirement-income system). An EET scheme, in contrast, would be able to align withdrawal taxes with the personal income tax system to ensure consistency.

The timing of contributions will also affect the overall impact of taxes on final retirement balances. Individuals who are able to increase their contributions close to retirement will be less affected by earnings taxes. Figure 16 also considers the total impact of taxes for individuals who, in addition to SG contributions, make voluntary concessional contributions in the final 10 years before retirement.

Figure 16: Total impact of super taxes on balances over 45 years of accumulation



Note: Assumes that SG contributions increase by 3% each year, super assets earn 5.2% per annum with 1% net capital gain. Individuals are assumed to make voluntary contributions in each of the 10 years leading up to retirement, equal to 4 times the amount of SG contributions in the same year. Voluntary contributions are assumed to be taxed at the same rate as SG contributions.
Source: PBO analysis.

[34] Modelled based on earnings of 5.2% plus net capital gains of 1%, with contributions growing by 3% each year. The impact will depend on how and when contributions are made – for instance, non-concessional contributions are typically taxed higher, as are contributions made further from retirement – and the rate of return on investment.

Conclusion

This explainer has explored how super is taxed, why the timing of when contributions are made matters, and the distributional impacts of super taxes. It has also explored how Australia's super tax system compares to similar schemes in other OECD countries.

Higher-income earners, on average, benefit more from super tax concessions than lower-income earners. The introduction of tax-free withdrawals in retirement (with no limit) from 1 July 2007 created an incentive for wealthier individuals to make a large contribution to their super accounts, even with caps on contributions. With the contributions caps having since come down, and the introduction of the transfer balance cap from 1 July 2017, it is now more difficult and less beneficial for individuals to accumulate very large balances.

Super tax systems similar to Australia's are relatively uncommon in other OECD countries, with most other schemes taxing withdrawals and few taxing earnings. Australia's super tax system meant that revenue could be raised sooner when the SG was introduced in 1992, but it is less progressive than what could be achieved under an EET system where withdrawals are taxed in line with personal income. The Age Pension – the third pillar of the retirement-income system – is, however, progressive through means testing.

The second explainer in this series (forthcoming) will explore the longer-term fiscal impact of the super system, including its interactions with the Age Pension and integration into the retirement-income system as a whole. It will investigate the implications of an ageing population for the retirement income system.