

## Research Insights

# Do caps on superannuation tax-breaks really improve the budget?

Tightening caps on superannuation tax-breaks prompt high income earners to reduce their taxable income, which means that fiscal savings are lower than expected.

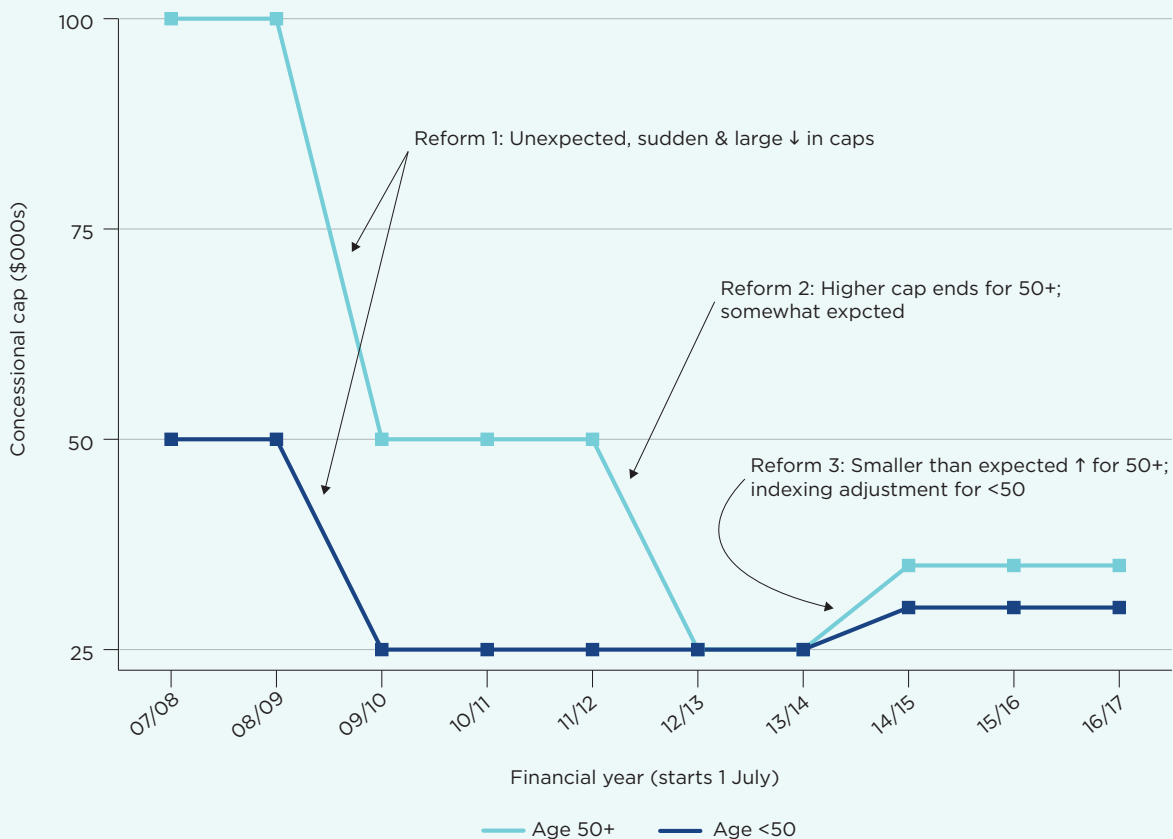
# Tax concessions for private pensions

Many governments provide tax concessions for contributions made into private pensions (eg. superannuation) to ease pressures on public pensions. The savings from any lower public pension receipt, however, needs to be balanced against the lost tax revenue from the concessions. In Australia, foregone tax revenue from concessions associated with voluntary contributions, and compulsory employer contributions, is estimated by Treasury to be \$21 billion in 2021-22, or around one quarter of the cost of the Age Pension.

To help reduce these fiscal costs, since 2007 Australia has generally reduced age-specific caps on annual concessional contributions (Figure 1). Specifically, caps were reduced and synchronised from \$100,000 and \$50,000 in 2007-08, for those 50 and above and those under 50 respectively, to \$25,000 in 2012-13. In 2014-15, the caps were somewhat relaxed to \$35,000 for those 50 and above and \$30,000 for those 50 and under.

In our study we estimate the impacts of these cap changes on short-term tax revenue and employment. Our analysis is based on data from the Australian Tax Office (ATO) Longitudinal Information Files (ALife), which links tax and superannuation data over time. We compare the tax declarations of individuals who experience a change in their cap from one year to the next to the declarations of individuals in adjacent birth cohorts who experience no cap change over the same years. Our main estimates are based on individuals whose concessional contributions are in the top 5% and who are aged 48-51. These 'high-contributors' earn around \$200,000 per year on average and are chosen because they, unlike most Australians, are likely to be affected by the tightening of the caps.

Figure 1: Concessional contribution caps by age and year over sample period, 2007/2008–2016/2017



# Key Insights

## 1 Tightening the caps reduced the contributions

High contributors adjust their superannuation contributions in response to changes to the cap. Our estimates indicate that high contributors reduce their total contributions by \$6,750 (19%) on average in response to a \$25,000 decrease in the cap.

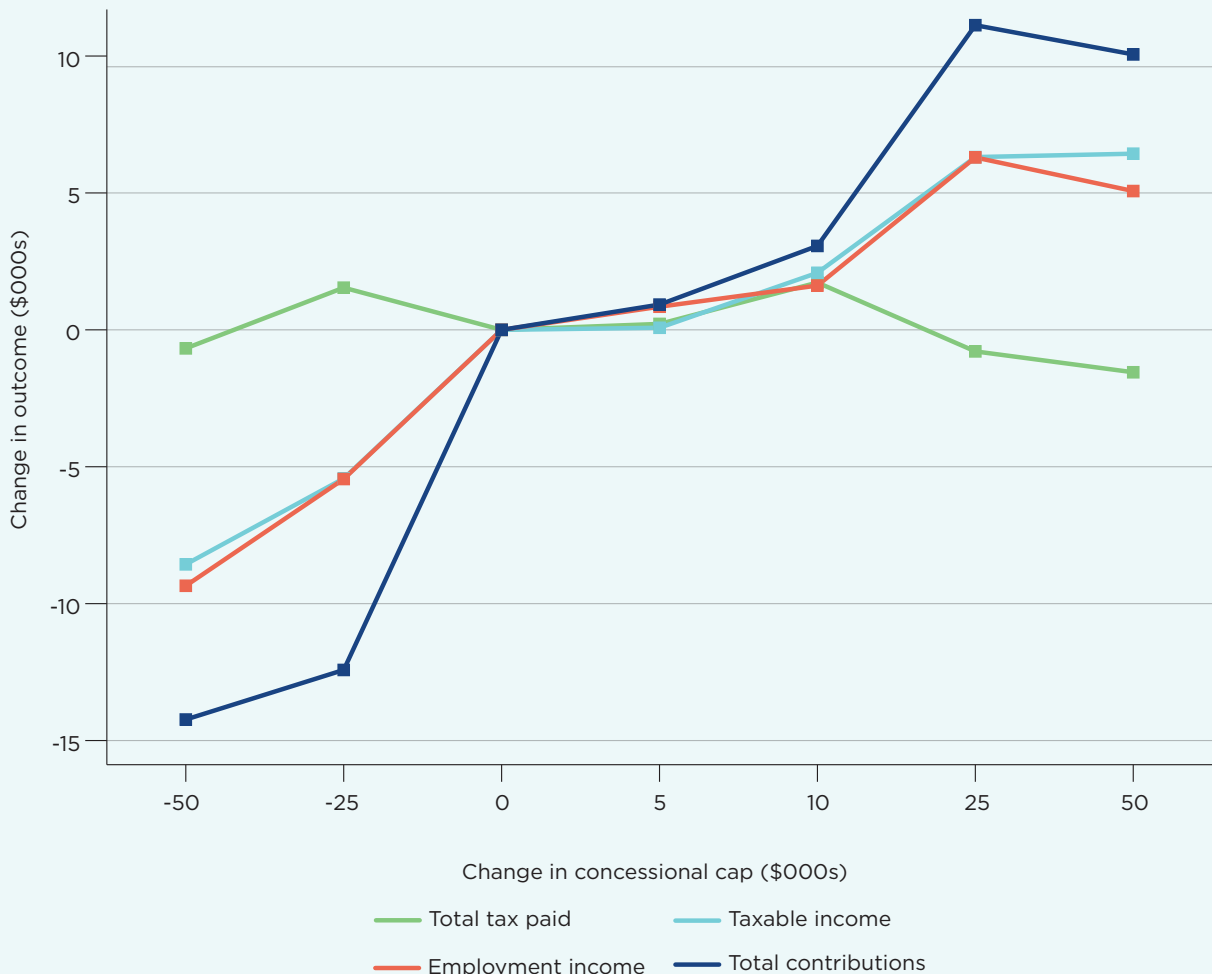
This is driven by a decrease in concessional contributions, with minimal effect on non-concessional (after-tax) contributions.

## 2 As contributions declined, so too did employment income

High contributors reduce their total taxable income in response to decreases in the cap, indicated by a positive correlation between cap changes and the income of high contributors (Figure 2). We estimate that high contributors reduce their total taxable income by \$4,375 (2.2%) in response to a \$25,000 cap decrease.

The decline in taxable income results from a reduction in reported income from employment sources - wages and business income - with no change in unearned income or deductions. There is no change in income among lower contributors, who are not affected by the less generous tax concessions.

Figure 2: Association between cap changes and changes in our key outcome variables (from year t-1 to t) among high contributors, 2007/2008–2016/2017



### 3 Loosening the caps had the opposite effect on contributions and income

Cap increases and decreases have similar effects but in the opposite direction. Our estimates suggest that when caps were loosened, high contributors increased their contributions and increased their taxable income from employment sources (Figure 2).

### 4 Cap changes were roughly tax neutral in the short run

As shown in Figure 2, there is little association between annual cap changes and corresponding annual changes in the amount of income tax paid by high contributors. This reflects the fact that, when caps have fallen, the increase in tax receipt from fewer concessional contributions has been offset by a decrease in taxable income from employment income.

To demonstrate, consider the fictitious case of Simone, a 51-year-old air traffic controller. In 2011-12, Simone had a taxable income (for tax lodgment) of \$120,000 and additionally made concessional contributions of \$35,000 (\$13,000 compulsory employer contribution plus \$22,000 that she made voluntarily through salary sacrifice). In 2012-13, to comply with the decrease in the cap from \$50,000 to \$25,000, she reduced the amount she salary sacrificed by \$10,000, which automatically increases her taxable income by \$10,000.

For the ATO, this means an extra \$10,000 is taxed at the marginal tax rate of 37% instead of at the 15% concessional rate, increasing tax collections by \$2,200. However, because the tighter cap means that more of her employment income is subject to a 37% tax rate, Simone volunteered for fewer overtime shifts in 2012-13, which reduced her taxable income by \$6,000, making the total \$124,000. For the ATO, this reduces income tax collections by approximately \$2,200, offsetting the gain from the reduced tax concessions.

### 5 Income responses may reflect labour supply decisions of high contributors

Restricting concessional contributions means that a larger fraction of employment income is paid directly into high contributors' bank accounts and taxed at the marginal tax rate (often 45%) instead of the 15% concessional rate. This tax increase resulted in lower employment income for both employees and self-employed, with larger reductions for the latter. For both groups, the higher tax rate may have discouraged high-contributors from working long hours and/or applying for higher-paid jobs/promotions. Supporting this interpretation, we find no evidence that the effects on income are driven by individuals shifting income to their spouse (who may be less constrained) or to periods when the cap is higher. Nonetheless, we cannot rule out other tax minimising behaviors that may lead to changes in employment income, such as business owners drawing a wage to top-up their superannuation.

# Importance of understanding the behaviour of high-income earners

The cost of tax concessions for superannuation contributions is high, and successive Australian Governments have aimed to claw back these costs by tightening caps on concessional contributions.

The key finding from our study, that efforts to reduce these costs have been thwarted by responses from high income earners, underlines the importance of understanding high-income earner responses to tax and superannuation settings.

High income earners are extremely influential in determining overall income tax receipt – in 2018/19, one third of total income tax revenue came from the top 3.5% of taxpayers (ATO 2021) – and they often behave very differently to the average Australian. High income earners often have high financial literacy, are highly engaged in financial decisions, and are well resourced to respond in sophisticated ways to minimise their tax liability.

The recent release of the ALife data, a large 10% sample of tax-filers tracked over time, provides new opportunities for research insight into the behaviour of these financially engaged individuals. Prior to ALife, research on high-income earners in Australia was restricted to representative longitudinal surveys that have much smaller samples and are subject to income reporting biases.

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## Further Information

### Datasets:

We use data from the ATO Longitudinal Information Files (ALife), a 10 per cent random sample of all registered tax-filers (since 1980) linked to annual tax and superannuation records produced by the Australian Taxation Office.

### References:

Australian Government Treasury (2021). Tax Benchmarks and Variations Statement ([https://treasury.gov.au/sites/default/files/2022-01/p2022-244177\\_0.pdf](https://treasury.gov.au/sites/default/files/2022-01/p2022-244177_0.pdf)).

Australian Taxation Office (2021). Table 6, Taxation Statistics 2018-19, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2018-19/?anchor=Individualsstatistics#Individualsdetailedtables>

### Further reading:

Chan, M. K., Morris, T., Polidano, C., & Vu, H. (2022). Income and saving responses to tax incentives for private retirement savings. Melbourne Institute Working Paper Series 03/22. <https://melbourneinstitute.unimelb.edu.au/publications/working-papers/search/result?paper=4024588>

Chan, M. K., Morris, T., Polidano, C., & Vu, H. (2022). Income and saving responses to tax incentives for private retirement savings. *Journal of Public Economics*, 206, 104598.

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