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The Compliance Costs of the Superannuation Surcharge Tax

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The Superannuation Surcharge Tax (SST) is a hidden tax, with significant effects on (so-called) higher income taxpayers. The SST was introduced in August 1996, and, according to the Australian Taxation Office, 'is intended to limit the concessionality of employer and deductible personal superannuation contributions for high income earners'. For the 2000/01 year it is levied at a rate of up to 15% on the surchargeable contributions of fund members whose adjusted taxable income exceeds the surcharge threshold of $81,493. This paper investigates the compliance costs on the industry. Other aspects such as SST start-up costs and industry attitudes are also assessed for the year 2000/01. Findings are based on an in-depth, quantitative and qualitative survey of 40 fund managers and administrators who appreciated the value of this research and sacrificed their time to provide us with data. Respondent funds account for 6.5% of superannuation fund members in Australia (the 'fund member population') and 3.8% of superannuation assets in Australia (the 'fund asset population').

SST (recurrent) compliance costs are falling over time, from an estimated $691 pa per SST member in 1997/98 to $140 pa per SST member in 2000/01 (mean estimate). The authors are reluctant to make aggregate compliance cost estimates essentially because of the very small number of funds providing compliance cost data. However, given this caveat and the usual qualifications found in most compliance cost studies, estimated gross recurrent compliance costs of the SST are very tentatively and conservatively estimated at $76 million for 2000/01, representing around 11% of SST tax revenue of $699 million (ATO data). It must be emphasised that this estimate is derived from the median estimate of $84 per SST member from relatively larger superannuation funds that theoretically should have lower compliance costs per SST member than smaller funds. Further, and tending to lower SST compliance costs expressed as a percentage of tax revenue, SST revenue has been forecast to rise to around $820 million in 2001/02 and 2002/03.

The superannuation industry, professional, tax and accounting bodies, and specialists in the field are all overwhelmingly critical of the SST for a variety of reasons, particularly eits inefficiency, high compliance costs and inequity (because SST compliance costs are spread over all fund members). Around 80% of survey responses indicated industry support for the abolition of the SST to be given a high priority status.

The fundamental conclusion of this research is that SST should be abolished at the earliest opportunity. The major reasons are its: inefficiency; high compliance costs; inequity in practice between superannuation fund members; and particularly its lack of transparency within the overall income tax system.

Introduction

This paper presents the key findings on SST compliance costs from an independent research project into the hidden costs of the SST[1]. The major objective is to provide an estimate of SST compliance costs (or hidden costs), defined as start-up and recurrent (gross) compliance costs of the SST.

This paper is presented as follows. First, following this introduction, the nature and organisation of superannuation and the industry in Australia is briefly reviewed. Next, section 2 discusses the background and approach of this study and the characteristics of the funds surveyed. Section 3 considers the characteristics and time trends of SST compliance costs. Section 4 considers the composition of SST compliance costs. The effect of abolishing SST but not the reporting requirement on fund members is discussed in section 5, followed by a drawing together of the main policy criteria and implications, with appropriate caveats in section 6. The qualitative aspects of this research, namely the views of fund managers on the SST and possible reform measures, follow in section 7. These are presented where possible in respondents' own words, for greater clarity and impact. The final section concludes this timely research. Further work is also briefly considered.

It should be noted that the research was based on the year 2000/01, and thus generally used 2000/01 estimates and data, based on our survey year and data availability from Government, the industry and other sources. However, where later data and information for 2001/02 was available this was cited. Unfortunately, in some parts of this research only data for earlier years was available. Further, our research d

The Industry

Superannuation is a form of savings and investment for the retirement of individuals. It affects the lives of nearly all the Australian population in one way or another. There are around 23.24 million accounts (some members have more than one account) in 226,480 funds holding around $527 billion in assets (Rice and McEwin, 2002; APRA, 2002). It has been estimated that, in aggregate terms, total employer and member contributions for superannuation account for just under six per cent of Gross Domestic Product (GDP) (Clare, 1998, p1). Of this around half is compulsory under the Superannuation Guarantee and the other half are 'more or less' voluntary contributions. The Government provides an Age Pension and other social security benefits for many retirees. This amounted to an

[1] The full report by Pope, Fernandez and Le (2003), *The Hidden Costs of the Superannuation Surcharge Tax*, is available from the Australian Tax Research Foundation, Sydney. The impact of the SST on individual taxpayers' effective marginal tax rates, typically 'hidden' and ignored in nearly all commentaries on individual income tax rates in Australia, is not discussed in this paper. Findings on this are presented in Pope, Fernandez and Le (2003).

estimated $18 billion in 1997/98, or 3.3% of GDP. This is low by international standards in developed countries, where the OECD average is 9% and rising (*ibid*.). Industry analysts and policy makers talk of the ‘three pillars of Australian retirement income provision’, namely a public sector ‘safety net’; compulsory self-provision; and encouragement of voluntary self-provision (*ibid*.). All of these pillars are inter-twined through Government taxation and social security policy in general and the taxation of superannuation in particular. One particular issue of note is the size of the tax expenditure (concession or tax relief) for superannuation. A Treasury estimate places the value of superannuation tax concessions at $8.7 billion in 1996/97, yet this has been disputed by Access Economics (1998). They argue that, when future benefits through reduced social security requirements are taken into account, superannuation is overtaxed by $1.7 billion using 1995/96 figures (*ibid*., p2).

The superannuation industry is organised into self-managed, wholesale (public sector, corporate and industry funds) and retail funds. The vast majority of funds by number are self-managed (222,738, or 95%) yet have only a small number of accounts (0.39 million or 1.6%). By contrast, corporate (3,235 in number), industry (139) and Government (94) funds account for 1.57 million, 6.98 million and 2.85 million fund accounts respectively. Retail funds, numbering 274, are sub-divided into employer master trust (2.78 million fund accounts), personal superannuation (4.02 million), Post Retirement (0.58 million), Retirement Savings Accounts (1.41 million) and Eligible Rollover Funds (2.68 million). The key features of the superannuation industry in terms of fund type, assets, the number of funds, and member accounts in June and December 2001 are presented in Table 1.

Table 1

Overview of the Superannuation Industry for 2001

Fund Type[a]		Funds under the SIS Act								
		Corporate	Industry	Public Sector	Retail	Total	Small Funds	Sub Total	Other[c]	**Total**
Number of Funds	Jun	3,235	139	94	274	3,742	222,738[b]	226,480	NA	**226,480**
	Dec	2,967	128	91	252	3438	230,500	233,938	NA	**233,938**
Number of Funds (%)	Jun	1.43	0.06	0.04	0.12	1.65	98.35	100	NA	**100**
	Dec	1.27	0.05	0.04	0.11	1.47	98.53	100	NA	**100**
Assets	Jun	73.6	44.6	114.0	156.6	388.8	86.6	475.4	48.5	**523.9**

($billion)	Dec	73.0	47.1	109.8	170.4	400.3	93.5	493.8	33.9	**527.7**
Assets (%)	Jun	14.06	8.51	21.76	29.88	74.21	16.54	90.75	9.25	**100**
	Dec	13.83	8.9	20.83	32.2	75.76	17.8	93.56	6.44	**100**
Members Accounts (million)	Jun	1.4	6.9	2.8	11.3	22.4	0.4	22.9	NA	**22.9**
	Dec	1.5	7.2	2.8	11.9	23.4	0.4	23.7	NA	**23.7**
Members Accounts (%)	Jun	6.21	30.16	12.41	49.52	98.30	1.70	100	NA	**100**
	Dec	6.33	30.38	11.81	50.21	98.31	1.69	100	NA	**100**

Source: APRA (2002), 'Superannuation Trends – December Quarter 2001'

Notes:

(a) This table excludes Retirement Savings Accounts.

(b) 8,052 of these funds were Small APRA funds (SAFs) and 214,686 were Self Managed Superannuation Funds (SMSFs) regulated by the ATO.

(c) Remaining superannuation assets residing in life office statutory funds regulated by the Life Act.

Thus less than 2 per cent of funds are standard employer funds or public offer funds that provide over 98% of Australians with superannuation (APRA, 2001). A large proportion of the remaining funds are small funds with less than 5 members. The bulk of fund members (90%) belong to the top 200 funds.

There is no governing prudential body that oversees all funds in Australia. Self Managed Superannuation Funds (SMSFs) are supervised by the Australian Taxation Office (ATO). The Australian Prudential Regulation Authority (APRA) is a statutory body[2] established to oversee the operation of superannuation funds and Retirement Savings Accounts (RSAs); however its powers are somewhat limited by the legislation[3]. The Association of Superannuation Funds of Australia (ASFA) is the leading industry body with data collection and research expertise, as well as advocacy and lobbying skills.

The taxation of superannuation in Australia is complex. In addition to taxing members' contributions into the fund at the rate of 15%, the earnings within the superannuation funds are also taxed at 15%. A complex tax regime determines the amount of exit tax imposed when the funds are paid out to the members. The introduction of the Superannuation Surcharge Tax (SST) in 1996 adds to the complexity to the taxation of superannuation funds. For the 2000/01 year, the SST is levied at a rate of up to 15% on

[2] The legislation that established APRA is the *Australian Prudential Regulation Authority Act* 1998.

[3] On the other hand, it may be argued that the APRA has the powers but has not exercised them well.

the surchargeable contributions of fund members whose adjusted taxable income exceeds the surcharge threshold of $81,493. The SST becomes fully liable at the 15% rate at adjusted taxable income levels of $98,955 and above in 2000/01. The starting threshold is indexed each year.

Since the adjustable taxable income include a member's taxable income, surchargeable contributions and reportable fringe benefits (as from 30 June 2000), the SST can impact on taxpayers with taxable incomes well below $81,493. A member with taxable income of $60,000 per annum may not have enough retirement income and may want large contributions to catch up. Contributions amounting to 36% of $60,000 taxable income would attract SST in 2000/01. This is likely to discourage a member from saving for retirement. According to the ATO, the SST 'is intended to limit the concessionality of employer and deductible personal superannuation contributions for high income earners'.

Taxation of Superannuation

The taxation of superannuation funds is a complex area and is only briefly summarised here. When a person makes a contribution to a superannuation fund, an Approved Deposit Fund (ADF), a Pooled Superannuation Trust (PST) or a Retirement Savings Account (RSA), the contribution is taxed at three levels before being paid out as retirement income. These three levels[4] are:

- Contributions to the fund;
- Income earned in the fund;
- Taxation on withdrawal of benefits.

A fourth level of tax, the Superannuation Surcharge Tax (SST) was introduced in 1996. The SST only applies if a members' adjusted taxable income exceeds the surchargeable threshold. The rate at which SST is charged also varies from 0% to 15%, depending on members' adjusted taxable income. For the year 2000/01, adjusted taxable income of $81,493 would have attracted SST at 0% rate, whereas adjusted taxable income of $98,955 would have attracted SST at the full 15% rate. The SST adds to the complexity to the taxation of superannuation funds.
The person making the contributions may also be entitled to tax deductions and tax rebates.

Role and Purpose of SST

[4] Some commentators state four levels with SST being in addition to the contributions tax applicable to all fund members. Others cite three with SST being subsumed under the term contributions tax.

The Superannuation Surcharge Tax (SST) is an incremental tax of up to 15%[5] levied on surchargeable superannuation contributions of high income earners, i.e. members whose adjusted taxable income exceeds the surcharge threshold for that income year.[6] For the 2002 income year, the adjusted taxable income of over $85,242 will attract SST, with the maximum 15% rate applying when adjusted taxable income reaches $103,507.[7] For the year 2000-01, the surchargeable thresholds ranged from $81,493 to a 15% maximum applying to $98,955. The starting threshold is indexed each year. The SST is in addition to the 15% contributions tax referred to above.

The introduction of the SST in August 1996 was claimed to be a response to concerns over the tax advantages afforded to high-income earners through superannuation tax concessions that are less readily available to lower income earners. Other commentators considered it as an expedient means for the Government to raise additional revenue. The effect of the SST in improving equity appears somewhat limited as high income earners still have the most to gain from superannuation, even after the introduction of the SST, due to their resources for moving funds away from more highly taxed forms of savings towards higher levels of retirement incomes, without affecting their consumption (Kehl, 2001). However, it is doubtful whether superannuation will continue to remain an attractive investment for high income earners, considering that individuals are entitled to a 50 per cent discount on capital gains made on or after 21 September 1999, compared to only a 33.3 per cent discount for certain superannuation funds.

The Government has proposed to reduce the top rate of SST to 13.5% as from 1 July 2002 for the 2002/03 tax year, with further reductions in subsequent years to 12% in 2003/04 and 10.5% in 2004/05. It has been estimated by the Treasury (Budget Papers, 2002-03) that SST revenue would be reduced by around $60 million, to around $760 million in 2004/05[8]. It should be noted that the SST base is continuing to broaden (whether these rate cuts are enacted or not).

Research Method

[5] The SST rate is being reduced, commencing in the 2002-03 tax year, under the Superannuation Legislation Amendment Bill 2002. From 1 July 2002, the rate will be reduced to 13.5%, followed by 12% from 1 July 2003 and 10.5% from 1 July 2004. At the time of writing the legislation had not passed through Parliament. PRAFULA PLS CHECK. MESSY! IS IT STILL GOING THRU?

[6] Section 7(2) of *Superannuation Contributions Tax (Assessment and Collection) Act* 1997.

[7] The surcharge threshold is indexed each year in accordance with Section 9(2) of *Superannuation Guarantee (Administration) Act* 1992.

[8] The Taxation Institute of Australia (2001) estimated a much higher reduction, namely that this measure will reduce SST revenue to around $400 million in 2004/05 (ie a reduction of around $190 million on 1999/2000 figures).

This paper presents the key findings on SST compliance costs from an independent research project into the hidden costs of the SST[9]. The major objective is to provide an estimate of SST compliance costs (or hidden costs), defined as start-up and recurrent (gross) compliance costs of the SST.

The methodology adopted in this study was the collection and analysis of both primary and secondary data. Original, primary data has been collected by means of a depth survey of respondent fund administrators. Although this research's survey of 40 funds was very small in the context of tax compliance literature, given the quality of the data and the dearth of other estimates in this field, the authors' consider it appropriate to draw conclusions and policy recommendations on the basis of the data provided. Moreover, our data has been crosschecked and compared with other data from both the superannuation industry and professional bodies wherever possible. Respondent funds account for 6.5% of superannuation fund members in Australia (the 'fund member population') and 3.8% of superannuation assets in Australia (the 'fund asset population'), and this increases the authors' confidence in our findings.

This research is presented as follows. First, in this introduction, the nature and organisation of superannuation and the industry in Australia is briefly reviewed. Next, section 2 discusses the background and approach of this study and the characteristics of the funds surveyed. Section 3 considers the characteristics and time trends of SST compliance costs. Section 4 considers the composition of SST compliance costs. The effect of abolishing SST but not the reporting requirement on fund members is discussed in section 5, followed by a drawing together of the main policy criteria and implications, with appropriate caveats in section 6. The qualitative aspects of this research, namely the views of fund managers on the SST and possible reform measures, follow in section 7. These are presented where possible in respondents' own words, for greater clarity and impact. The final section concludes this timely research. Further work is also briefly considered.

It should be noted that this study is based on the year 2000/01, and thus generally uses 2000/01 estimates and data, based on both our survey year and data availability from Government, the industry and other sources. However, where later data and information for 2001/02 is available this is cited. Unfortunately, in some parts of this research only data for earlier years is available. Further, this study focuses on the industry's tax compliance costs. The compliance costs of the SST borne directly by individual taxpayers rather than the industry are recognised but beyond the scope of this study. Also, the Australian Taxation Office's administrative costs of the SST in particular and superannuation taxation overall are recognised but not considered in any detail.

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[9] The full report by Pope, Fernandez and Le (2003), *The Hidden Costs of the Superannuation Surcharge Tax*, is available from the Australian Tax Research Foundation, Sydney. The impact of the SST on individual taxpayers' effective marginal tax rates, typically 'hidden' and ignored in nearly all commentaries on individual income tax rates in Australia, is not discussed in this paper. Findings on this are presented in Pope, Fernandez and Le (2003).

Background and Characteristics of the Funds Surveyed

From a theoretical perspective, it is worth re-iterating that this study focuses on the compliance costs of the SST from an industry perspective, as it is funds that are likely to bear the greatest relative burden. Funds thus maintain superannuation records, submit information to the ATO and largely deal with any disputes. Of course individuals may spend time verifying their contributions, the calculation of adjusted taxable income and SST liability as calculated by the ATO, and any ensuing disputes. Individuals also have to consider their surcharge position when they contemplate making any salary sacrifice or member deductible contributions. This study acknowledges such ‘individual’ SST compliance costs (as opposed to ‘fund’ SST compliance costs) but unfortunately a separate study of the compliance cost burden of the SST upon individuals was beyond the scope of this study.

This section presents findings from an in-depth study of the recurrent compliance costs of superannuation funds drawn from the ‘Top 300’ funds by asset size in Australia in 2001 (Super Review, 2001). It is worth noting that our researchstudy did not benefit from the formal support of the Association of Superannuation Funds of Australia (ASFA) or any other industry body. Moreover, for ethical reasons, we did not offer any inducements such as small gifts or prizes for participation. The cost information we requested was reasonably complex for respondents to derive and would have needed at least several hours to extract and present in the format we requested. Thus our findings are based on up to 40 respondent funds, representing 6.5% of superannuation fund members in Australia (the ‘fund member population’) and 3.8% of superannuation assets in Australia (the ‘fund asset population’)[10]. Such figures increase confidence in our later findings. However, we recognize and acknowledge that our findings are based on funds from only a small part of this massive, complex industry and must therefore be treated with caution. In a sense our findings are indicative and can only ‘paint a picture’ of the likely impost of the SST on the industry as a whole. They do, however, shed light on an aspect of Australian taxation policy that, since its introduction, has been subject to much disquiet both in the industry and by those higher income taxpayers that are liable for SST. As is often the case with (recurrent) tax compliance costs, placing a monetary estimate upon the complex and hidden burden of SST compliance costs is no easy task, and one that has not been undertaken before, although the superannuation industry itself collected and presented estimates of SST start-up costs to the Government in 1996/97. The independence of our survey (from the superannuation industry, Government and any other vested interests) has thus much to commend it, although we acknowledge that the

[10] 1,493,331 survey fund members divided by 22.9 million population; and $19.67 billion survey fund assets divided by $524 billion population, as at June 2001.

number of participants (arising partly through such independence) renders drawing industry-wide conclusions problematic.

It is worth emphasising compliance cost terminology and also interpretation of data within the superannuation industry. This section is concerned with estimates of gross recurrent compliance costs, namely the resource costs to the country of a particular tax for any one year of its operation, and excluding start-up costs. We do not make any attempt to estimate net compliance costs ie taking into account any offsetting benefits such as cash flow benefits, tax deductibility and managerial benefits, as is often the case with business tax compliance cost studies (eg Evans *et al*, 1997). Compliance costs may be presented in disaggregate terms for survey data, and, where survey data is reasonably representative of the specific tax population, this may be 'grossed up' later in terms of the specific tax population to give an aggregate gross compliance costs estimate. Unfortunately, this cannot be undertaken with any confidence because of the low number of respondent funds in this study. This study refers to 'members' and 'SST members' for simplicity. It must be noted that strictly speaking the data we refer to is 'members' accounts' and 'members' accounts that are liable for the SST', respectively. Our findings are presented primarily for the 2000-01 financial year ie in annual terms, although some data relates back to the SST's first main year of operation, 1996-97, and the years in between.

Before proceeding with our findings on recurrent compliance costs, it is worth briefly citing an earlier estimate of SST start-up costs by Clare (1998). There are very few studies anywhere in the world that estimate tax start-up costs. Of the few that exist, it appears that start-up costs are significant and typically up to one year's worth of recurrent compliance costs. SST compliance costs for the first year of funds surveyed have been estimated at $141 million, or 30% of first year SST revenue of $470 million (Clare, 1998). Overall, SST start-up cost estimates follow the usual regressive pattern found in nearly all tax compliance cost studies. Such an estimate of SST start-up costs provides a later reference point for recurrent cost estimates.

The 40 funds that participated have a wide range of varying characteristics. Although our respondents represent a wide range of the industry in terms of asset size and number of members per fund, overall there is a bias towards larger funds, reflecting our original surveying source of the largest 300 funds in Australia. Of our 40 respondent funds, four may be classified as industry, five public and the majority (28) corporate; 17 are accumulated, one is defined and 19 are hybrid[11]. Also, our findings are based on qualitative assessments from our respondents and various sources within the industry and elsewhere, as well as the usual quantitative estimates. Given such a large, complex industry, such qualitative assessments should also be treated with some caution, as there may be specific exceptions to our sample and ensuing evaluation.

[11] We acknowledge a bias towards hybrid funds in our survey respondents.

In terms of asset size, they range from $31 million up to over $8 billion (2000-01 figures, and hereafter unless otherwise specified), with 33 funds between $31.4 million and $1.1 billion. The survey funds' mean asset size is $530 million and the median $105 million. For comparison, the industry average is $117.6 million excluding the 222,738 self-managed funds (Rice and McEwin, 2002). It should be re-emphasised that our study focused on Australia's largest superannuation funds by asset size. Our respondent funds represent around 3.8% of superannuation assets in Australia. A summary of our respondent funds by asset size and total fund members (for 2000-01) is presented in Table 2, which shows the sample bias towards larger funds. Our sample included three out of the four superannuation funds with assets greater than $1 billion.

Table 2: Respondent Funds by Asset Size and Total Fund Members, 2000-01

Fund Asset $ million	Average Fund Asset Size $ million	Average number of total fund members in category	Percentage of Respondent Funds	Percentage of Fund Population*
Less than 50	38	994	13.5	90.5
50-99	75	2,669	32.4	3.1
100 – 499	221	13,529	37.9	4.5
500 – 999	781	9,387	5.4	1.0
1,000 and over	3,481	312,288	10.8	<0.1

* Derived from data from R. Clare (2002), Association of Superannuation Funds of Australia (ASFA) Research Centre (private communication), with thanks.

Membership of funds surveyed ranged from just 135 members (all liable for SST) to 1.142 million members (with 1,500 SST members). One fund, with assets of $34.2 million, reported 1,774 members with only two liable for SST. Thus our respondents have a wide range of SST members expressed as a percentage of all their members, ranging from practically zero up to 100%. Overall, average (total) membership was 41,481 and the median 2,461, with average SST membership of 714 (2%) and a median figure of 183 (7%). For comparison, the industry average is 6,106 members per fund, excluding self-managed funds (Rice and McEwin, 2002). A breakdown of respondent funds by number of SST members and total fund members is presented in Table 3.

Table 3: Respondent Funds by Number of SST Members and Total Fund Members, 2000-01

	Total Fund Members					
SST Members	**Less than 1000**	**1000-4999**	**5000-9999**	**10,000-50,000**	**50,000 and over**	**Total**
Less than 50		3				3
50-99	2	4				6
100-499	2	6	2	2		12
500-999		1	1		1	3
1,000-4,999		1		1	1	3
5,000 and over				1	1	2
Total	4	15	3	4	3	29

Respondent funds reported a wide range of SST remittances to the ATO, ranging from just $3,000 paid in SST (for the fund with two SST members) to $5.1 million for the largest fund (assets value of $8,121 million, with 6,000 SST members). Average SST paid per member was $951, with a median of $1,098. The relative closeness of these mean and median figures is reassuring as it suggests that the effect of the SST on respondent funds' members is reasonably homogeneous between different sized funds.

Overall annual administrative costs of respondent funds ranged from only $35,000 up to $27 million, with mean and median figures of $2.1 million and $460,000 respectively. Expressed as a percentage of fund asset values, mean administrative costs represented 0.4% (median 0.44%). This compares with an industry average of 0.51% excluding self-managed funds (Rice and McEwin, 2002). These findings are reasonable (and expected) given an 'economies of scale effect' in the operation of most superannuation funds, and reflect the larger size of our respondent funds compared with the industry average.

Estimates of the Gross Recurrent Compliance Costs of the SST

Data validity

The mean annual SST compliance costs for the funds surveyed was $44,900 (median $12,000). The significant gap between the mean and median reflects the effect of one large fund in the sample in particular, incurring high compliance costs of $594,000 because of its size. The next highest value is $99,000. When we remove this highest (and possibly outlying) observation from the sample, the mean reduces substantially to $23,740 (and the median reduces to $11,500).

In order to verify the validity of respondents estimates a 'check' question was included that asked respondents 'If the SST was abolished, how much would your fund save in annual administration costs?'. In many instances respondents gave a range of dollar savings in reply, which were taken as 'low savings' and 'high savings' estimates. For the year of investigation (2000-01) ratios of savings to SST costs of 1.06 (upper range of savings) and 0.98 (lower range of savings) indicate that respondents detailed evaluation of SST compliance costs and other estimates are verified within a reasonable margin. However, these figures indicate that respondents tend to slightly over-estimate compliance costs when asked for only an approximate estimate of savings compared with a more detailed and time-consuming estimate of specific components. These ratios lend credibility to the estimates received on both a cost basis and a savings basis.

SST costs per fund (mean $44,900) lie between the upper (mean $45,000) and lower (mean $40,800) estimates of SST cost savings, as one would expect. In some instances however, the minimal savings from abolition were zero or negligible and the reason for this is the out-sourcing of administrative functions, where external administrators absorb the costs of the SST as part of the full fee for complete administrative services. Maximum savings were as high as $600,000, which closely reflects the maximum detailed SST cost estimate of $594,000.

Relative Estimates of SST Compliance Costs

(1) SST Costs per Fund Member

When spread over all members SST compliance costs are $14.40 per fund member (in 2000/01), with a median estimate of $4.16 per fund member. The range in per member costs is particularly extensive, from a minimum of $0.42 per fund member to a maximum of $222 per fund member. The minimum value related to the fund with the greatest asset value in the sample, being $8.12 billion. This fund also had the third largest number of fund members in the sample. The maximum per member cost was experienced by the fund with the smallest number of fund members.

(2) SST Costs per SST Member

For the year 2000-01 the mean (gross recurrent) costs of the SST per SST member were $140, with a median estimate of $84[12].

In terms of variability between funds, SST compliance costs per SST member ranged from a low of $4.29 up to $703.95, for funds with 7,000 SST members (45% of all members) and only two SST members (0.1% of all members) respectively. The majority

[12] Calculated from the cost per SST member for each fund; these are then averaged. Therefore only those funds that provided both SST costs and fund member numbers are included.

of funds (60%) had SST compliance costs per SST member of less than $100. The vast majority of funds (81%) had SST compliance costs per member of less than $10. The main reason for high, above average SST compliance costs is the failure to achieve economies of scale – either through a low absolute number of SST members eg funds with two and 135 members, or a low percentage of SST members eg a large fund with only 1.3% SST members of its total 1.142 million membership. These three funds had SST compliance costs per SST member of $704, $222 and $396 respectively.

(3) SST Costs per Member and SST Paid

Over 80% of funds remitted over $100,000 in SST. There was a fairly even spread of low SST costs per member (less than $4 pa) in terms of the amount of SST paid by each fund in absolute terms, as shown in Table 4.

Table 4: SST Costs per Member and SST Paid per Fund, 2000-01

	SST Paid ($)					
SST Costs per Member ($)	**Less than 50k**	**50k – 99k**	**100k-499k**	**500k-999k**	**1m & over**	**Total**
Less than 1	1		1	1	1	4
1-4		1	7		4	12
5-9		1	4		1	6
10-14	1		1			2
15 and over			1			1
Total	2	2	14	1	6	25

(4) SST Costs as a percentage of SST paid

When expressed as a percentage of SST paid, SST compliance costs are 15.53% (median 4.34%). It should be noted that in one instance, the compliance costs of SST exceeded the revenue collected for certain funds, peaking at 110% of SST paid. This example clearly offends tax principles of simplicity and efficiency. Perhaps not surprisingly, this fund had the largest number of fund members, and also the second highest asset value in the sample. However, the fund with the lowest percentage of costs (0.56%) had only 1,850 (less than the median) members and $272 million (more than the median) in assets. Accordingly, it would be difficult to justify a correlation between asset size or membership and compliance costs.

(5) SST Costs as a percentage of Annual Fund Administrative Costs

In terms of respondent funds' administrative costs, SST compliance costs are estimated to account for 3.86% (median 2.48%). The SST costs percentage component of annual fund administration costs reaches over 17% for maximum figures and less than 0.25% for the minimum in the sample.

(6) SST Costs per dollar of Fund Assets

In terms of per dollar of assets, SST compliance costs are, not surprisingly, negligible at less than $0.01 for every $2,632 of assets (for even the highest recorded estimates).

Overall, on the basis of our findings, we consider that a mean estimate of SST compliance costs of around $140 per SST member in 2000-01 may be an indicative magnitude of cost given the complexities and apparent inefficiencies (in terms of fund size and membership composition) in the industry. A more conservative estimate using the median figure is $84 per SST member. We recognise that it is arguable that certain atypical funds may distort our estimates. Against that, the selection of larger funds for our sample would tend, *ceteris paribus*, to lead to lower estimates than might exist in the industry overall because of an economies of scale effect.

Characteristics and Time Trends of SST Compliance Costs

wo major characteristics of SST compliance costs are investigated in this section. The first consideration is the 'economies of scale' effect, sometimes referred to as the regressivity of tax compliance costs, and well recognised in compliance cost literature eg Sandford *et al* (1989), Evans *et al* (1997), Pope (2001). In other words, in this context, smaller funds would be expected to bear higher SST compliance costs expressed as a percentage of SST liability than would larger funds. Secondly, the time trend, or what has been happening to SST compliance costs since SST effectively became operational in 1996-97, is also investigated. As mentioned earlier, the limitations of our data need to be recognised.

Measures of SST compliance costs include SST costs in aggregate dollar terms, as a percentage of fund administrative costs, as a percentage of SST paid, per SST member, and per total fund member. Measures of size include the number of SST members in the fund, the number of total fund members and the value of fund assets.

There is limited evidence to support the economies of scale effect regarding SST compliance costs, as shown in Tables 5 to 16. However, this effect is significantly less clear-cut than in studies of business tax compliance costs eg Evans *et al* (1997). Whether fund size is expressed in terms of SST members or all funds members makes little difference. For example, SST compliance costs per SST member range from $32 to $302 between 250 to 708 SST fund members yet are as low as $75 for a fund with only 53 SST members. A fund with 80 SST members reports SST compliance costs of $34 per SST member compared with $396 for a fund with 1,500 SST members. In support of economies of scale, four of the top six largest funds in terms of SST members (794 to 7,000) report SST compliance costs per member between $14.40 and $4.30. Of the 13 funds with 200 or more SST members, six reported SST compliance costs per member greater than $90. SST costs per SST member range from $222 for a fund with only 135 (total) members to $396 for a fund with 1.142 million members. In between lows of $28, $34 and $14 are recorded by funds with 453, 1,150 and 1,846 members respectively. Highs of $704 and $405 are recorded for funds with 1,774 and 1,247 members respectively. These findings are surprising given the clear-cut economies of scale in nearly all studies of tax compliance costs previously published.

A reasonable threshold for SST costs appears to be less than 4 per cent of fund administrative costs, with 72 per cent of (respondent) funds in this category (see Table 6). Of the funds with costs greater than 4 per cent, all but one (24 per cent of total) have less than 250 SST members. This tends to support the existence of some degree of economies of scale. As a percentage of SST paid, a threshold seems to be less than 10 per cent, with 69 per cent of funds in this category and 58 per cent less than 5 per cent (see Table 7). Funds with a low number of SST members (less than 250) accounted for 61 per cent of all funds in this under 10% of SST paid category, weakening any economies of scale argument. The evidence on SST costs in dollars per SST member tends to support some economies of scale, with five of nine funds reporting costs of less than $10 per SST member having SST membership of 750 or more (see Table 8). Further, funds with higher absolute costs tended to be smaller. When spread over all fund members, whilst all funds with over $10 pa SST dollar costs per member had less than 250 SST members, half of the 22 funds with costs under $10 pa had less than 250 members (see Table 9). Thus many funds with a relatively lower number of SST members can achieve relatively low SST compliance costs, thus tending to negate any strong economies of scale argument. Note that the number of observations in the following Tables is less than the overall respondent figure of 40 given earlier because of missing values.

Table 5: The effect of Fund Size in Terms of the Number of SST Members on SST Compliance Costs, 2000-01

	SST Compliance Costs ($)						
Number of SST Members in Fund	Less than 10,000	10,000-24,999	25,000-49,999	50,000-74,999	75,000-99,999	100,000 or more	Total
Less than 99	5	3					8
100-249	3	2	2				7
250-499	1		2		1		4
500-749					1		1
750-999		1					1
1,000 or more		1	2	1		1	5
Total	9	7	6	1	2	1	26

Table 6: The Effect of Fund Size in Terms of the Number of SST Members on SST Compliance Costs as a Percentage of Fund Administrative Costs, 2000-01

	SST costs as a % of Fund Administrative Costs							
Number of SST Members in Fund	Less than 1%	1.0% - 1.9%	2.0%-3.9%	4.0%-5.9%	6.0%-7.9%	8.0%-9.9%	10% or more	Total
Less than 99	1	3	1	1	2			8
100-249		1	3	1		1	1	7
250-499			2					2
500-749		1						1
750-999	1					1		2
1,000 or more	1	1	3					5
Total	3	6	9	2	2	2	1	25

Table 7: The Effect of Fund Size in Terms of the Number of SST Members on SST Compliance Costs as a Percentage of SST Paid, 2000-01

	SST costs as a % of SST Paid						
Number of SST Members in Fund	Less than 5%	5%-9%	10%-14%	15%-19%	20%-24%	25% or more	Total
Less than 99	3	2		1		2	8
100-249	5	1				1	7
250-499	2			2			4
500-749						1	1
750-999	1						1
1,000 or more	4					1	5
Total	15	3	0	3	0	5	26

Table 8: The Effect of Fund Size in Terms of the Number of SST Members on SST Compliance Costs in Dollars per SST Member, 2000-01

	SST Costs in Dollars Per SST Member							
Number of SST Members in Fund	Less than 5	5-9	10-49	50-99	100-249	250 – 499	500 or more	Total
Less than 99			1	2	3	1	1	8
100-249			2	3	2			7
250-499			1	1	1	1		4
500-749					1			1
750-999			1					1
1,000 or more	1	1	2			1		5
Total	1	1	7	6	7	3	1	26

Table 9: The effect of fund size in terms of the number of SST members on SST compliance costs in dollars per total fund member, 2000-01

	SST Costs in Dollars per Total Fund Member						
Number of SST Members in Fund	Less than 1	1-4	5-9	10-24	25-39	40 and over	Total
Less than 99	1	4	1	1	1		8
100-249		2	3	1		1	7
250-499		3	1				4
500-749	1						1
750-999		1					1
1,000 or more	2	2	1				5
Total	4	12	6	2	1	1	26

In terms of the relationship between SST compliance costs, measured in various ways, and fund size measured by total fund membership, a number of larger funds have high or relatively high compliance costs. For example, one fund with between 10,000 and 49,999 fund members had SST compliance costs of over 10% of fund administrative costs (Table 11). In terms of percentage of tax paid, half of the funds with SST compliance costs greater than 25% of SST paid had total membership of 10,000 and over (Table 12). Over a quarter of funds (3 out of 11) with SST compliance costs of $100 or more per SST member had 10,000 or more members (Table 13). Although 5 out of 17 smaller funds (with less than 5,000 members) had SST compliance costs of $10 or more per (total) fund member, 12 out of the 17 achieved costs of less than $10 (Table 14). The largest funds (with 10,000 or more members) had SST compliance costs of $4 or less (Table 14). Thus all but the smallest funds (less than 1,000 members) are capable of matching their larger counterparts in terms of SST compliance costs, based on this measure.

Table 10: The effect of fund size in terms of total fund members on SST compliance costs, 2000-01

	SST Compliance Costs ($)						
Number of Fund Members	Less than 10,000	10,000-24,999	25,000-49,999	50,000-74,999	75,000-99,999	100,000 or more	Total
Less than 1,000	1	1	1				3
1,000 - 4,999	8	4	2				14
5,000 - 9,999		2	2				4
10,000-49,999			1	1	1		3
50,000 and over			1		1	1	3
Total	9	7	7	1	2	1	27

Table 11: The effect of fund size in terms of total fund members on SST compliance costs as a percentage of fund administrative costs, 2000-01

	SST costs as a % of Fund Administrative Costs							
Number of Fund Members	Less than 1%	1.0% - 1.9%	2.0%-3.9%	4.0%-5.9%	6.0%-7.9%	8.0%-9.9%	10% or more	Total
Less than 1,000			1			1		3
1,000 – 4,999	1	3	5	2	1			12
5,000-9,999	1	1	1			1		4
10,000-49,999		1	1				1	3
50,000 and over	1	1	1					3
Total	3	6	9	2	2	2	1	25

Table 12: The effect of fund size in terms of total fund members on SST compliance costs as a percentage of SST paid, 2000-01

	SST costs as a % of SST Paid						
Number of Fund Members	Less than 5%	5%-9%	10%-14%	15%-19%	20%-24%	25% or more	Total
Less than 1,000	2	1					3
1,000 – 4,999	8	2				3	13
5,000-9,999	2			2			4
10,000-49,999	2					1	3
50,000 and over	1					2	3
Total	15	3	0	2	0	6	26

Table 13: The effect of fund size in terms of total fund members on SST compliance costs in dollars per SST member, 2000-01

	SST Costs in Dollars per SST Member							
Number of Fund Members	Less than 5	5-9	10-49	50-99	100-249	250 – 499	500 or more	Total
Less than 1,000			1		2			3
1,000 – 4,999			4	5	2	1	1	13
5,000-9,999			1	1	2			4
10,000-49,999	1		1			1		3
50,000 and over		1			1	1		3
Total	1	1	7	6	7	3	1	26

Table 14: The effect of fund size in terms of total fund members on SST compliance costs in dollars per total fund member, 2000-01

	SST Costs in Dollars per Total Fund Member						
Number of Fund Members	Less than 1	1-4	5-9	10-24	25-39	40 and over	Total
Less than 1,000				1	1	1	3
1,000 – 4,999	1	6	5	2			14
5,000-9,999		3	1				4
10,000-49,999		3					3
50,000 and over	3						3
Total	4	12	6	3	1	1	27

Although there is no obvious relationship between fund asset size and SST compliance costs, measured in various ways[13], it seems reasonable to conclude that the smaller funds (less than $100 million in assets) are capable of matching larger funds in terms of SST compliance costs, especially in terms of the percentage of SST paid (Table 15) and SST costs per fund member (Table 16).

[13] Refer Pope, Fernandez and Le (2003), *supra* note 8, Tables 6.14 to 6.6.18, pp67/68, for full details.

Table 15: The effect of fund size in terms of fund assets on SST compliance costs as a percentage of SST paid, 2000-01

	SST costs as a % of SST Paid						
Value of Fund Assets ($m)	Less than 5%	5%-9%	10%-14%	15%-19%	20%-24%	25% or more	Total
Less than 49	1	1				1	3
50-99	6	2				1	9
100 – 499	4			2		3	9
500 – 999	2						2
1,000 and over	2					1	3
Total	15	3	0	2	0	6	26

Table 16: The effect of fund size in terms of fund assets on SST compliance costs in dollars per total fund member, 2000-01

	SST Costs in Dollars per Total Fund Member						
Value of Fund Assets ($m)	Less than 1	1-4	5-9	10-24	25-39	40 and over	Total
Less than 49	1	1			1		3
50-99		6	3				9
100 – 499	1	2	3	3		1	10
500 – 999		2					2
1,000 and over	2						2
Total	4	11	6	3	1	1	26

It therefore appears that, on balance, factors other than size, however measured, appear responsible for varying levels of SST recurrent compliance costs. The exact nature of these factors appears complex and would require further investigation.

Although based on limited numbers, particularly for earlier years, our survey provides some indication of the time trend in SST compliance costs since SST was introduced. Essentially the data shows that SST compliance costs are falling over a range of measures, as shown in Table 17. Thus SST compliance costs per SST member have fallen from around $691 in 1997/98 to around $140 in 2000-01, or by 80%. This is not surprising as it demonstrates the ‘learning curve’ effect and possibly that of economies of scale (although previous data is unclear on this effect). Over the same period the average number of SST members in respondent funds rose from 503 in 1997-98 to 714 in 2000-

01, or around 42%. The SST taxpaying population has increased since its introduction, particularly because of the inclusion of fringe benefits (from 30 June 2000) in the adjusted taxable income formula and also rising real income levels taking members above the SST threshold (although note that this is indexed).

Table 17: (Mean) SST compliance costs from 1997-98 to 2000-01

Year	SST costs as a % of Fund Administrative Costs	SST costs as a % of SST Paid	SST Costs in Dollars per SST Member	SST Costs in Dollars per Member
1997-1998	16.00	76.24	691.19	48.56
1998-1999	10.12	46.04	456.69	32.70
1999-2000	7.67	27.19	361.06	25.25
2000-2001	3.86	15.53	139.76	14.40

Note: The year 1996-97 has been excluded because of a very low number of observations for most categories.

Composition of SST Compliance Costs

The ongoing compliance costs of the SST involve both human and capital components. Our survey results that follow are reflective of the most widely experienced costs (in terms of the number of funds affected) as well as the most expensive costs (relative to other costs).

Respondents were asked to indicate how various cost heads were affected by the introduction and operation of the SST. No distinction was made between in-house and out-sourced costs. For example, ‘IT Staff’ includes employees of the fund as well as external IT support services. The results show that the SST affected administration staff costs in 90% of the funds surveyed, representing the single most widely experienced cost across the industry. Much of this can be attributable to the costs of training staff in the reporting requirements associated with the SST. The impact on IT software costs and actuarial fees was also strongly felt, affecting 83% and 63% of the funds, respectively. IT software costs include the cost of upgrading existing software, and the use of the software to ‘record and report data’. Increased IT staff costs were prevalent amongst more than half the respondents. In some cases, these costs were specific to SST in the form of ‘dedicated surcharge [IT] staff’.

‘Other’ costs comprised of items not previously categorised elsewhere. Under this head, one fund referred to the costs of outsourcing the SST reporting requirements to a third party administrator, as it would have been ‘too costly to do in-house’. General administration fees (exclusive of administration staff) and personnel officers were also additional costs. It may be assumed that these costs are specific to funds that outsourced their SST administration, if not their entire administrative functions. Several funds also pointed out that in addition to the cost heads, fund members were also affected by the SST. Furthermore, costs were also incurred in the provision of ‘communications material’ to members.

The relative costs incurred by each of these heads varied across the funds. Respondents were asked to rank the cost heads, according to the most affected, second most affected and third most affected by the SST. This ranking can be interpreted as a measure of the actual costs incurred as a result of the SST. Fund sentiments concerning the items they felt were ‘most’ affected, or most costly, are summarised as follows. These results indicate that the magnitude of IT software costs was greater than that of administrative staff costs, even though more funds experienced increased administration costs than IT software costs.

Data that is likely to throw further insight into the composition of SST compliance costs from other studies and surveys is extremely limited. ASFA (2001) found that the bulk of administration costs were taken up by labour (including fees for external administrators). Computer and communication expenses were also significant. As the priority given to communications increased, member communications became a ‘major and growing expense item’ (ASFA, 2001, p13). Professional fees were also noted as a ‘relatively high cost item’ (*ibid.*). A previous CPA Australia survey estimated that the collection of the surcharge would cost Australian small business more than $30 million in accounting fees and charges alone (CPA, 1997).

Previous ASFA studies found legislative and regulatory changes to be the single most significant factor impacting on administration costs. This shifted in the July 2001 results that reported the need for specialist advice and member communications as the most important factors.

The Bateman and Piggott (1999, p15) survey reported increased ongoing administration costs due to the surcharge for 90% of the respondents. Most reported an increase in costs of between 0% and 5% for most funds though more than 10% of respondents experienced cost increases greater than 10%. The proportion of costs attributable to contribution collections and processing ranged from less than 5% for corporate funds to up to 50% for industry funds (*ibid.*). Aggregate administration costs for the 1997-8 year were measured at $2.1 billion for 18.4 million accounts and $360 billion in fund assets in June 1998.

Effect of Abolishing SST but Not Reporting Requirement on Fund Members

It should be recognised that, as part of overall Government taxation policy, the ATO may wish to continue to collect data on fund members that it currently obtains from funds through SST administration even if SST was to be abolished[14]. It is worth noting that for constitutional reasons, the regulator (APRA) does not have powers to mandate reporting requirements to the same extent that the ATO can under Commonwealth taxation heads of power[15]. Reasons for this may include a wider policy of tracking income and investment flows of 'high tax revenue risk' individuals or sectors as part of its efforts to minimise the 'cash economy'. This study does not speculate on these costs for the superannuation industry as our objective is to focus on SST compliance costs.

Apart from the actual transaction costs of paying the SST on behalf of members, all other compliance costs relating to the SST are costs arising from the reporting requirements under SST legislation. Therefore an abolition of the surcharge liability alone, without abolishing the reporting requirements, would not result in any significant reduction in compliance costs, though taxpayers would welcome the disappearance of the tax. If SST was abolished, then any ensuing ATO administrative or reporting requirements on the industry would form part of funds' overall administrative costs and would have to be spread over all funds' members.

This issue may well have to be considered by the Government, ATO and the superannuation industry if the abolition of SST becomes a serious policy option.

Policy Implications

Aggregate estimates and caveats

The small number of funds surveyed renders the drawing of policy implications rather tenuous, and the authors fully recognise this. No doubt the administrative and compliance costs of the SST are but one of many factors in Government tax policy making, and one that Government may be inclined to give relatively less weight to than, say, revenue raising and equity arguments. Nonetheless, on the basis that some

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[14] It appears that the Government's newly introduced co-contribution arrangement will depend on data deriving from the SST.

[15] However, it may be argued that APRA relies on its tax and corporations power. It can ask and require information on contributions, and does to a degree, albeit at an aggregate level. Arguably, it chooses not to collect information, rather being unable to collect it.

illumination is better than no lighting at all, we cautiously draw the following policy implications from the foregoing analysis and a very tentative aggregate estimate.

An upper estimate of gross recurrent compliance costs of the SST is around $126 million for 2000/01 based on mean compliance costs of $140 per SST member[16], representing 18% of SST tax revenue of $699 million. A lower estimate of gross recurrent compliance costs of the SST is around $76 million for 2000/01 based on median compliance costs of $84 per SST member[17], representing 10.9% of SST tax revenue of $699 million[18]. However, it must be re-emphasised that our estimate is derived from larger superannuation funds that theoretically should have lower compliance costs than smaller funds.

For the 2000/01 financial year, operating expenses for the superannuation industry[19] amounted to $3.5 billion (APRA, 2002), representing an annual cost of $155 per member account. Taking these annual per member account costs, our estimate of $14.40 per fund member for the SST represents 9.3% ($14.40[20]/$155) of annual per member administration costs[21]. However, in the context of an average administrative cost per fund member of $110.84 ($2,576 million in administrative costs divided by 23.24 million accounts; Rice and McEwin, 2002, pp18 and 16 respectively) the relative percentage estimates change somewhat. SST compliance costs represent between 3.8% and 13% of all fund members' average administrative costs[22]. In comparison, the annual per member costs for the SST as a percentage of annual administration costs for our *surveyed* funds are lower, at 3.86%. This might be explained by the size of the funds surveyed, being Australia's largest funds by asset size.

Equity

It is a reasonable expectation especially by people outside of the superannuation industry that SST compliance costs would be borne in full by SST members. Indeed, this may have been the Government's original intention and supposition. However, in practice

[16] $140 times 900,000 SST assessments in 2000/01. Note that this mean estimate of $140 includes some funds with very high SST compliance costs that 'pulls' the mean higher. The extent to which these are outliers is difficult if not impossible to tell given our small sample. The 900,000 population figure is based on the number of SST assessments and not the number of SST payers (refer earlier discussion). This appears reasonable given that fund SST compliance costs are based on actual account operation. This issue may, however, affect any estimate of SST operating costs that includes the ATO's administrative costs of the SST.

[17] $84 (median estimate) times 900,000 SST assessments in 2000/01.

[18] Based on SST revenue of $699 million (ATO, 2002, Taxation Statistics 1999-2000, p216). This figure is significantly higher than the earlier ATO SST revenue estimate for 2000-01 of $589 million.

[19] This excludes RSAs and Assets regulated under the Life Act.

[20] See Table 17.

[21] Using our median survey estimate of $4.16 SST per fund member gives a much lower percentage estimate of 2.7%.

[22] $14.40 divided by $110.84 and $4.16 divided by $110.84 respectively.

SST compliance costs tend to be spread over all funds members by nearly all funds (95% of funds surveyed reported this policy) through members' fees, which inevitably reduce the national pool of funds for retirement. The effect of this practice is arguable. On one hand this is theoretically inequitable and counters usual tax policy objectives by transferring SST compliance costs from the targeted group of higher income earners to lower and middle income earners. As funds generally charge the same membership fees to all members, without discriminating on the basis of liability for the surcharge, the result is that all superannuation account holders are affected by the tax, despite any liability to pay the tax. The remaining 5% of funds that did not equally spread the costs across all members were employer-sponsored funds where the employers themselves bore the administration costs rather than the employees and hence members' fees and their effect on superannuation benefits were not in issue.

In effect, nearly all fund member accounts are subject to additional costs of between $4.16 pa and $14.40 pa for SST recurrent compliance costs, rather than SST members only paying between an additional $84 pa and $140 pa. Many would argue that, whatever the reasons, and remembering that these are estimates only based on respondent data, this is an inequitable policy outcome of the SST. However, against that view it may be argued that it would be inequitable for a few surcharge payers to foot the bill in a fund where the ATO requires reporting on thousands of others to establish that they do not have to pay. Administration costs are just as related to not paying the surcharge as to paying the surcharge. It would seem unfair if, say, someone with a $1,000 surcharge bill had to pay a $500 administration fee.

Another factor in the equity issue is the extent to which high income is equivalent to high wealth, or at least high potential superannuation benefits. Recent data from the IFSA, cited at the Senate Select Committee (2002)[23], suggests that there is a wide range in superannuation account balances of SST payers, and that the average age of SST account holders is around 47 and their median account balance is only about $50,000. This re-inforces the earlier argument that SST is not limited to the 'rich'; equity arguments are not a valid reason against the SST's abolition.

Simplicity

Low or reasonably low tax compliance costs are one indicator of the degree of simplicity of a particular tax. Thus another perspective on SST compliance costs is to compare them with other tax compliance costs. Expressing tax compliance costs as a percentage of tax revenue is the usual measure for making inter-tax comparisons, and we use that measure here. It must be noted that the percentage compliance cost estimates used for all taxes apart from SST are for 1994/95, and derived from the Evans *et al* (1997) study for the

[23] Hansard, Senate Select Committee (2002), Superannuation and Standards of Living in Retirement, 10 July, p246, [Online], at http://www.aph.gov.au/hansard/senate/committee/s5593.pdf.

ATO. It is likely that for some taxes, particularly those with lower revenue, these percentage estimates would have changed over a six year period. Of course the Wholesale Sales Tax (WST) has been abolished and replaced by the Goods and Services Tax (GST) in July 2000. As yet, there are no reliable estimates of Australian GST recurrent compliance costs, although overseas studies give some indication of the magnitude involved (eg Sandford and Hasseldine, 1992, for New Zealand). Also, the estimates for other taxes are often *taxpayer* compliance costs ie net costs after offsetting benefits such as cash flow are taken into account, rather than gross or *social* costs, and are therefore somewhat lower than the SST costs[24].

On available estimates (from Evans *et al*, 1997, pp76, 74, 57 and ix), at worst SST *social* compliance costs (at 18%[25]) are one of the highest of all major Commonwealth taxes[26]. They are significantly higher than PAYE[27] (1.3%), personal income tax (4%), income tax including Capital Gains Tax (6.8%) and the now abolished WST (4.7%). However, it must be emphasised that these are *taxpayer* compliance costs ie after taking into account cash flow and other offsets, and therefore lower than the SST estimate that did not allow for any offsets. These taxes excluding WST account for $79.5 billion or 87.7% of Commonwealth Government tax revenue in 1994/95 (Evans *et al*, 1997, p48). Only the FBT (17.1%) and company income tax (15.8%) have comparable *social* compliance costs to SST, and the nature of FBT renders any comparison problematical[28]. Even at best using the median estimates from our study, SST *social* compliance costs (at 10.9%) are higher than the compliance costs of most Commonwealth taxes and significantly higher than the most efficient (employers') *taxpayer* PAYE tax compliance costs (1.3%). In a sense comparison with PAYE tax compliance costs offers the most appropriate yardstick as both SST and PAYE compliance costs represent costs borne by third parties in collecting taxes from personal income taxpayers by the most efficient method, namely withholding.

The time trend for SST compliance costs is likely to be downwards for a number of theoretical reasons, both in terms of absolute dollar costs and when expressed as a percentage of tax paid. First, there is the 'learning curve' effect. Secondly, as a greater number of taxpayers enter the SST net because of rising real incomes, funds may earn

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[24] Evans *et al* (1997) use the terms *taxpayer* and *social* compliance costs, whereas Sandford, Pope and other researchers prefer the more traditional terms *gross* and *net* compliance costs respectively. Extra care is therefore needed when making inter-study and inter-tax comparisons. Such comparisons are fraught with difficulty (see Evans *et al*, 1997, pp58-60 for useful discussion, based on work by Sandford, 1995, p405).
[25] Note that the survey estimate percentage (based on respondents' SST payments) is lower at 15.5%.
[26] The now abolished Prescribed Payments System had estimated compliance costs of 22% of tax revenue in 1994/95 (Evans *et al*, 1997).
[27] The Pay-As-You-Go (PAYG) system, part of major Government tax reform and commencing in July 2000, replaced Pay-As-You-Earn (PAYE). The term applicable at the time of the cited study is used throughout this research.
[28] Essentially FBT may increase the Personal Income Tax revenue by encouraging taxpayers to take their remuneration as normal salary rather than in the form of fringe benefits such as a company car. Thus expressing compliance costs as a percentage of FBT revenue is not a particularly reliable measure.

economies of scale because of largely fixed costs ie SST compliance costs are being spread over a greater number of taxpayers over time (although this study has found little, if any, evidence of economies of scale; refer earlier discussion). Further, the Government has changed the definition of adjusted taxable income for SST, such that it now includes fringe benefits (from 30 June 2000), thereby bringing in a larger number of taxpayers into the SST net for the first time. Inflation and bracket creep *per se* does not present a problem for SST as the SST adjusted taxable income threshold is indexed each tax year.

The lowering of SST rates announced during the 2001 Commonwealth elections are due to take effect from 1 July 2002[29]. The 15% rate is to be reduced to 13.5% in 2002-03, 12% in 2003-04 and 10.5% in 2004-05. Other things remaining unchanged, this measure will lower SST revenue thereby increasing SST compliance costs expressed as a percentage of tax revenue and making any comparisons with other tax compliance costs worse than they otherwise would have been. It is interesting that the Government favoured probably the more politically expedient measure of lowering rates rather than increasing the current adjusted taxable income threshold of $85,000. Raising the threshold level is a widely held principle in lowering tax compliance costs (Sandford *et al*, 1989, p213; Pope 2001, pp141-142). However, whilst this is far less applicable to SST for the reasons discussed earlier, concerns regarding SST compliance costs were obviously not a feature in the Government's rate changes to SST announced during its election campaign in late 2001.

Overall

To sum up, the depth nature of this study compared with the large scale survey estimates of Evans *et al* (1997) renders comparisons very problematical. Nonetheless it appears that, from the estimates available, SST compliance costs are much higher than employers' PAYE tax compliance costs. SST compliance costs are invariably spread over all fund members for obvious practical, cost considerations yet such a policy is counter to equity and user-pays arguments. SST compliance costs are tending to fall over time (both in absolute dollar costs per member and % of tax revenue terms). In this researchstudy we found little if any evidence of economies of scale (the usual major reason in many other compliance cost studies), although that is not to say that they do not exist. The inference is that factors such as administrative 'learning' experience and improving information technology are responsible for costs falling over time. The recent lowering of SST rates and ensuing revenue reductions may reverse this trend as far as SST costs expressed as a percentage of SST revenue is concerned.

Overall, there is a reasonably strong case for the abolition of SST on the grounds of high recurrent compliance costs in comparison with other Commonwealth taxes, and, somewhat ironically, because of equity arguments arising from the fact that SST compliance costs are generally not borne by SST taxpayers.

[29] Legislation is pending at the time of writing. PRAFULA????

Industry Attitudes to the Superannuation Surcharge Tax

> *'The surcharge/tax is a rather strange piece of public policy – by design it plucks the tax goose in a way which generates the maximum squeals and discomfort for both the goose and the plucker!' (Clare, 1998, p22)*

The above quote illustrates the ASFA views of the compliance costs of administrating the SST for both the funds liable to pay it and the ATO who collect it. Effectively the taxpayer is hit thrice, in terms of ATO administration costs, their own and their superannuation fund's compliance costs, plus their SST liability incurred. Described as a 'nightmare come true', the SST was expected to cost funds millions, according to the CPA Australia (CPA, 1998). The economic implications of such high administrative costs are the diversion of resources away from more productive efforts (Australian Accountant, 1997). A Superannuation Centre of Excellence report of the problems associated with the SST has been colourfully labelled 'Thirty Ways to Lose Your Super', a label representative of the industry wide contempt for the surcharge (Australian Accountant, 1996). Other commentators eg Blizzard (1997), Hudson (1999), have also voiced their opposition to SST.

Survey responses were obtained from fund administrators directly responsible for reporting details of the SST. In total, 32 out of 40 responses (80%) indicated support for the abolition of the SST to be given a high priority status (priority of one or two on a scale of one to five) by the industry's more prominent and experienced personnel. There were a number of reasons offered for this view (in respondent's own words):

Superannuation is already overtaxed and very complicated; SST adds another level of complexity and cost.

Government should be encouraging and not discouraging superannuation savings.

For large groups of members the costs of collecting revenue is greater than the revenue collected; too expensive to administer relative to the revenue collected.

Complexity, inefficiency and cost of administration, collection arrangements, difficulty of keeping track of movements of former members getting assessed long after exiting a fund; too high a cost.

Costs of communicating to members, answering queries, causes members distress; Surcharge is not fully understood by members leading to confusion for call centre staff dealing with members directly.

Costs of paying assessments.

Reduced retirement benefits for members as they pay for increased administration fees.

Unnecessary tax burden.

The tax is inequitable (costs borne by all members).

Tax is discriminatory and biased against self-funded retirees, the 'rich', defined benefit fund members (some of whom pay surcharge on contributions which may never represent full benefit potential if resigning before 55).

Costs of labour time, administration, compliance, IT, training, member communications – high cost for no return to funds and members.

Politically 'sneaky' - the Government set up the surcharge underhandedly as not a new tax when obviously it is. The way it is run is totally unbelievably complex – they should have done it via tax returns and not via super funds. But if would have been obvious to individuals that it was another tax.

Biggest problem administration-wise is the time lag and subsequent member movements especially funds that have been wound up, merged or taken over.

The delay in collecting the tax is often well over two years.

Surcharge is a burden on fund administration and an unnecessary cost impost of a scheme's membership for such a limited number of high-income members.

Survey suggestions for reform

Survey respondents made the following recommendations for SST reform:

The contribution tax should be dropped to zero so that the SST would no longer be necessary

Too expensive to administer for the revenue collected – cheaper to increase the high income tax rate by small amounts.

Main problem is time and effort in collecting data for ATO, answering member queries and paying surcharge assessments when they arrive. Reduction in rates wouldn't help; only outright abolition.

Should be part of general tax collection.

Should be abolished when overall change in taxation of superannuation is put in place

More equitable to remove 15% contribution tax.

Currently too many taxes involving superannuation. Govt should be looking at abolishing if not the surcharge tax (this is the 'messiest' tax), the 15% contribution tax

Threshold is really far too low. One would think a figure of $175k would be more realistic. However the total abolition of the tax would make superannuation easier to administer and understand.

Conclusions

The SST was introduced in August 1996, and, according to the ATO, 'is intended to limit the concessionality of employer and deductible personal superannuation contributions for high income earners'. For the 2000/01 year it is levied at a rate of up to 15% on the surchargeable contributions of fund members whose adjusted taxable income exceeds the surcharge threshold of $81,493. Essentially the adjusted taxable income is the summation of a member's taxable income, surchargeable contributions and reportable fringe benefits (applicable from 30 June 2000). Thus for fund members with high employer contributions (and/or high individual voluntary contributions) the SST can impact on taxpayers with taxable incomes only somewhat above the $60,000 pa threshold of the 47% top marginal tax rate. The SST becomes fully liable at the 15% rate at adjusted taxable income levels of $98,955 and above in 2000/01. The starting threshold is indexed each year.

In 1999/2000 (the latest year for which reliable statistics are available), around 900,000 SST assessments were issued that raised $589 million, or an average of $655 per assessment.

From 1 July 2002, for the 2002/03 tax year, the Government proposed reducing the top rate of SST to 13.5%, with further reductions in subsequent years to 10.5% in 2004/05. Treasury estimates that this will reduce surcharge collections by $60 million, from an estimated peak of $820 million in 2001/02 and 2002/03 to $760 million in 2004/05.

The ASFA (relying on APRA data) estimated the 1999/2000 administration costs for superannuation at $2.45 billion, for 21.7 million superannuation fund accounts, 6 million workers and $477 billion in fund assets, as at June 2000. These figures indicate some inefficiencies, with multiple superannuation accounts for some Australian workers, arising largely through labour mobility and individuals' failure to close dormant accounts. These administrative costs include tax compliance costs that would otherwise not exist but for the tax regime upon superannuation and that normally remain hidden. This study has focussed on SST compliance costs only and not all of the industry's tax compliance costs.

When discussing tax compliance cost estimates, caution must be used, especially in a study of this nature[30]. Particular care is needed when comparing findings from different studies or sources, as the methodology may be different. Nonetheless, hopefully some consensus of 'order of magnitudes' may emerge in an unduly complex industry where many regulatory and tax compliance costs are obfuscated. The authors draw conclusions on the basis that 'some illumination is better than none at all', and fully acknowledge the limitations of this study.

There are very few studies anywhere in the world that estimate tax start-up costs. Of the few that exist, it appears that start-up costs are significant and typically up to one year's worth of recurrent compliance costs. SST compliance costs have been estimated at (at least) $141 million, or 30% of first year SST revenue of $470 million, based on research by the ASFA (Clare, 1998). Overall, SST start-up cost estimates follow the usual regressive pattern found in nearly all tax compliance cost studies.

SST (recurrent) compliance costs are falling over time, from an estimated $691 pa per SST member in 1997/98 to $140 pa per SST member in 2000/01. Estimated gross recurrent compliance costs of the SST are tentatively estimated at $76 million for 2000/01 (based on our median estimate), representing 10.9% of SST tax revenue of $699 million. However, it must be re-emphasised that our estimate is derived from larger superannuation funds that theoretically should have lower compliance costs than smaller funds. Further, and tending to lower SST compliance costs expressed as a percentage of tax revenue, SST revenue has been forecast to rise to around $820 million in 2001/02 and 2002/03.

From our small number of observations, it appears that smaller funds, measured on various criteria (eg number of SST members, number of total fund members, value of assets), are generally capable of achieving as low of cost levels as larger funds. In other words, SST compliance costs did not seem to exhibit the usual strong economies of scale effect found in nearly every other compliance cost study. However, this is not to say that they do not exist, but merely that our survey found little if any evidence supporting an

[30] Such cautionary comments are found in nearly all tax compliance cost studies eg Sandford *et al* (1989), Evans *et al* (1997).

economies of scale argument. Likely reasons for this finding include the very small number of observations and the complexity of the industry, particularly the effects of any out-sourcing on SST compliance cost estimates.

SST compliance costs are (nearly always) spread over all fund members (for administrative ease and cost reasons). This is an inequitable (and probably unforeseen) outcome of SST. Estimated SST compliance costs (at around 11% of tax revenue) appear to be significantly higher than for other comparable taxes, especially withholding taxes, particularly the employers' withholding tax Pay-As-You-Earn (now Pay-As-You-Go), given the usual caveats found in compliance cost studies. Indeed, great caution is needed with these aggregate SST estimates because of the nature of this particular compliance cost study.

Given the nature of the industry and the available estimates, the relative magnitudes of SST start-up and recurrent compliance costs (at $141 million and $76 million respectively) seem reasonable. It is worth noting that, compared with the few studies that exist internationally, the ratio of SST start-up to recurrent costs is relatively higher than for other start-up cost studies.

The superannuation industry, professional, tax and accounting bodies, and specialists in the field are all overwhelmingly critical of the SST for a variety of reasons, particularly its inefficiency, high compliance costs and inequity (because SST compliance costs are spread over all fund members). Around 80% of survey responses indicated industry support for the abolition of the SST to be given a high priority status.

Overall Policy Implications

ASFA, the IAA (Institute of Actuaries of Australia), the ACOSS (Australian Council of Social Service) and the Economics, Commerce and Industrial Relations Group have put forward recent proposals for reform (Kehl, 2001). These may be summarised into four major policy options, discussed briefly below. All of these policies would need detailed evaluation by the superannuation industry and Treasury in due course.

First, there is much support for the abolition of the SST either in isolation or as part of overall superannuation reform (this study's survey results and, for example, Kehl, 2001; TIA, 2001; CPA, 2002; ABA, 2002). A much-voiced complaint is that superannuation is excessively taxed and complex. The immediate benefits of abolishing the SST would be a simplification of the operation of superannuation funds (Kehl, 2001). There appears to be a growing consensus in favour of removing contributions taxes (eg CPA, 2002, p5). ASFA estimated the impact of removing contributions taxes to the value of $2.1 billion if implemented in 2001-02 (Clare, 2000), with delayed impact given that the SST relates to contributions made in previous periods. The CPA (2002, p5) state that '[t]he surcharge should be reviewed with the view to removing it in its entirety beyond the proposed three-year period. We recognise that there are equity issues, but consider these should be dealt with in another manner.' According to ASFA (Clare and Connor, 1998), 'a more equitable way to deal with taxation of superannuation is at the benefits stage'. Presumably such a policy approach would have to address the loss of SST revenue of $589 million in 1999-2000 (ATO, 2001, p81), and an estimated $820 million in 2001/02 and 2002/03 (Treasury estimate; Budget Papers, 2002-03).

A major argument against abolition of SST is likely to be on equity grounds. Assessments of equity need to be based on a range of criteria and not just income. In the context of SST, it appears erroneous to equate high income to high wealth, or even high potential superannuation benefits (through high account balances). To re-iterate, recent data from the IFSA, cited at the Senate Select Committee (2002)[31], suggests that there is a wide range in superannuation account balances of SST payers, and that their average age is around 47 and their median account balance is only about $50,000. This re-inforces the argument that SST is not limited to the 'rich'; equity arguments are thus not a valid reason against the SST's abolition.

Secondly, Bateman and Piggott (1999) suggest that a conversion of the SST from a fund basis to an individual basis would be more equitable, consistent and simple. The alternative approach for superannuation tax reform suggested by these authors involved an integration of fund and personal taxation.

Thirdly, a well-established compliance cost principle, fully discussed in the international literature, is to raise the threshold level in order to reduce the number of taxpayers. Such a measure lowers gross (or social) compliance costs by taking taxpayers out of the 'tax net'. However, given the peculiarities of both the superannuation industry and the SST, it is considered that this option is much less, if at all, applicable in any attempt to lower compliance costs. Whilst increasing the adjustable taxable income threshold for SST would lower tax compliance costs for some taxpayers the effects on the industry are likely to be small and possibly negligible. The major reason for this is the ATO's reporting requirement on all fund members that is currently linked to the SST. Any changes to the adjusted taxable income threshold level are likely to be more concerned with equity, tax incentive and political factors rather than compliance cost and efficiency factors.

Fourthly, much of the reporting requirements stem from the complex nature of SST assessment calculations and the numerous variables involved. It appears that efforts to make the tax 'fairer' by taking into account so many variables have resulted in the imposition of an expensive tax in terms of administrative and compliance costs. A simpler overall formula may eradicate the bulk of the reporting requirements, although it may come at the cost of equity.

[31] Hansard, Senate Select Committee on Superannuation, 10 July 2002, p246, [Online], at http://www.aph.gov.au/hansard/senate/committee/s5593.pdf.

To conclude, the simplest and ‘first choice’ policy measure that is likely to receive widespread superannuation industry support would be to abolish SST, either as a one-off measure or part of a much needed review of the overall taxation of the superannuation industry. The revenue shortfall could be made up by: increasing personal income tax rates above $60,000; increased taxation at the benefits stage (although time lags may raise difficulties); or increases in indirect taxation (because of high current Australian personal income tax rates).

Other proposals fall into the ‘second best’ category. The least attractive would be any proposal to simply transfer the primary compliance cost burden of the SST from the superannuation industry to individual taxpayers. This would undoubtedly increase gross compliance costs (and possibly ATO administrative costs) of the SST still further. Any of these ‘second best’ proposals would need very careful research and implementation otherwise they would merely exacerbate an already over-complex and costly tax regime for superannuation.

Further Research

From the literature reviewed during the course of this research, it seems that there is a reasonable argument for a comprehensive and thorough review of superannuation arrangements in Australia. Of particular concern seems to be the prudential supervision and regulation of all superannuation funds, the burden of existing regulation and compliance, the availability of one source of reliable data and information on the industry, the taxation of superannuation and the provision of adequate retirement pensions given Australia’s ageing population. The relationship of the superannuation industry and its taxation to that of the social security system and the cost of providing the Government age pension is also worthy of further investigation. The authors would support any Government review in these areas. In any review, the principle of simplicity and low(er) compliance costs should be given a much greater weighting in public policy than hitherto.

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