AUSTRALIA

Australia: pension system in 2006

Australia's retirement income system has three components: a means-tested age pension funded through general taxation revenue; the superannuation guarantee, a compulsory employer contribution to private superannuation savings (mainly through defined contribution plans); and voluntary superannuation contributions and other private savings, which are encouraged to support self-provision in retirement.

Key indicators

		Australia	OECD
Average earnings	AUD	55 200	47 600
	USD	41 600	35 800
Public pension spending	% of GDP	3.5	7.2
Life expectancy	at birth	81.1	78.9
	at age 65	84.9	83.4
Population over age 65	% of working-age population	21.5	23.8

Qualifying conditions

Age Pension is payable from age 65 for men. Women's pensionable age – currently 63 – will increase gradually to become 65 by 2014. The minimum age for withdrawing superannuation guarantee benefits is currently 55, but this will increase gradually to 60 by 2025.

Benefit calculation

Defined contribution

The superannuation guarantee was introduced in 1992. It consists of a mandatory employer contribution to a private pension plan. The pension plans may be operated by the employer, industry associations, and financial service companies or even by individuals themselves. The mandatory contribution rate has been 9% of employee earnings since the 2002-03 tax year.

Employers need not contribute for workers earning less than AUD 450 a month (equivalent to AUD 5 400 a year), but they can choose to contribute for these workers (note that this minimum has not been raised in the past). There is also a limit to the earnings covered by the superannuation guarantee: employers need not contribute for employees' pay above this threshold. For each quarter of the financial year 2004-05, this amount is AUD 32 180 and for each quarter of the year 2005-06, it is AUD 33 720. This limit is worth around 2½ times average wages and is indexed to a measure of average earnings.

The withdrawal stage of the superannuation guarantee complicates the calculations. Although there are some defined-benefit occupational plans, most employees are members of defined-contribution schemes. Members can take out the accumulated capital as a lump sum or some sort of income stream. Currently, most benefits are taken as a lump sum. For comparison with other countries (where defined-benefit plans predominate), the capital from the superannuation guarantee is assumed to be converted to a price-indexed annuity. The annuity calculation is based on mortality data for Australia.

Targeted

Age Pension is designed to provide a safety net for those unable to save enough through their working life and to supplement the retirement savings of others. The income and assets tests (means test) are used to target payments to those in need.

The value of the Age Pension is adjusted biannually and is paid fortnightly. In September 2005, the maximum single rate of pension was AUD 489 a fortnight, increasing to AUD 500 in March 2006 and AUD 512 in September 2006. (All values have been rounded to the nearest dollar.) This gives an average for the tax year of an annual benefit of AUD 12 737, equivalent to 23% of average earnings.

Age Pension's value is increased in line with price increases as measured by the Consumer Price Index (CPI). Where necessary, a further increase is made to ensure that it does not fall below 25% of the average of pre-tax Male Total Average Weekly Earnings on the national definition (which is slightly different from the earnings measure used in OECD analysis).

The Age Pension is withdrawn once annual income from other sources exceeds a threshold known as the "free area". This is adjusted annually in July. The values for 2006 were AUD 124 in the first half and AUD 128 in the second half of the year (again calculated fortnightly). The tax year figure for 2006 was therefore AUD 3 224, or 5.8% of average earnings. The withdrawal rate is 40% (single or couples combined). There is also an assets test. However, over 90% of pensioners affected have their benefits reduced by the income rather than the assets test (and so it has been assumed in the modelling that the income test is binding). Almost 40% of pensioners have their benefit reduced by the means test, and are therefore on part-rate Age Pension. Just over 60% of pensioners are on the maximum rate Age Pension.

Variant careers

Early retirement

Access to superannuation benefits (including superannuation guarantee benefits) is currently possible for retirement on or after age 55 (increasing to age 60). Individuals who are still working can also access their benefits from age 55, but only in the form of a non-commutable income stream. Age Pension is not paid earlier than the qualifying age for men (age 65) and women (age 63, increasing to 65 by 2014).

Late retirement

It is possible to defer claiming superannuation after 65. Employers are required to make superannuation contributions under the superannuation guarantee arrangements for their eligible employees up to the age of 70.

It is also possible to defer claiming the Age Pension after 65. The pension bonus scheme pays a once-only, tax-free lump sum to eligible members who defer claiming age pension and continue to work. The bonus is paid when the eligible member claims and receives age pension. A person must register and work a minimum of 12 months from date of registration, and must complete at least 960 hours of gainful work each year. The bonus can be accrued for up to five years. The amount of bonus depends on the rate of Age Pension a person qualifies for when they eventually claim and receive it. The bonus is 9.4% of the basic age pension entitlement for the first year of deferral. For two years, the bonus is four times that amount, nine times for three years, 16 times for four years and 25 times for five years. The maximum, five-year bonus is equivalent to 2.35 times one year's maximum Age Pension entitlement.

Childcare

There is no specific protection for periods out of work in the superannuation guarantee. Voluntary contributions are possible for periods out of paid work.

The means-tested structure of the Age Pension provides some protection for people with periods out of the workforce, in that it provides a safety net and supplements the retirement incomes of those unable to save enough during their working life.

Unemployment

There is no specific protection in the superannuation guarantee for periods out of work. Voluntary contributions are possible for periods out of paid work.

There are no credits in the superannuation scheme for periods of unemployment.

Personal income tax and social security contributions

Taxation of pensioners

Older Australians and other Australians who receive a government pension may be entitled to one of two personal tax concessions in addition to the standard reliefs.

A credit (the senior Australians tax offset) is available for those of pensionable age (see under qualifying conditions above) who also satisfy a residency test. This is AUD 2 230 for singles in 2005-06 with income up to an income threshold of AUD 21 968 and is withdrawn at a rate of 12.5% for income in excess of the threshold. The credit fully phases out for singles at an income of AUD 39 808 and above.

There is a credit for pensioners in receipt of certain pension income (the pensioner tax offset), which has different eligibility criteria from the senior Australians tax offset. It is not possible to claim both of these offsets and the latter is more generous for those eligible for both. The effect of the credit is that all those receiving the full rate of the government pension will have no net income tax liability, and most of those who receive a part pension will have a reduced liability. The credit is non-refundable; it cannot create a negative tax liability.

Taxpayers eligible for the senior Australians tax offset benefit from a higher value of the low-income Medicare levy threshold (AUD 21 968). This means that pensioners receiving the full amount of the offset will pay no Medicare levy. The normal rate of the levy is 1.5% of income.

A private health insurance rebate is available to those taxpayers who have private health insurance. The normal rate of private health insurance rebate is 30 per cent. However, from 1 April 2005, for people aged from 65 to 69 years is it 35 per cent, and for people older than 70 years it is 40 per cent.

Taxation of private pensions

The superannuation guarantee has some tax extracted at all three possible stages: when contributions are made, when investment returns are earned and when benefits are withdrawn.

A 15% tax is levied on deductible employer contributions to the fund.

Investment earnings of the superannuation fund are taxed, again at 15%. Investment earnings on assets supporting a pension are tax free. (However, the effective tax rates are usually lower through imputation credits and the capital-gains-tax discount.)

Superannuation benefits are subject to taxation on withdrawal, whether taken as a lump sum or as an income stream. Benefits taken as an income stream are taxable at normal rates. However, there is an annual tax-free allowance for the return of capital and the taxable portion of the income stream is subject to a non-refundable rebate of 15 per cent. This rebate is available on the value of the income stream that is within the applicable reasonable benefit limit. Income streams that meet certain conditions (known as complying income streams) are assessed for this purpose against the pension reasonable benefit limit, AUD 1 297 886 in 2005-06). All other income streams are assessed against the lump sum reasonable benefit limit AUD 648 946 in 2005-06). These limits are indexed annually to wages.

In May 2006, the Government announced plans to introduce significant changes to superannuation and social security arrangements. Known as the Better Super reforms, these changes largely apply from 1 July 2007.

Better Super includes significant changes to the taxation of end benefits. From 1 July 2007, superannuation benefits paid from a taxed sources (that is, where tax has been paid on contributions and earnings) either as an income stream or as a lump sum are tax free for people aged 60 and over. The taxation of superannuation benefits for those below the age of 60 has also been simplified.

Under Better Super, reasonable benefit limits have been abolished. Instead, superannuation concessions are limited by caps on contributions to superannuation. Concessional contributions (which include all contributions made by an employer on an individual's behalf) that exceed an annual threshold (AUD 50 000) will be subject to an additional tax levied on the individual. The individual may choose to pay this tax by withdrawing amounts from the fund.

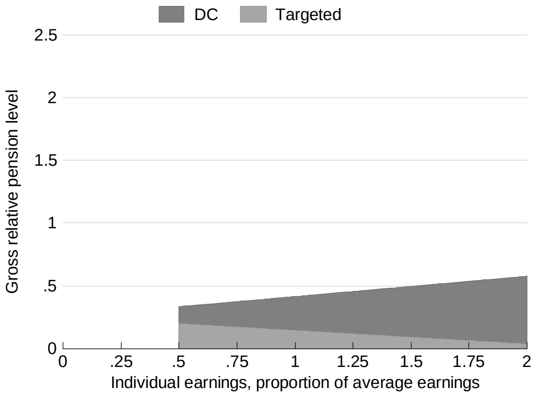
The Government has also announced a halving of the pension assets test taper rate from AUD 3 to AUD 1.50 per fortnight commencing 20 September 2007. This change will decrease effective marginal tax rates and improve incentives to save.

Social security contributions paid by pensioners

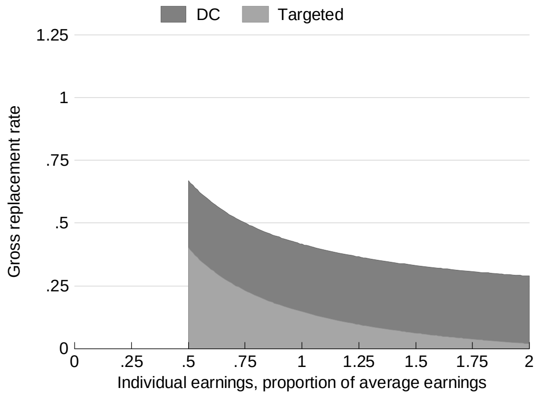
There are no social security contributions in Australia. The Age Pension and other benefits are financed from general revenues.

Pension modelling results: Australia

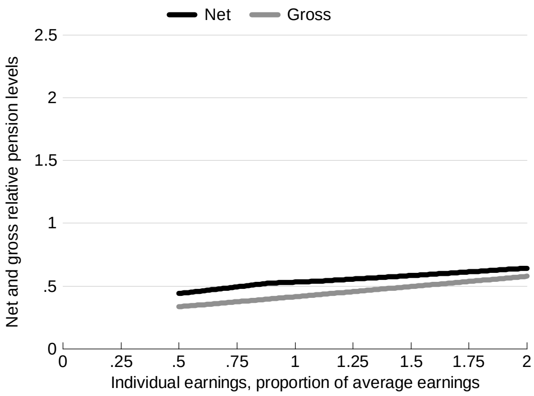
Gross relative pension level



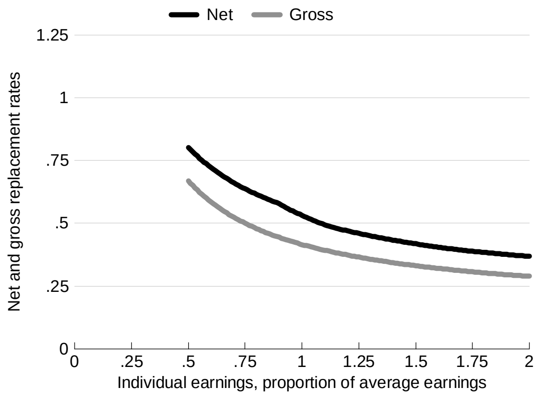
Gross replacement rate



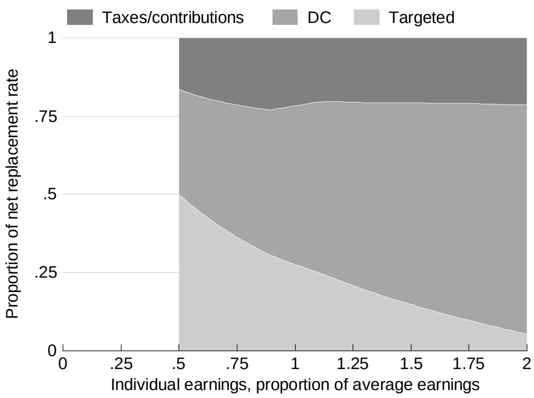
Net and gross relative pension levels



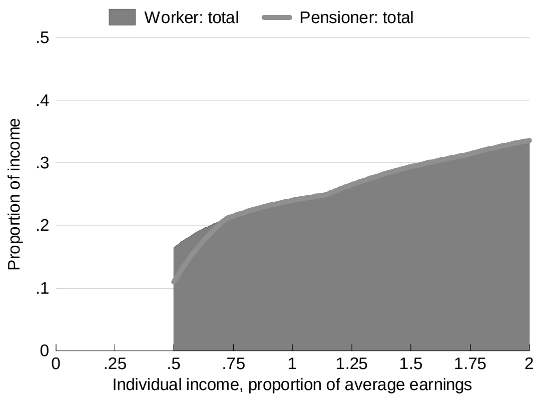
Net and gross replacement rates



Sources of net replacement rate



Taxes paid by pensioners and workers



Men *Women* (where different)	*Median earner*	*Individual earnings, multiple of average*				
		0.5	*0.75*	*1*	*1.5*	*2*
Gross relative pension level (% average gross earnings)	39.3	33.5	37.5	41.6	49.7	57.7
Net relative pension level (% net average earnings)	51.7	44.1	49.4	53.1	58.3	64.3
Gross replacement rate (% individual gross earnings)	45.7	67.0	50.0	41.6	33.1	28.9
Net replacement rate (% individual net earnings)	59.2	80.2	63.7	53.1	41.8	36.8
Gross pension wealth	7.7	11.7	8.5	6.9	5.3	4.5
(multiple of average gross earnings)	*9.0*	*13.7*	*9.9*	*8.1*	*6.2*	*5.2*
Net pension wealth	7.7	11.7	8.5	6.7	4.8	3.8
(multiple of average net earnings)	*9.0*	*13.7*	*9.9*	*7.8*	*5.5*	*4.4*