

# TAXATION AND SUPERANNUATION LITERACY IN AUSTRALIA:

*what do people know (or think they know)?*

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*To date, basic taxation issues, and to a lesser extent superannuation, have largely been excluded from the measurement and education aspects of financial capability, both in Australia and overseas. This paper explores outcomes of an Australian survey of tax literacy, and reports on levels of confidence in relation to tax and superannuation issues – highlighting areas where large gaps exist between people's level of confidence in understanding and their actual levels of understanding. It argues that these aspects should be incorporated into future financial literacy education strategies and research.*

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Financial literacy<sup>1</sup> has become an important focus not only for government, but also the education and community sectors, the broader finance industry and financial advisers. The underlying premise is the need to create an environment in which people have the knowledge, skills and confidence to protect themselves from financial risk and make sound financial decisions. In 2011 the Australian Government released the National Financial Literacy Strategy, which outlined the importance of having sound financial literacy skills within the context of 'changes in demography, and increased consumer responsibility for superannuation decisions and retirement incomes' (Australian Securities and Investments Commission 2011, p. 4). An important element of financial literacy is confidence in understanding financial concepts.

In 2007 the Financial Literacy Foundation<sup>2</sup> undertook research which explored Australians' attitudes, abilities and confidence in understanding a range of financial and money management concepts. One of the findings was that people's attitudes and beliefs about money can adversely affect their actual financial literacy and that where actual ability is lacking, effort should be focused on building confidence and competence (Financial Literacy Foundation 2007, pp. 48–49). Further, in 2011, the *ANZ Survey of Adult Financial Literacy* in Australia found that self-efficacy (self-confidence and belief in improving one's financial situation) had a strong association with 'staying informed' behaviour and therefore suggested a greater likelihood of being actively engaged in managing one's own finances (ANZ 2011, p. 2).

This paper explores self-assessed confidence within the context of taxation and superannuation. To date, basic taxation issues, and to a lesser extent superannuation issues, have largely been excluded from both the measurement and education aspects of financial literacy models. This is despite the fact that surveys have indicated people often have lower confidence or lower ability in more complex financial areas. This paper will present findings from a recent survey of taxation literacy in relation to self-assessed confidence in understanding taxation and superannuation issues. The paper will also present findings that explore the extent to which confidence is aligned with overall Tax Literacy Scores (i.e. knowledge and ability). These findings help government, finance and education professionals to gain an appreciation of Australians' level of confidence in understanding taxation and superannuation issues.

## **Financial literacy and confidence in context**

The *ANZ Survey of Adult Financial Literacy* provides the most comprehensive measures of financial literacy in Australia. These surveys measure financial literacy on the basis of a financial literacy framework that was first posed in the United Kingdom by the Adult Financial Literacy Advisory Group (Financial Services Authority 2004). The surveys take into account the following factors in determining a person's overall financial literacy score: numeracy; financial understanding and competence; and financial responsibility. In 2011, financial behaviours and self-efficacy were also measured for the first time.

In terms of where tax concepts fit within this framework, the ANZ survey includes the following statement: 'Please note that other potential aspects of adult financial literacy (e.g. taxation; understanding of how and why government is financed; awareness and understanding of government benefits; understanding of how fees are calculated and how to minimise them) were agreed upon as being beyond the scope of the current project, and therefore not included in the framework' (ANZ 2003, p. 18). It has been argued that an understanding of basic taxation issues such as rights and responsibilities of taxpayers and the basic framework of the Australian taxation system should form part of any financial literacy framework (Chardon 2011). Some have also noted that financial literacy research should continue to agree upon a suitable framework for measurement and also explore those specific areas which are most critical to financial success (Worthington 2006, 2013).

As taxation knowledge has never been measured in detail in any Australian survey, there is currently no data to determine whether it might be an area where people have low levels of literacy or whether there are specific aspects of taxation which need to be focused on or targeted. However, there are a number of findings from Australian research which highlight that tax and superannuation issues should not be 'outside the scope' of financial literacy. The 2011 ANZ survey found that 53 per cent of respondents would invest in a scheme marketed as having a return 'well above market rates at no risk' (ANZ 2011). This is relevant given that the Australian Taxation Office (ATO) and the Australian Securities and Investments Commission (ASIC) are often concerned about the extent to which taxpayers expose themselves to risk through aggressively marketed tax schemes. Also, all surveys (2005, 2008 and 2011) reported that Australians had lower levels of understanding in relation to superannuation (and also its tax treatment) than they had for basic banking.

In relation to confidence, a Financial Literacy Foundation survey found that people's attitudes and beliefs about money can adversely affect their actual financial literacy and that where actual ability is lacking, effort should be focused on building confidence and competence (Financial Literacy Foundation 2007, p. 49). The survey found that although participants were generally confident about their ability to get information and deal with financial service providers (>80 per cent confidence), only 64 per cent agreed that they understood financial language. Though the Financial Literacy Foundation research found that confidence does not always result in increased actual ability, it has nevertheless been argued that building confidence in relation to financial matters can have an impact upon the degree to which people seek assistance with financial

decisions, make better financial decisions and overcome attitudes or beliefs that prevent proactive steps being taken (Financial Literacy Foundation 2007; Lusardi and Mitchell 2006).

The results of the prior research along with the results presented in this paper are particularly relevant to financial advisers, planners and accountants. When explaining more complex investment strategies or retirement planning strategies it should not be assumed those basic underlying principles or terms are already understood by clients. In order to raise this confidence and understanding, promote better communication and decision making, it is therefore important to know the level of confidence and understanding clients are likely to have when it comes to all aspects of the advice being provided.

### **The survey**

The survey was conducted in 2011 with the aim of measuring the levels of tax literacy in Australia. The questions in the survey were designed around the results of previous focus groups. In order to design a valid survey instrument six focus groups were conducted with a total of 25 participants. The focus groups explored tax and superannuation as components of financial literacy and specific areas of tax and superannuation which might impact on positive financial decision making.

The focus groups determined that the following categories were basic concepts of tax and superannuation that should be understood in order to be considered financially literate:

- > understanding the tax equation (taxable income = assessable income - deductions)
- > understanding what deductions one is entitled to
- > understanding how marginal tax rates work
- > understanding the difference between deductions and offsets
- > understanding the tax effects of investing in property
- > basic superannuation concepts.

Apart from 10 demographic questions, the remainder of the survey questions fell into one of three categories: confidence questions; knowledge questions; and attitudinal questions. Generally, each question around confidence in a particular area was matched with one or more ability/knowledge questions. The survey was used to determine an overall confidence score and overall tax literacy score for each participant. The survey was conducted online and there were 604 useable responses after checking and validation. Table 1 presents the demographic details of the sample.

**TABLE 1: Survey sample**

		N	%
Gender	Male	188	31.1
	Female	416	68.9
Age bracket	18-29	190	31.5%
	30-44	231	38.2
	45-54	118	19.5
	Over 55	65	10.8
		604	
Employment hours	Full-time paid work	333	55.1
	Part-time or casual paid work	117	19.4
	Full-time student	75	12.4
	Full-time student working >15 hours per week	58	9.6
	Other (including retired)	21	3.5
Employment category	Working for an employer	496	82.1
	Self-employed/contractor/small business operator	34	5.6
	Other	10	1.7
	I am not in paid work	64	10.6
Education level	Secondary year 10 or less	18	3
	Secondary (to year 12)	89	14.7
	Trade, apprenticeship or other TAFE	97	16.1
	Undergraduate degree (Bachelor)	164	27.2
	Postgraduate degree (Masters, Doctorate, professional)	233	38.6
	Other (coded system missing)	3	0.5
Total income	\$0-\$20,000	113	18.7
	\$20,000-\$49,000	140	23.2
	\$50,000-\$100,000	255	42.2
	\$100,000-\$150,000	55	9.1
	>\$150,000	20	3.3
	Prefer not to say (coded system missing)	21	3.5

**Findings**

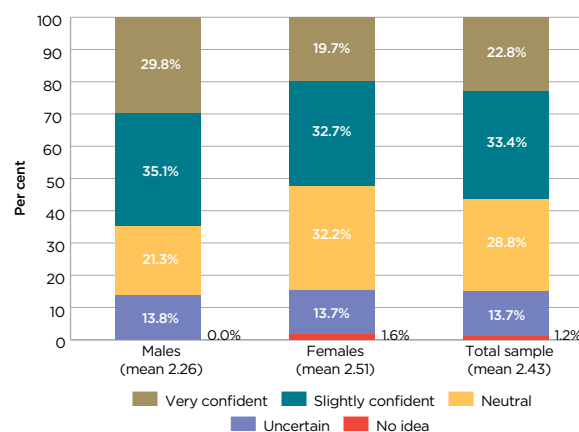
There were 14 questions in the survey which related to participants’ self-assessed confidence in understanding basic tax and superannuation issues. These confidence questions were followed by a series of knowledge questions in order to determine whether there was any disparity between self-assessed confidence and actual understanding.

This paper will focus on the specific findings in relation to overall confidence and how this related to the different demographics. Overall confidence in this paper is expressed as a mean value between 1 and 5 for a corresponding category (1 = very confident; 5 = no idea). This discussion will be followed by an overview of specific questions where self-assessed confidence did not align with knowledge/ability. Comparisons will be made with the 2007 Financial Literacy Foundation research which focused on confidence in broader financial literacy.

**Gender**

Figure 1 shows the overall confidence findings in relation to gender. It shows the mean confidence of males was slightly higher than females. This difference was statistically significant (p=.003). The finding is consistent with previous research which found that males are more confident in their abilities to understand financial concepts than females (Financial Literacy Foundation, 2007, 2008).<sup>3,4</sup>

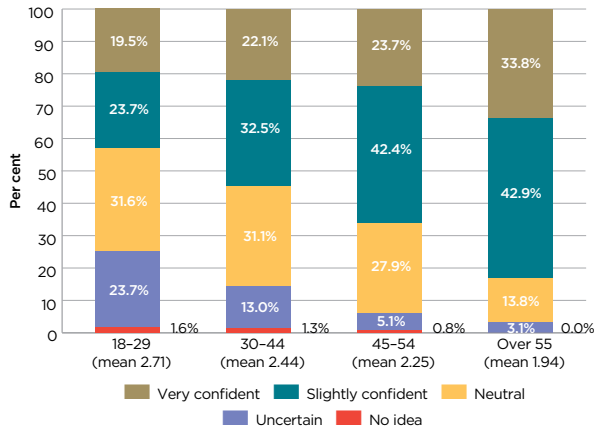
**FIGURE 1: Overall confidence — Gender**



## Age

Figure 2 shows overall confidence in relation to age. It shows confidence gradually increases as age increases. This is partly in line with the 2007 Financial Literacy Foundation research, where confidence generally increased with age but fell slightly in the over-64 age category (Financial Literacy Foundation 2007).

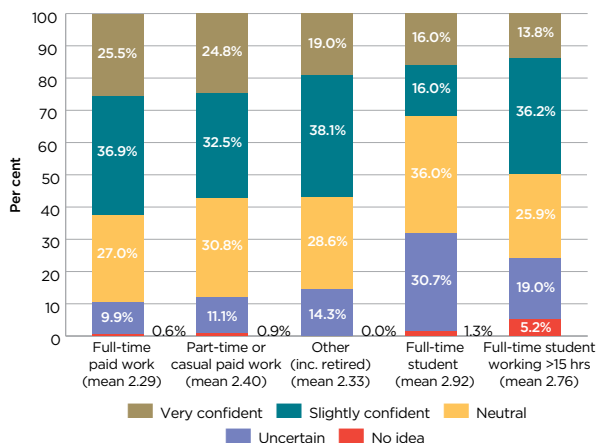
**FIGURE 2: Overall confidence – Age**



## Employment hours

Figure 3 shows the category with the lowest overall confidence was 'full-time students' (working less than 15 hours per week) and those with the highest were in 'full-time work'. This suggests that confidence in understanding basic tax and superannuation issues does not begin to increase until there is some exposure to full-time paid work. The results also showed 'full-time students working > 15 hours per week' had greater confidence than those full-time students with less paid work experience. The 'Financial Literacy Foundation' research did not separately explore results by employment hours. However, the results here were in line with the results in relation to overall 'tax literacy', which indicated that those in full-time or casual paid work were more likely to have a higher Tax Literacy Score (TLS) than those 'full-time students working less than 15 hours per week'.

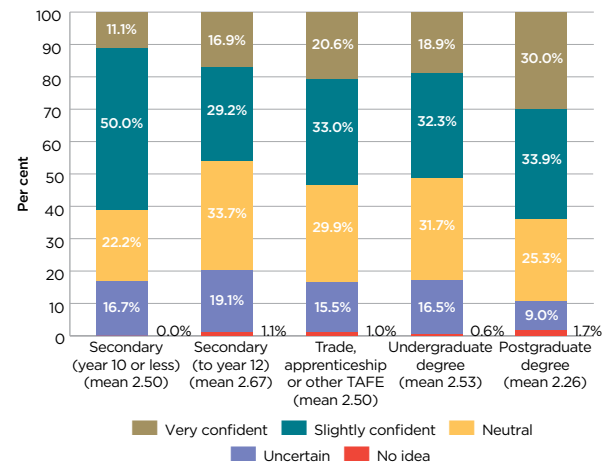
**FIGURE 3: Overall confidence – Employment hours**



## Education

From Figure 4 it can be seen that those with 'postgraduate degrees' had the highest overall confidence. Those with 'secondary (to year 12)' as their highest level of education had the lowest overall confidence. This difference was statistically significant ( $p=0.005$ ). The results are consistent with the broader financial literacy research which suggests that those with lower levels of education are more likely to have lower levels of financial literacy (ANZ 2008). Those with postgraduate education are likely to be more confident in tax and superannuation issues than all other groups with less formal education.

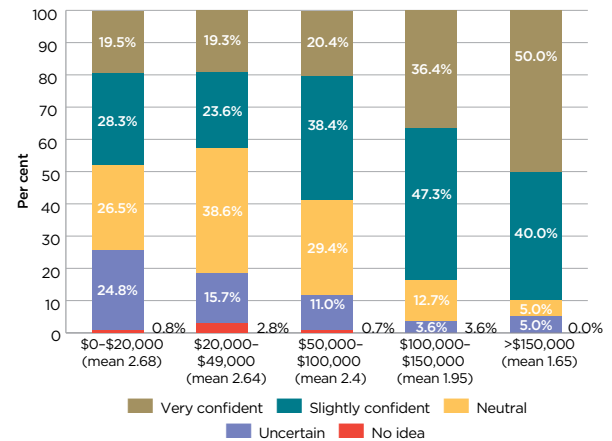
**FIGURE 4: Overall confidence – Education**



## Income

Figure 5 shows that confidence in understanding tax and superannuation concepts generally increases as total income increases. The mean difference in confidence between the lowest and highest income brackets was statistically significant ( $p=0.000$ ). This is in line with the Financial Literacy Foundation research which reported that, in almost all categories tested, confidence increased as income bracket increased (Financial Literacy Foundation 2007, pp. 77-83).<sup>5</sup>

**FIGURE 5: Overall confidence – Income**



The following section will explore the survey findings in relation to confidence in specific areas of taxation and superannuation, and whether confidence aligned with actual understanding for those specific concepts.

### Confidence vs actual understanding of specific concepts

Table 2 presents the findings in relation to some of the specific knowledge questions in the survey (which is available on request from the authors) and how they compared to self-assessed confidence. It shows that 'Confidence in understanding the meaning of Taxable Income' had particularly high self-assessed confidence (mean of 1.59 is between very confident and slightly confident), yet when posed the knowledge questions, only around 50 per cent gave correct responses to both the theoretical and calculation questions. This indicates there may be some misunderstanding about the meaning of taxable income within the population. Conversely, 'Confidence in understanding the meaning of marginal rates of tax' was notably less than the previous question in terms of confidence (mean of 2.70 is close to neutral). However, the correct response rates were significantly higher. This may indicate that participants perceived marginal tax rates to be a more complex area and therefore assessed confidence as lower.

In relation to 'Confidence in understanding the meaning of Deductions', participants' self-assessed confidence was close to slightly confident (but higher than the overall mean confidence of 2.43). However, this did not translate into actual understanding. Participants performed quite poorly (43.5 per cent correct) when posed a question which asked them to calculate the actual cost of a deductible item after taking into account the tax saving. There were also similar misunderstandings in relation to offsets, where a low mean confidence is seen for 'Confidence in understanding the meaning of Offsets' (2.75 is close to neutral).

For the question which asked participants to identify the actual dollar effect of claiming a tax offset (i.e. the fact that an offset is a dollar-for-dollar amount rather than a reduction of taxable income), the correct response rate was quite low (45.4 per cent). This finding supported earlier results of the focus groups where there was significant discussion around the difference between deductions and offsets. This finding is important in situations where the government may be trying to 'sell' a particular policy that involves either deductions or offsets. It may be useful to conduct an education campaign outlining the difference between the two.

**Table 2: Specific questions in survey**

Specific questions	Confidence (1) very confident (5) no idea	Correct %
<b>Confidence in understanding the meaning of taxable income.</b>	<b>1.49</b>	
Applying the meaning of taxable income.		52.3%
Calculating taxable income.		50%*
<b>Confidence in understanding the meaning of marginal rates of tax.</b>	<b>2.70</b>	
Calculating tax payable using marginal rates of tax		71.5%
Applying marginal tax rates to an extra \$1 of income.		74.2%
<b>Confidence in understanding the meaning of deductions.</b>	<b>1.82</b>	
Applying the effect of deductions.		43.5%*
<b>Confidence in understanding the meaning of offsets.</b>	<b>2.75</b>	
Applying the effect of offsets.		45.4%*
<b>Confidence in understanding the meaning of Medicare Levy.</b>	<b>2.00</b>	
Understanding the rate of Medicare Levy.		46.5%*
Understanding how Medicare Levy is calculated.		46.7%*
Knowledge of current rate of compulsory employer superannuation.**		57.0%
Awareness of superannuation being taxed at a lower rate than other investments.**		57.3%

**Notes:** The table compares confidence in understanding particular concepts against actual scores for knowledge questions. Column 2 shows the mean confidence score for the corresponding question described in Column 1. Column 3 shows the correct response % for each of the questions that counted toward the overall tax literacy score.

\* Number of correct responses <50%.

\*\* No corresponding confidence question was posed for these.

The most surprising finding was in relation to the Medicare Levy. 'Confidence in understanding the meaning of Medicare Levy' was relatively high (mean of 2.0 is close to slightly confident), yet only 46.5 per cent of participants correctly identified the rate of Medicare Levy as 1.5 per cent. This is interesting given that the rate of Medicare Levy has remained unchanged for 18 years.<sup>6</sup>

Although overall understanding of superannuation issues was comparatively high, the results nevertheless indicate that 43 per cent of participants were not aware that the rate of compulsory employer superannuation was 9 per cent and only marginally more knew that superannuation was taxed more favourably than other investments. It should be noted that this survey was conducted before the recent changes to compulsory superannuation were announced.

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*These results are consistent with the ANZ survey results which consistently indicate that consumers find superannuation issues more difficult than others. However, these results also indicate that consumers may find basic taxation issues more difficult than superannuation issues. Again, the results are important for government and advisers in terms of what consumers understand (or don't understand) about the current system.*

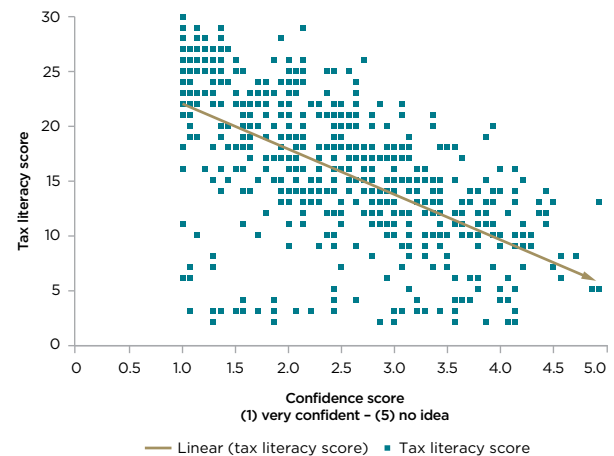
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### Analysis of overall confidence vs overall tax literacy score (TLS)

Figure 6 presents each participant's overall TLS<sup>7</sup> against their overall confidence score.<sup>8</sup> The results show that TLS generally increases as confidence increases. There are some observations where confidence was very high (i.e. in the range 1-2) and TLS was quite low (i.e. in the range 0-10). Interestingly there are almost no observations where confidence is low (i.e. in the range 4-5) and TLS is high, suggesting that overconfidence may not be common in relation to tax and superannuation matters. This finding supports some initial evidence in previous financial literacy research which has suggested that overconfidence is more common in basic areas of finance rather than those more complex areas (Bateman et al. 2012; Financial Literacy Foundation 2007; Gallery et al. 2011).

Statistical analysis showed that overall confidence explained a significant proportion of variance in TLS<sup>9</sup> but that there remained other reasons for variance in TLS. This result supports previous financial literacy research which has indicated that confidence is an important aspect, but that it does not always translate into higher literacy results. Further research will be necessary to explore the extent to which overconfidence (and underconfidence) is significant in the specific demographic groups.

**FIGURE 6: Tax literacy score and confidence**



### Conclusions

This paper has explored overall confidence in relation to tax and superannuation issues within the context of financial literacy. It was argued that although financial literacy has become an important focus for government and other stakeholders, taxation and superannuation issues have largely been excluded from both the measurement and education aspects. This is despite the fact that research in Australia has shown lower levels of literacy in relation to superannuation than in other areas, and that financial confidence tends to be lower for more complex areas. The results presented in this paper indicate that confidence in tax and superannuation issues is likely to be lower for females, younger age brackets, those on lower incomes and those with less exposure to paid work.

These results will provide useful information to government, and finance and education professionals about which segments of the population may be less confident about tax and superannuation issues, as well as specific areas where they are likely to be less confident or have less knowledge.

### Acknowledgement

The author would like to acknowledge the useful comments made by Associate Professor Mark Brimble, Griffith University and Associate Professor Brett Freudenberg, Griffith University in analysing the data for this article.

## Endnotes

- 1 Internationally, 'financial capability' is a more accepted term: it is defined by Kempson, Collard and Moore (2005) as incorporating 'financial knowledge, skills and attitudes', and by Leskinen and Raijas (2005) as 'consisting of an individual's personal characteristics influenced by various factors in his/her micro and macro environment'. In Australia, however, the term financial literacy is more widely used and is defined as 'the ability to make informed judgements and to make effective decisions regarding the use and management of money'.
- 2 The Financial Literacy Foundation was previously a standalone government body prior to its amalgamation into ASIC when the *National Financial Literacy Strategy* was released in 2011.
- 3 In the previous survey, the only category in this prior research where females reported slightly higher confidence than males was in relation to 'ability to understand budget and day-to-day finances' (males agree 89.5 per cent, females agree 91.4 per cent).
- 4 Values for 'no idea' are expressed as 0.0 per cent where there were no participants in that category.
- 5 'Ability to understand budget and day-to-day finances' was the only category where those in the \$50,000-\$100,000 bracket were slightly more confident (92.2 per cent agree) than those in the >\$100,000 bracket (91.2 per cent agree).
- 6 Apart from one-off increases to fund particular projects or policies.
- 7 TLS was calculated by scoring each participant on the knowledge questions out of a maximum of 31 correct.
- 8 Confidence score was determined by calculating the average for each participant against the fourteen confidence questions posed in the survey.
- 9  $R^2 = .36$ ,  $F(1, 602) = 348.75$ ,  $p < .000$ .

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