Parliament of the Commonwealth of Australia

Fourth Report of the
Senate Select Committee on Superannuation

Super — Fiscal and Social Links

Taxation Laws Amendment (Superannuation) Bill 1992

Social Security Legislation Amendment Bill (No 3) 1992
Divisions 16-19 (inclusive)

and related terms of reference

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CHAPTER 1 : INTRODUCTION

1.1 On 5 June 1991, the Senate established a Select Committee on Superannuation to inquire into, and report on, a set of terms of reference (See Appendix A) which was one of the most detailed and comprehensive ever given to a Senate Committee.

1.2 Since its appointment, the Committee has reported on its 17 terms of reference according to four themes:

- the regulation of superannuation which was addressed in the Committee's first report, *Safeguarding Super;*

- the depth and breadth of superannuation coverage which was covered in the second report, *Super Guarantee Bills,* and a background paper titled *Super System Survey;*

- the impact of superannuation on the financial sector was covered in the Committee's third report, *Super and the Financial System,* which also addressed the problem of unfunded liabilities in public sector superannuation; and

- fees, charges and commissions relating to the provision of superannuation. This matter has been addressed in a number of reports and issues papers and is expected to be reported on in early 1993.

1.3 Table 1.1 lists the Committee's reports and papers against the relevant terms of reference.

Table 1.1 List of Committee Reports and Papers

The Committee has presented the following papers and reports to the Senate:

Title	Date	Term of Reference
Super System Survey – A Background Paper on Retirement Income Arrangements in Twenty-one Countries	December 1991	(q)
Papers relating to the Byrnwood Ltd, WA Superannuation Scheme	March 1992	(c) and (e)
Interim Report on Fees, Charges and Commissions in the Life Insurance Industry	June 1992	(g) and (h)
First Report of the Senate Select Committee on Superannuation – *Safeguarding Super* – The Regulation of Superannuation	June 1992	(a), (c), (d), (e), (f), (h), (i), and (j)
Second Report of the Senate Select Committee on Superannuation – *Super Guarantee Bills*	June 1992	(l), (m), (o) and (p)
Super Charges – An Issues Paper on Fees, Commissions, Charges and Disclosure in the Superannuation Industry	August 1992	(g) and (h)
Third Report of the Senate Select Committee on Superannuation – *Super and the Financial System*	October 1992	(d)
Fourth Report of the Senate Select Committee on Superannuation – *Super – Fiscal and Social Links*	December 1992	(k), (b) and (n)

1.4 This report, *Super – Fiscal and Social Links*, the fourth report of the Committee, addresses the taxation of superannuation, its interaction with the social security system, simplification, vesting and preservation in the context of two pieces of legislation referred by the Senate to the Committee on 12 November 1992.

1.5 The Bills, **Taxation Laws Amendment (Superannuation) Bill 1992** and **Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)**, were introduced in the Parliament by the Government following the *Security in Retirement* statement of 30 June 1992. They contain a number of changes which are intended to both simplify superannuation arrangements and to encourage Australians to make greater self provision for their retirement.

Conduct of the Inquiry

1.6 Having taken over 4 000 pages of evidence during more than 25 days of public hearings on these and other matters, the Committee is well placed to comment on the provisions of the two Bills. In view of the fact that the Bills did not exist when the Committee held its initial round of public hearings and, having regard to the complexity of superannuation tax law, the Committee agreed to convene an additional public hearing on Thursday, 26 November 1992 before finalising this report.

1.7 A list of witnesses appearing before the Committee is at Appendices B, C and G and a list of submissions (and other relevant evidence) is at Appendices D and E.

1.8 This report is more detailed than the standard report of a Committee on the referral of a Bill because it addresses three of the 17 terms of reference on the Committee's on-going inquiry. The terms of reference addressed by this report are:

> ... to inquire into and report upon the following matters:
>
> (b) the taxation arrangements which apply to superannuation;
>
> (k) the rules applying to contributions and the vesting and preservation of benefits; and
>
> (n) the possibilities for simplifying superannuation.

1.9 In order to facilitate community discussion, the Committee agreed that, unless otherwise ordered, written submissions would be published on receipt. Likewise, the Committee circulated uncorrected *Hansard* transcripts as soon as they became available. References in the Report to oral testimony are to page numbers in these uncorrected *Hansard* transcripts.

1.10 In order to clarify whether a particular reference is to the Committee's on-going inquiry into superannuation or to the specific inquiry into these Bills (Taxation and Social Security), the following practice has been adopted:

- written submissions to the on-going inquiry are referred to as 'Sub no xx' (the list of submissions to the on-going inquiry is at Appendix E);
- written submissions to the Bills inquiry are referred to as 'Sub no ST xx';
- oral evidence to the general inquiry as recorded in the uncorrected *Hansard* proof appears as 'Evidence, p xx.'; and

- oral evidence to the inquiry into the Bills as recorded in the uncorrected *Hansard* proof appears as 'ST Bills evidence, p xx.'

Amendments Received by the Committee

1.11 During the course of the inquiry the Committee received a number of amendments or suggestions for amendments. Details of these are at Chapter 9.

Appreciation

1.12 The Committee records its appreciation of the written submissions and oral evidence tendered to both its inquiries. The Committee also acknowledges the cooperation of the Parliamentary Secretary to the Treasurer, Senator the Hon Bob McMullan, departmental officers and other witnesses for attending and answering questions during the public hearings. The Committee also records its appreciation of the advice given by Treasury and Australian Taxation Office officials relating to the sections of this report which outline current superannuation taxation arrangements.

1.13 The Committee wishes to express its appreciation of the work performed in the secretariat by seconded officers from The Treasury, Ms Lynne Curran, and the Australian Taxation Office, Mr Gary Bauer.

Minority Reports

1.14 This report contains two minority reports. The first is by Senators Alston and Watson, and the second is by Senator Kernot.

CHAPTER 2 : DESCRIPTION OF THE BILLS AND RELATED TERMS OF REFERENCE

2.1 Superannuation, as it operates in Australia, is highly complex. It involves a labyrinth of government regulations designed to establish fund compliance and security, a plethora of taxation rules to give this form of saving a boost over other forms to encourage self provision within the bounds of prudent fiscal management, and many other provisions to allow it to mesh with age pension arrangements and other principles of social security policy.

2.2 Its complexity has been exacerbated by attempts to fine tune retirement incomes policy via the taxation system. In order that existing entitlements are preserved and equity prevails, these fine tunings have taken effect under phase-in, or 'grandfathering', arrangements which have invariably made superannuation in Australia even more complex. Notwithstanding these changes, it was widely recognised during the inquiry that substantial change needs to be made to the fiscal and social security aspects of retirement incomes policy to achieve the desirable objective of providing all Australians with a secure retirement.

2.3 The Committee also notes that the taxation of superannuation provides substantial government revenue.

2.4 During the inquiry, the Committee was often made aware of the need for the equitable treatment of the different types of retirees, for example, those on Commonwealth age pension benefits, private sector occupational superannuation pensions and self-funded retirement incomes. This report therefore endeavours to address the development of policies which are both equitable and symmetrical in their impact on all retirees.

2.5 One of the aspects of policy symmetry which needs the attention of both Commonwealth and State Governments is that of unfunded public sector superannuation debt. The Committee believes that it is logically inconsistent to pursue a policy of full funding of superannuation in the private sector and at the same time allow unfunded public sector debt to rise. This is a matter which the Committee addressed in its third report, *Super and the Financial System*, which contains a recommendation calling on the Commonwealth and the States to develop a consistent and coherent policy. The Committee believes that, at the very least, a start must be made on the phasing-in of full funding of public sector superannuation.

Previous Conclusions of the Committee

2.6 The Committee, in its first and second reports, made a number of *prima facie* observations about deficiencies in the current policy which have been followed up in this report. The following points were made in this regard:

Superannuation and the Age Pension

- The Committee stresses that, in the long run, the greater the numbers who are independent of the age pension, the greater will be the scope for real increases in the age pension for those who must rely on it.[1]

- The Committee acknowledges that the SGL upholds the 55 year preservation rule. Further, the Committee is well aware of the sound reasons for the rule in so far as it applies to employees who work in occupations which necessitate early retirement, but urges that the Government consider measures to better integrate this aspect of the social security and occupational superannuation systems.[2]

- Unlike most other OECD countries, Australia does not require that retirees take retirement benefits in pension form. In recent years the Government has sought to encourage benefits in this form by having a higher Reasonable Benefit Limit (RBL) for people who take their superannuation benefit as a lifetime ... pension or annuity.[3]

Taxation

- The Committee notes however, that, under current taxation arrangements, there is every incentive for better paid workers to contribute to superannuation and few tax incentives for low income earners. The Committee acknowledges that the current arrangements include some inequity and need to be addressed.[4]

Simplicity

- Superannuation in Australia is a most complex matter. It is provided in and outside the workplace and by a range of financial institutions.[5]

Double Dipping

- One of the problems of this policy which has been the subject of considerable attention during the Committee's hearings is the practice of

1 *Super Guarantee Bills*, p 30

2 ibid, p 65

3 *Safeguarding Super*, p 9

4 ibid, p 31

5 ibid, p 16

'double dipping'. Double dipping involves taking a superannuation lump sum which has received significant tax concessions, consuming it rapidly and then receiving an age pension. Whilst the evidence given to the Committee was largely anecdotal and not based on any systematic longitudinal data, 'double dipping' is common in Australia. It was submitted, however, that there are legitimate uses for lump sums other than purchasing an income stream, for example, paying out mortgages and other debts. Double dipping is facilitated by the preservation age for superannuation benefits being set at a lower age than the age pension age for men (65 years) and women (60 years). It is this policy scenario which allows some retirees who retire before the pensionable age to spend their lump sums and at a later stage become eligible for the full pension or a greater pension benefit than would have been available had the lump sum not been dissipated.[6]

Hardship Provisions

- Retirees who take superannuation benefits not subject to compulsory preservation before age 55 have them taxed at significantly higher rates. Award superannuation contributions and contributions for which tax deductions are allowed are subject to preservation. However, compulsorily preserved benefits can be accessed under the hardship provisions of the *Occupational Superannuation Standards Act* (OSSA), taxed at a pre 55 years rate and used for purposes other than retirement. These issues will be examined in detail in the Committee's third report.[7]

Level of Pensions

- At no stage of the Committee's inquiry was a demand made for the Government to reduce the present level of pension benefit expressed as a percentage of AWE, that is, 25 per cent. Those witnesses representing the interests of welfare groups submitted that the current age pension is too low and needs to be increased.[8]

Changes Proposed in the Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)

2.7 The **Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)** amends the following Acts:

- *Social Security Act 1991;* (the principal Act);
- *Social Security (Family Payment) Amendment Act 1992;*

6 ibid

7 *Safeguarding Super,* p 9

8 *Super Guarantee Bills,* p 18

- *Health Insurance Act 1930;* and
- *National Health Act 1952.*

2.8 Divisions 16-19 (inclusive) of the bill, the only provisions of the Bill referred to the Senate Select Committee on Superannuation, will effect significant changes to retirement incomes policy.

2.9 Division 16 will amend the principal Act to simplify the treatment of managed investments, in respect of the incomes means test for pension eligibility, by assessing income from them on an on-going basis according to actual performance of the previous 12 months.

2.10 Division 17 is designed to exempt from the income and assets tests any money in a superannuation or rollover fund until pension age or until an annuity or pension commences to be payable from the fund.

2.11 Division 18 will extend to listed shares and other listed securities the provisions which apply to managed investments, that is, their growth in value will be taken into account under the means test on social security pensions and other benefits.

2.12 Division 19 is the change under this Bill which has attracted most attention from submitters to the inquiry. It provides that the value of allocated pensions and allocated annuities will be taken into account for the purpose of the assets test, and further provides that they will be income tested according to the fund earning rate.

Changes Proposed in the Taxation Laws Amendment (Superannuation) Bill 1992

2.13 This Bill has five parts which amend the following Acts:

Part 1. Preliminary

Part 2. *Income Tax Assessment Act 1936;*

Part 3. *Occupational Superannuation Standards Act 1986;*

Part 4. *Superannuation Guarantee (Administration) Act 1992;* and

Part 5. *Taxation Administration Act 1953.*

2.14 As foreshadowed in the Treasurer's *Security in Retirement* statement, the legislation:

- sets new limits for the amount of deductions available to an employer or self employed person for contributions to a superannuation fund;

- replaces the existing deduction and rebate arrangements for personal superannuation;

- changes the taxation of pension and rollover products;

- alters a number of entitlements in relation to the rolling over of eligible termination payments, and limits the tax concessions on redundancy, early retirement and invalidity payments; and

- introduces flat dollar RBLs (Reasonable Benefit Limits) as a replacement for salary linked limits.

2.15 The Bill also amends the *Occupational Superannuation Standards Act (OSSA)* by, *inter alia,* allowing superannuation funds to hold a member's benefit for up to 90 days while the member decides whether to rollover the benefits, and permits retirees to transfer their benefits into superannuation funds.

2.16 Finally, the Bill amends the *Superannuation Guarantee (Administration) Act 1992* to bring into force a number of changes foreshadowed when it was debated in the Senate in June 1992 including:

- provision for flat rate contributions under the SGC; and

- extension of the measure to apply before 21 August 1991.

The Scope of the Recommendations made in Addition to Matters Contained in the Bills

2.17 As stated in Chapter 1, and earlier in this Chapter, this report goes further than commenting on the two Bills. To this end it considers the evidence the Committee has received on the related terms of reference and makes recommendations on matters in addition to those contained in the Bills. Furthermore, it covers the preservation age issue, which is expected to be the subject of future legislation/regulation, and recommends that the Government change its policy on early access to superannuation benefits in cases of hardship.

CHAPTER 3 — VESTING AND PRESERVATION OF BENEFITS

Introduction

3.1 The Government's retirement incomes policy has two objectives: increasing the incomes of retirees and reducing the burden of aged care on the national budget. Superannuation, properly designed and administered, can assist in achieving both objectives. The optimum operating conditions to achieve this are:

- **Breadth of cover.** As large a proportion of the population as practicable should be covered. This was the rationale of the taxation concessions which have always applied to both occupational and personal superannuation and was the prime purpose behind the introduction of award superannuation. The latter was only partially successful however, owing to significant levels of both non-compliance and non-award employment. The introduction of the Superannuation Guarantee Charge as from 1 July 1992 has the effect of making superannuation compulsory for all employees, including casual, part-time and intermittent employees.

- **Depth of cover.** The greater the contributions in respect of each employee, the greater is the foundation for the ultimate accumulation of benefits. Award superannuation provided for employer contributions equal to three per cent of earnings. Under the SGC legislation, employer contributions are set to rise progressively to nine per cent by 2002. A further three per cent may come from employee contributions. The Government has announced a decision to support the inclusion in existing superannuation award provisions of the rates of contribution to superannuation funds required by the Superannuation Guarantee Scheme as they become operative.[1] Contributions of 12 per cent over a working life of 40 years should be sufficient to provide a retirement income of at least 40 per cent of earnings.[2] The age pension is currently about 26 per cent (single), or 43 per cent (married), of AWE.[3]

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[1] House of Representatives *Hansard*, 2 April 1992, p 1767

[2] John Dawkins, *Security in Retirement*, AGPS Canberra June 1992, p 19

[3] Treasury sub no 195, p 5

- **Optimum net returns.** Given the level of employer and employee contributions, the benefits payable by superannuation funds (other than defined benefit funds) are governed by the extent to which trustees are successful in optimising the net returns of the funds and by the level of taxation on contributions and earnings. The maximisation of investment returns must be tempered by considerations of liquidity and safety and prudential controls are imposed to minimise losses due to faulty investment decisions and fraud. Outgoings on administration, fees and commissions need to be contained. These aspects of fund operation have been dealt with either in earlier reports of the Committee or elsewhere in this report. The Government, through the OSS Regulations, exercises a supervisory role and has foreshadowed a tightening of its prudential controls.

- **Minimum leakage.** Ideally, all net accumulations of funds, whether from contributions or fund earnings, should be retained until needed to produce retirement income and not dissipated on changing jobs or becoming unemployed, as frequently occurs. The vesting of employer contributions and the preservation of benefits, so that they may not be drawn until retirement from the workforce, are important in this context. The Government's policy regarding the early release of funds on hardship grounds is also critical in the context of containing leakages.

- **Provision of retirement income.** The final link in the chain is closed when the benefits are taken in the form of, or are used to generate, retirement income. The use of benefits for any other purpose, however necessary or worthy, detracts from the central purpose of superannuation, that is, the provision of retirement income. Furthermore, anything which tends to weaken the incentive to use benefits to produce retirement income operates to frustrate the implementation of government policy.

3.2 To date, policies have been, or are being, developed to strengthen the first three of these elements. With regard to the fourth, minimum leakage, a start has been made by the Government to improve vesting and preservation rules and proposals for a further strengthening are set out in this chapter.

3.3 In order to secure the final link – the provision of a retirement income stream – two problems need attention: the continuing preference to take benefits as lump sums rather than income streams, and the disincentive to invest for retirement income inherent in the interaction of the means test and income tax with the age pension. These two related issues are dealt with in the following chapter.

Concepts

3.4 In the context of superannuation, vesting is the conferring on a fund member the ownership of all or part of the accrued benefit applicable to that member. As virtually all funds have for many years recognised the members' ownership of their own contributions and as OSS Regulations 6 and 7 now require the vesting of members' contributions and accrued earnings, the aspects of vesting that remain to be addressed relate to the ownership by members of benefits arising from employers' contributions.

3.5 Preservation is the withholding of access to the whole or part of fund benefits by members until they have attained a specified age, or until the occurrence of a specified event, such as retirement, death or permanent incapacity.

3.6 Portability enables members leaving one fund to transfer the whole of their vested benefits to a new fund on change of employment.

Application

3.7 Under both award and SGC superannuation arrangements, all benefits are immediately vested in the members and preserved to retirement after reaching age 55.

3.8 The position with employer-sponsored occupational schemes is more complex and is governed by the individual trust deeds as well as by the OSS Regulations. Some trust deeds have no provision for the vesting of employer contributions, but most provide for a phasing in of vesting with length of service. In accumulation schemes, the vesting is based on the actual employer contributions in respect of each employee. Defined benefit schemes usually base pre-retirement vesting on a multiple of the employee-financed benefits.

3.9 Current government policy, as announced in the 1989/90 Budget, provided for the vesting of all employer-financed benefits accruing after 1 July 1995 at a rate of 10 per cent for each subsequent year of service, so that after 10 years of service from that date, full vesting would apply to all benefits accruing from that date. However, it has since been announced that:

> ... in light of the Superannuation Guarantee Charge and given the importance of vesting for labour mobility, the Government will review the previously announced 1995 vesting proposals.[4]

[4] John Dawkins, op cit, p 56

3.10 Compulsory preservation of benefits is a relatively new concept in Australia. It currently applies to benefits arising from private superannuation arrangements, tax-assisted member contributions, employer contributions under award superannuation and any new or increased employer financed and vested benefits brought in after 21 December 1986.[5]

3.11 It should be recognised that the earnings component of final benefits usually exceeds the contributions component by a substantial amount. The Association of Superannuation Funds of Australia (ASFA) estimates that two-thirds of typical final benefits comes from fund earnings and only one-third from contributions.[6] The vesting of these earnings is thus an issue of major concern.

Significance of Vesting

3.12 The significance of vesting, or the lack of it, lies in its impact on the withdrawal benefits payable to members, especially those in employer-sponsored schemes, who resign or whose employment is otherwise terminated prior to retirement.

3.13 In the absence of vesting, resigning members are entitled only to the benefits attributable to their own contributions. The benefits attributable to the employers' contributions – typically at least equal to, but often significantly larger than, the employees' contributions – remain in the funds. The consequences of this may be one or more of the following:

- reserves, including excess reserves, may be higher than otherwise;
- employer contributions may be reduced or deferred;
- employee contributions may be lower than otherwise; or
- the level of residual benefits may be greater than otherwise.

3.14 All of these outcomes result in the transfer of tax-assisted benefits from resigning members to employers and/or to employees other than those in respect of whom the contributions were initially made. A further consequence is the discouragement of employment mobility through the limitation on portability of superannuation benefits.

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[5] OSS Regulations 9 – 11

[6] Evidence, p 2127

3.15 Resigning members are clearly the losers under these conditions: they are deprived of benefits which have been set aside on their behalf and which they could claim to have earned. More importantly, their retirement benefits are greatly diminished, thereby reducing their capacity to finance their own retirement. Among those most adversely affected will be those who, whether by choice or by the nature of their occupations, change jobs frequently and women, particularly those whose careers are interrupted by family commitments.

3.16 The government is also a clear loser, as the lower level of self-financed retirement incomes necessarily increases the call on age pensions.

3.17 Sponsoring employers and fund members continuing to retirement are the winners, sharing the benefits outlined above. As the AMP points out, the vesting of employer contributions is designed to encourage longer service. Employers wishing to do this could gradually increase contributions, thereby achieving similar results.[7]

3.18 The increases in fund surpluses resulting from the retention of unvested contributions in respect of withdrawing members, and from the failure to fully vest earnings on members' contributions prior to 1987, was illustrated in evidence by Mr David Hughes, a trustee of the Shell Australia Contributory Pension Fund, and Mr Bernard Maloney, of Chifley Superannuation Services.[8] Mr Maloney also claimed that some employers deliberately brought about redundancies with the objective of augmenting fund surpluses prior to repatriation.[9]

3.19 It has been estimated that half of the Australian workforce changes jobs every five years.[10] If this estimate is anywhere near the mark, the potential loss of benefits attributable to the lack of full vesting must be extremely large.

Significance of Preservation

3.20 If the level of vesting were to be increased, a further problem would remain: resigning employees would receive considerably larger withdrawal benefits from their superannuation funds than they now do; but there would be no assurance that these additional sums would be held and reinvested for retirement – the temptation to dissipate all or part of the benefits may be

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[7] Sub no 120, p 39

[8] Evidence, pp 637,696

[9] Evidence, pp 697-699

[10] Beth Quinliven, *Picking the Right Superannuation Scheme*, p 53, cited by Attorney-General's Department, sub no 107, p 25

difficult to resist. Any additional benefits resulting from improved vesting provisions would therefore need to be preserved if they are to be fully effective, that is, if they are to make a full contribution to retirement incomes.

3.21 But preservation itself is not a sufficient guarantee of an improvement in self-financed retirement. Where preservation is compulsory under the OSS Regulations, the age specified is 55, that is, benefits may not be withdrawn before then without incurring tax penalties. A further limitation is that the benefit may be paid only on retirement from the workforce, a proviso which, however, does not readily lend itself to definition, monitoring or enforcement.

3.22 As age pensions are payable at age 60 for women and 65 for men, there is a gap during which it is possible for retirees to draw their superannuation benefits and then rearrange their affairs so as to meet the requirements of the means tests for the age pension, a practice known as 'double dipping'. Among the options for the achievement of a reduction in assets are repayment of mortgages and other debts, upgrading of homes, overseas travel, purchase of motor vehicles and other major items and more sophisticated schemes involving the placement of funds with family members or trusts.

3.23 Under current legislation, the Department of Social Security (DSS) requires all pension applicants to provide information on financial transactions during the five years prior to application date in order to ensure that any assets disposed of without adequate consideration are taken into account in the assets test. Thus, a male applicant at age 65 may have up to five years to rearrange his affairs without fear of scrutiny.[11]

3.24 There are, regrettably, few statistics available which would provide a reliable indication of the magnitude of the double-dipping problem. Some light is thrown on the problem by ABS figures on intended and actual disposal of lump-sum superannuation payments, quoted by the Treasurer and reproduced in the Tables 3.1 and 3.2.

3.25 The figures in the following tables indicate that around 80 per cent of persons aged over 45 intend to use their lump sums primarily to produce retirement income or to pay off mortgages or on improved housing, with the housing component accounting for about 12-15 per cent of the total. Other figures quoted by the Treasurer dealt with the actual, rather than the intended, use of lump sums. They indicated that, while almost 80 per cent of the people actually used most of their lump sums for those purposes, the housing component accounted for about one-quarter of the total.[12]

[11] Evidence, p 127

[12] John Dawkins, op cit, p 351

3.26 Weaknesses in these figures are, firstly, that the classification of each lump sum is determined by its principal use and no apportionment to other uses is made. Secondly, they relate to persons, not to dollars, so that lump sums of $10 000 and $1 000 000 are given equal weight. Thirdly, the inclusion of housing leads to a number of uncertainties of interpretation. While the repayment of a long-established mortgage or other indebtedness is consistent with the optimisation of retirement income, this is not so obviously the case where a mortgage is entered into late in a working life, or even after retirement, to expand or otherwise upgrade housing, on the assumption that a superannuation lump sum will be available to pay it off.

Table 3.1 Persons aged 45 to 74 covered by a superannuation scheme: Intended disbursement of lump sum payments from superannuation schemes

Intended disbursements of lump sum payment from a superannuation scheme (a)	1988 (b) per cent	1991 BY AGE 45-54 per cent	55-64 per cent	65-74 per cent	Total
Roll it over/invest in ADF deferred annuity or other superannuation schemes	38.5	42.3	32.8	22.1	39.5
Purchase an annuity	*	2.3	1.6	0.0	2.1
Invest the money elsewhere	28.7	25.2	28.8	48.4	26.5
Pay off home/pay for home improvements/buy a new home	11.8	14.2	15.6	14.7	14.6
SUBTOTAL	**79.0**	**84.0**	78.9	85.3	**82.6**
Pay for a holiday	10.8	7.9	10.4	5.3	8.6
Other	10.2	8.1	10.7	9.5	8.8
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

(a) Represents the primary purpose of the disbursement
(b) Disaggregated data by age is not available

Source: ABS *Superannuation Australia*, November 1991 (Cat no 6319.0) Unpublished ABS data for 1988.

Table 3.2 Persons who retired from full-time work early and who belonged to a retirement scheme: actual disbursement of lump sum payments from superannuation schemes

Disbursement of lump sum payments (a)	1986 '000	1986 per cent	1989 '000	1989 per cent
Invest in rollover funds (b)	28.8	9.3	92.5	18.0
Invested the money	133.1	43.1	190.8	37.2
Paid off home/pay home improvements	77.7	25.2	122.6	23.9
SUBTOTAL	**239.6**	**77.5**	**405.9**	**79.1**
Paid for holiday	16.4	5.3	30.3	5.9
Other	53.0	17.2	76.8	15.0
TOTAL	**309.0**	**100.0**	**513.0**	**100.0**

(a) Represents the primary purpose of the disbursement
(b) This includes annuity, deferred annuity and approved deposit fund investments

Source: ABS, *Retirement and Retirement Intentions, Australia*, November 1986 (Cat no 6238.0)
ABS, *Retirement and Retirement Intentions, Australia*, November 1989 (Cat no 6238.0), unpublished data

3.27 The Treasury, in its modelling of future superannuation savings, adopts an 'unfavourable' assumption that 'every lump sum up to $30 000 is dissipated' for the entire population of retirees.[13] Dr Vince Fitzgerald estimates that the annual leakage due to non-preservation is currently in the order of $2.5 billion, but will gradually decline, as shown in Table 3.3.[14]

Table 3.3 Transfer Leakage

Year	$ bn	Year	$ bn	Year	$ bn	Year	$ bn
1991	2.76	1996	2.03	2001	1.52	2006	1.14
1992	2.54	1997	1.97	2002	1.40	2007	1.10
1993	2.36	1998	1.90	2003	1.31	2008	1.08
1994	2.20	1999	1.79	2004	1.24	2009	1.06
1995	2.10	2000	1.66	2005	1.18	2010	1.04

3.28 Notwithstanding these uncertainties, there can be little doubt that, to a significant but unknown extent, one of the key objectives of the Government's retirement incomes policy is being frustrated.

[13] SGC evidence, p 16

[14] Sub no 263, p 2

3.29 The preservation age is not the only factor contributing to the encouragement of double dipping. The now almost standard practice of taking benefits in the form of lump sums rather than as pensions is also a major contributor – without this practice, the problem could not arise. And even with compulsory preservation up to the pension age, dissipation would still be possible, even though much more difficult to conceal. The worst, if unlikely, case for the applicant would be a five-year wait under the retrospective examination provisions.

Significance of Portability

3.30 If all funds provided for full portability, both inward and outward, and if all contributions were fully vested and preserved, it would be possible for the lifetime contributions in respect of every employee to be transferred with each job change and to be accumulated in a single fund on retirement.

3.31 However, relatively few funds permit such transferability so that, even with full vesting and preservation, an employee would retire with benefits spread over a number of funds – one for each employer. Portability therefore assists both labour mobility and administrative efficiency.

3.32 While a degree of portability exists between some funds in the public sector, full portability is still some distance away. The New South Wales Government recently told the Commonwealth Joint Parliamentary Committee on Public Accounts that:

> One of the most significant barriers to mobility between public sectors has been the lack of portability of superannuation between the Commonwealth and the States ... Currently, [transfer] arrangements require detailed negotiation between the two funds in each case and are complicated by the operation of different systems for the provision of death and disability insurance.[15]

3.33 Notwithstanding this firmly expressed view, the Department of Finance told a Senate Estimates Committee only a few weeks later that:

> ... despite many conversations and approaches to various State Governments, the Queensland Government was the only government that was prepared to adopt a reciprocal arrangement with the Commonwealth Government under the [pre-1991] arrangement – much to our disappointment, I might add.[16]

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[15] JCPA inquiry into *The Management of Human Resources in the Australian Public Service*; submission by NSW Government, p 403

[16] Evidence, Senate Estimates Committee B, 22 September 1992, p 177

3.34 The Committee believes that portability among funds in the private sector will not become general until its beneficial effects and practicability have been demonstrated in the public sector. Further, it believes that the Commonwealth should take the lead in bringing this about.

Recommendation 3.1

The Committee recommends that, as a matter of urgency, the Commonwealth should initiate discussions with the States with a view to facilitating portability between them and that these objectives be achieved by the end of 1993.

Further Vesting

3.35 In view of the key role played by vesting and preservation in the building up of the capacity to earn income in retirement and of the large, unvested benefits accrued in occupational funds, the Committee expected to have placed before it well argued and well documented evidence on these topics. However, no estimates of the amount of accrued, but unvested, benefits were placed before it and there was little analysis of arguments for and against the vesting of these benefits, other than unsupported assertions. No consideration was given to partial vesting.

3.36 Many of those associated with the establishment and management of superannuation funds were opposed to any further vesting of employer-financed benefits.[17] The general view was that this would raise costs to employers by eliminating the subsidies inherent in the foregoing of unvested benefits through early termination. According to this view, the probable outcome would be a discouragement of voluntary benefits, leading to major restructuring, or even closure, of sponsored funds. Some believed that the exposure to higher resignation withdrawals would require the maintenance of higher levels of liquidity, at the expense of higher yielding but less liquid investments such as equities.

3.37 A few even felt that the very existence of defined benefit funds would be threatened. Others considered that the voluntary nature of the contributions should render them inviolate to any outside direction, particularly if any retrospectivity was involved.

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[17] ASFA, sub no 89; Institute of Actuaries, sub no 108; Noble Lowndes, sub no 80; LIFA, sub no 114; the Accounting bodies, sub no 119; National Mutual, sub no 100; and AM Corporation, sub no 96.

3.38 On the other hand, supporters of increased vesting as one way of increasing retirement incomes included AMP, (who also stressed the need for defined benefit funds to develop appropriate vesting formulas or, failing that, OSS Regulations), the Commonwealth Attorney-General's Department, the South Australian Employers' Federation, ACOSS and Mr Cliff Newman, a member of the Superannuation Committee of the Institute of Actuaries.[18] Clayton Utz pointed out that full vesting would virtually eliminate the accumulation of 'unplanned' surpluses in defined benefit funds and the resulting disputation over their ownership.[19]

3.39 Treasury, which has the principal role in the development of superannuation policy, acknowledged the vital importance of vesting and preservation and identified the inadequacies of the existing arrangements.[20] However, it made no comments on the desirability or feasibility of increasing the vesting of pre-1995 accrued benefits.

3.40 On 30 June 1992, the Government announced a series of proposed changes to the superannuation rules. As noted above in paragraph 3.9, the proposed changes to the vesting rules, scheduled to operate from 1995, are under review.

3.41 The Committee believes that it is important to eliminate, or at least reduce, the leakage of funds set aside for retirement income but dissipated on early termination of employment through inadequate vesting and preservation arrangements. In particular, it does not believe that it is legitimate to use these sums to subsidise either employers or other fund members. Accordingly, it believes that serious consideration should be given to seeking a mechanism whereby a greater proportion of existing employer-financed benefits in occupational funds could be vested without serious harmful effects on the funds.

3.42 It is probable that an increase in vesting requirements would have some adverse impact on business costs. Mr Michael Devlin, of AM Corporation, pointed out to the Committee that:

> ... the withdrawal surplus is a major part of the funding formula. Most defined benefit funds would have funding rates approximately double what they currently are if there was full vesting.[21]

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[18] Sub nos 120, 107, 185, 35 and 3

[19] Evidence, p 622

[20] Sub no 195, pp 31-34

[21] Evidence, p 746

3.43 Consideration of increased vesting therefore raises the question of equity: to what extent, if any, should funds set aside for the retirement of one employee be used to subsidise the retirement of others or the labour costs of employers? The Committee notes the growing acceptance of universal superannuation as an integral component of the retirement income mix, a necessary element of which is provision for retirement throughout the working life. The lack of universal vesting of employer contributions cuts across this principle. If an increase in vesting results in increased business costs, then that must be recognised as an inevitable consequence of the removal of any subsidy.

3.44 Greater vesting need not affect liquidity requirements and long-term investment goals if proper action is taken with regard to preservation, as there would not be any immediate call to pay withdrawal benefits. It need not adversely affect defined benefit funds if, for this purpose, they are treated in a similar manner to accumulation funds. As to the voluntary nature of the contributions and the retrospectivity involved, it should be remembered that employer contributions are generally made under contract as part of the conditions of employment and are tax deductible; vesting would merely ensure that they were used for the purpose for which they were made. Retrospectivity would both remedy an injustice and serve the national interest.

3.45 The Committee believes that the present situation is highly unsatisfactory, but accepts that an attempt to solve it with a sweeping recommendation for full and immediate vesting could be counter productive. Nevertheless, it believes that some action is necessary.

3.46 A recent survey indicates that employer contributions to sponsored funds are, on average, almost double those of employees.[22] It follows that the vesting of employer contributions in these funds up to the level of already-vested employee-financed benefits should pose few difficulties and would still leave substantial sums unvested. The impact could be further softened by phasing in the change over a period of years.

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[22] Noble Lowndes, *Australian Benefits Survey*, 1992/93

Recommendation 3.2

The Committee recommends that the Government take steps to provide for the mandatory vesting, as from a date to be determined, of a significant part of the employer-financed benefits in occupational superannuation funds accrued to that date but not otherwise vested. An example of a possible scheme is:

(i) The amount to be vested shall be not less than each member's contributions, plus fund earnings, to that date.

(ii) The amount should be vested over a ten year period.

(iii) Where existing rules would, if applied, result in a greater sum being vested in any member, those rules should apply.

Recommendation 3.3:

The Committee recommends that, in relation to Recommendation 3.2 regarding increased vesting requirements, the base date should be the date on which the Government announces the adoption of the policy in order to protect the interests of then-existing members. Employees retrenched or dismissed after the announcement, but before the base date, should be entitled to whatever vesting they would have been entitled to if the base date had been the date of their termination.

Recommendation 3.4:

The Committee recommends that immediate vesting of all employer contributions subsequent to the vesting base date be compulsory.

Preservation Measures

3.47 In order to be fully effective, measures to improve vesting need to be accompanied by measures requiring the preservation of the vested benefits. The ideal arrangement from the standpoint of both maximising retirement benefits and simplifying of implementation would be a requirement that all benefits should be preserved.

3.48 Such a requirement would raise issues of equity, for example, in relation to the treatment of those member contributions subsequent to 1 July 1983 which receive no tax assistance. This was recognised in the new preservation arrangements announced on 30 June 1992 which will come into force on 1 July 1996. Under these proposals, all benefits will have to be preserved, except for the greater of:

- a member's undeducted contributions after 1 July 1983; and
- a member's cash vested resignation (or retrenchment) benefit as at 1 July 1996 (or other specified annual review date), indexed to average weekly ordinary time earnings.[23]

3.49 These provisions will both simplify the rules and significantly increase the amounts subject to preservation. However, the Committee notes that there would be a four-year gap between the announcement and the implementation of the proposal, prolonging the scope for preservation leakage to no good purpose. The need for such a delay in the implementation of a proposal, which is essentially a simplification measure and which has no immediate financial consequences, was not made clear in *Security in Retirement* and the Committee believes that the timing should be reconsidered.

Recommendation 3.5

The Committee recommends that the commencement date of the new rules to substantially increase the amount of benefits to be compulsorily preserved, as announced in *Security in Retirement*, should be reconsidered by the Government with a view to earlier commencement.

3.50 With regard to the preservation age, the Committee takes the view that all reasonable steps should be taken to make double dipping as difficult and as transparent as can be achieved with reasonable equity. Accordingly, it takes the

[23] John Dawkins, op cit, pp 70-71

view that the closer the preservation age is to the pension qualifying age, the more likely is this objective to be achieved. It firmly believes that the onus lies squarely on those favouring an earlier preservation age to justify their position, rather than on those who favour lifting the age.

3.51 In this respect, it takes issue with the ACTU, which expressed the view that the onus lay on those wishing to raise the age to quantify the level of double dipping and to prove that a material contribution to its reduction would thereby be made.[24] Very few of the other witnesses defended the existing preservation age of 55.

3.52 The Australian Retirement Fund (ARF) stressed that employees did not like preservation and that 55 was 'probably the right age' at present; but had no views on its long-term suitability.[25] Mr Dale Hennessy, Director of the Queensland Government Superannuation Office, while conceding that some preservation was acceptable, seemed to be advocating double dipping when he told the Committee that:

> Most people would see superannuation as legitimately providing a bridge between retirement from the work force and the age of entitlement to the social security pension ... It is hardly rational to restrict a person's access to a sizeable superannuation asset until the age at which access to social security is permitted and in the process deprive the person of a reasonable standard of living in the meantime.[26]

3.53 The Treasury conceded that 'the current age discrepancy undoubtedly presents the potential for such practices' and pointed out that 'raising the preservation age would ensure that superannuation benefits are withdrawn closer to age pension age.'[27] Yet it stopped short of making a firm recommendation to that effect and went on to outline three indirect measures designed to discourage double dipping, namely:

- tax penalties on benefits taken before pension age;
- the inclusion of deemed rates of return on early benefits as income for means test purposes; and
- requiring all early benefits to be taken as pensions.[28]

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[24] SG evidence, pp 51,19

[25] Evidence, p 330

[26] Evidence, p 1177

[27] ibid, p 33

[28] ibid, p 34

3.54 Furthermore, in its oral evidence, the Treasury would not concede that there were economic or financial reasons for raising the preservation age to 60, claiming that it was 'not a straightforward question'.[29]

3.55 DSS recognised that 'the issues of vesting and preservation are central to superannuation' and favoured a faster phasing-in period for the proposed 1995 vesting changes. However, while conceding that raising the preservation age to 60 was 'an option that merited some consideration', it was more concerned at the large volume of benefits paid out before age 55.[30] Such payments, excluding those attributable to redundancy and invalidity, amounted to 37 per cent of all eligible termination payments (ETPs) in 1989-90.[31]

3.56 The majority of the Committee welcomes the Government's decision to raise the preservation age to 60 years but notes that some witnesses, notably ACOSS, The Institute of Actuaries and LIFA, favoured an earlier phase-in timetable.[32]

Recommendation 3.6:

The Committee by majority recommends that the preservation age be raised to 60 years in accordance with the phasing in proposals outlined in *Security in Retirement.*

Recommendation 3.7

The Committee further recommends that the Government should, as a matter of urgency, initiate research into all aspects of appropriate retirement ages and the extent of double dipping in Australia.

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29 Evidence, p 2109

30 ibid, p 1277/8

31 Australian Taxation Office, cited by The Treasury, sub no 195, p 32

32 Evidence, pp 2158, 2117, 2116

Special Provisions

3.57 The Committee notes that certain occupations have long-established retirement ages below the general level of 65 years, for example, the armed services, police, airline pilots and coal miners. It sees no reason why those special cases should not be provided for in the Regulations, but would urge caution in expanding their number, particularly where retirement ages below 60 are specified.

3.58 Unemployment, for those over the age of about 45 years, is a particularly intractable problem and many of those affected seek early payment of their superannuation benefits.[33] There is provision under the OSS Regulations for special treatment in cases of hardship and the ISC informed the Committee that such requests were running at an annual rate of 30 000 per year in March 1992. The rate for the whole of 1991 had been 9 000.[34] Such requests are processed in the first instance by fund trustees and LIFA reported a doubling of applications in each of the years 1991 and 1992. About 85 per cent of applications were recommended by fund trustees for approval, but the ISC was somewhat more strict and withheld approval in many cases. LIFA noted that the processing of these requests was a substantial administrative burden and sought promulgation by the ISC of more specific, written guidelines.[35]

3.59 The Committee acknowledges the work of the Australian Financial and Credit Reform Association in providing counselling services to those in financial difficulty. The Association's policy is that superannuation benefits be accessed only under the following circumstances:

- All options to resolve the financial hardship of the consumer have been canvassed in an informed manner;
- The benefit of the access will make a substantial difference to the financial situation of the consumer;
- The current benefit of access to the consumer outweighs the long term benefit [of preservation to retirement age];
- The accessed funds are to be used to protect an existing home or existing income protecting asset or for necessary emergency medical treatment;

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[33] The average duration of unemployment for those aged 45 and over is 82 weeks, compared with 44 weeks for those under 45 – ABS Labour Survey, Cat 6203

[34] Evidence, p 1853

[35] LIFA, paper presented to ASFA Seminar on Financial Hardship, Canberra July 1992

- The accessed funds are not to be used to supplement income;
- Access is at the initiative of the consumer; and
- Access should be determined by an authority independent of industry operating on the following guidelines:
  - The procedure be efficient and with definite expeditious guidelines, and
  - The procedure be at no cost to the consumer.[36]

3.60 The Committee notes that the principal purpose of superannuation is to provide for retirement and thereby alleviate possible future hardship. It should not be regarded as a fund available for stand-by relief during the period of a normal working life. In those circumstances, the Committee believes that social security is the proper channel through which emergency relief is available, rather than through a loss of future superannuation benefits.

3.61 Overseas countries, most of which operate defined benefit schemes, do not allow early release of benefits in either the pension or a lump sum form. The Committee notes that ready availability of lump sums has contributed to the increase in applications for early release of benefits.

3.62 The Committee believes the Government should address the following questions:

- Is early access to benefits severely undermining the objectives of retirement incomes policy?
- Can early access to a lump sum benefit make a significant difference to the long term well being of the recipient?
- Is there a consistency of treatment of applications for hardship assistance?

3.63 The Committee notes that there is a cyclical trend for persons to seek early access to retirement benefits. Also, there appears to be a tendency for some applicants seeking this form of assistance to see their lump sum as being a remedy for immediate problems which could be solved under some other arrangement, for example, social security assistance or re-negotiations and/or rearrangement of personal finances.

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[36] Sub no 271

3.64 If this trend is allowed to continue, early access to benefits on the scale currently being experienced will result in a significant leakage of superannuation funds.

3.65 The Committee believes that the abolition of early access to benefits in cases of hardship should be one of Australia's long term retirement incomes goals. However, the Committee was unable to reach a unanimous agreement on a short or medium term implementation timetable for this policy.

Recommendation 3.8:

The Committee recommends that the ISC, the organisation which it believes is best placed to administer this policy, work towards the achievement of the Committee's long term goal to eliminate early access to retirement benefits. The Committee also recommends that the ISC promulgate a policy to ensure consistency of treatment of applications and further recommends that the ISC develop a more limited set of rules setting out clearly the circumstances for hardship assistance.

CHAPTER 4 : SUPERANNUATION AND THE AGE PENSION

Lump Sums or Pensions

4.1 Superannuation benefits may take the form of lump sums, life pensions (usually with a reversionary benefit to a surviving spouse), or a combination of the two. Lump sums, in turn, may be used to purchase annuities, or other income streams such as allocated pensions, invested to provide income, applied to the reduction of debt or spent.

4.2 In its background report, summarising retirement income policies in 21 overseas countries, the Committee noted that 'lump sum retirement benefits generally represent a small part of total retirement income'.[1] It went on to point out that, in contrast, Australia exhibited a strong preference to take superannuation benefits in the form of lump sums. It attributed this to:

- taxation arrangements which historically have favoured lump sum payments over annuities and pensions. The 1988 taxation changes, which included amendments to the RBL, remedied this situation to some extent but anomalies remain;

- the small size of benefits, particularly for older workers who have only recently received award superannuation. Such benefits would be insufficient to purchase an annuity;

- the lack of facilities to preserve superannuation entitlements until 1983 when Approved Deposit Funds and Deferred Annuity Funds were created;

- a perception that lump sum benefits could be used to pay off the mortgage or finance consumer expenditure on change of employment; and

- a desire to bequeath capital assets.[2]

4.3 Other attractions of lump sums, depending on individual circumstances, include:

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1 Senate Select Committee on Superannuation, *Super System Survey,* Canberra, 1991, p 1

2 ibid, p 2

- *Flexibility.* The retiree has control over the amount and direction of investments and of the amount drawn down each year.

- *Inflation-proofing.* The retiree may be able to invest the lump sum in such a way as to avoid, or minimise, the erosion of purchasing power through inflation.

- *Certainty.* The receipt of a lump sum avoids the risk – however slight it may be – of failure to maintain pension payments owing to fraud or fund insolvency.

- *Double-dipping.* It is often possible for retirees to arrange their affairs so that they can receive a lump sum and retain their eligibility for the age pension.

4.4 From the standpoint of the funds, the payment of lump sums offers a simple and economical means of discharging liabilities, whereas pensions involve regular payments, with associated maintenance of financial and tax records, for many years. Lump sums have the further advantage for fund managers of passing the inflation risk on to the retiree.

4.5 On the other hand, there are distinct disadvantages and risks associated with a reliance on lump sums:

- *Investment Skills.* Retirees may lack the investment skills necessary to balance income maximisation against risk aversion, to hedge against inflation and to make the sum last the required life span. Some who commence their retirement with those skills may lose them as they grow older. Others may be the victims of incompetent or unscrupulous investment advisers or managers.

- *Dissipation.* Some retirees will be unable to resist the temptation to spend excessively on such items as holidays and consumer goods. Others may do so as part of a deliberate plan to engage in double-dipping.

4.6 Governments are well aware of the disadvantages of lump sums: if they fail to yield adequate retirement income, whether through a lack of investment skills or through dissipation, the retirees will fall back on the age pension and the relevant superannuation taxation concessions will have been wasted.

4.7 By contrast, benefits taken in the form of pensions or annuities are backed by substantial investments, professionally managed, a regular lifetime income is assured and indexation for inflation can be obtained. Dissipation is impossible and the whole of the benefit is therefore applied to the provision of retirement income.

Proposals for Encouraging the Use of Pensions

4.8 Most of the major participants in the industry, together with the principal departments concerned with superannuation, favoured a strengthening of measures for the encouragement of pensions and annuities in their evidence to the Committee.

4.9 The Alexander Consulting Group proposed that the maximum lump sum should be 20 per cent of the total benefit, subject to a proviso that, where the total value of all benefits was $50 000 or less, the whole could be taken as a lump sum.[3]

4.10 Mercer Campbell Cook and Knight expressed the view that further encouragement of pensions and annuities through the taxation system was needed, as well as a widening of the eligibility criteria to enable funds to provide annuities directly to retirees.[4]

4.11 Noble Lowndes proposed that there be no distinction in the tax treatment of the pre- and post-1 July 1983 components of lump sums and that they be taxed as follows:

- Benefits received prior to age 60, less undeducted contributions, be taxed at 25 per cent.
- Benefits received after age 60, less undeducted contributions and amounts below the threshold, be taxed at 20 per cent.
- The threshold for post-60 payments to remain at $73 776, indexed to AWOTE (Average Weekly Ordinary Time Earnings).
- Concessional components in respect of permanent and total disablement to be eliminated and the beneficiaries encouraged to take an income stream, subject to the ordinary 15 per cent rebate.[5]

4.12 The Institute of Actuaries was another organisation favouring the use of the tax system to 'give positive encouragement to provision of pensions as opposed to lump sums.'[6]

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[3] Sub no 61, p 7

[4] Sub no 79, p 8

[5] Sub no 80, p 5

[6] Sub no 108, p 35

4.13 The Accounting bodies, while regarding it as 'logical' that an increased proportion of benefits should be taken in the form of pensions, felt that 50 per cent should remain available in lump sum form.[7]

4.14 AMP favoured a limit on lump sums, determined by way of either a percentage of total benefit or a fixed dollar amount.[8] The Department of Social Security (DSS) adopted a similar approach, proposing either a 50/50 lump sum/pension split or adopting the current ETP tax threshold ($73 776) as a lump-sum maximum.[9]

4.15 The Superannuation Economics Research Group of the University of New South Wales did not believe that preferential tax treatment would be successful in achieving a substantial switch to annuities and, in consequence, advocated a regulation requiring all benefits to be taken as annuities, at least to the point at which age pension eligibility ceases.[10] The group also pointed out that, while indexation was necessary in order to counteract the erosion of the purchasing power of annuities through inflation, this requirement substantially increased the price of annuities and therefore reduced their immediate rates of return.[11]

4.16 In order to overcome this problem, the Group proposed a major change in the structure of government debt. It advocated a substantial increase in the proportion of the debt in the form of inflation-indexed bonds (currently 1.2 per cent of the total) and long-term debt – that is, 15 years or more to maturity (currently less than two per cent). Such a combination would enable annuity providers to 'lock up' their annuity obligations and their supporting government securities and 'throw away the key'.[12] The Committee believes that this proposal has considerable merit and warrants investigation by the Government.

Recommendation 4.1:

The Committee recommends that the Government investigate the possible expansion of long term debt instruments with a view to affording annuity providers greater opportunities to provide lower-cost indexed products.

7 Sub no 119, p 20

8 Sub no 120, p 13

9 Sub no 127, p 12

10 Sub no 150, pp 19, 20

11 ibid, p 20

12 ibid, p 21

4.17 The Treasury, while recognising the 'clear advantages of pensions and annuities from a retirement incomes policy perspective' also recognised a 'legitimate' role for lump sum benefits. It therefore opposed a prohibition on lump sums but supported either a direct limitation on lump sums or an increase in the attractiveness of benefits taken as income streams.[13]

Government Policies

4.18 Governments have so far been reluctant to impose any compulsion to take pensions or annuities instead of lump sums but have relied on taxation measures to achieve this objective.[14] The main provisions, current or proposed, are:

- Higher RBLs where benefits are taken in the form of pensions or annuities. This increases the level of taxpayer support for the relevant contributions.

- Exemption from tax of the income of funds generated to provide pensions or annuities.

- A 15 per cent rebate on the amount of pensions and annuities from taxable funds included in assessable income, that is, the gross amount less the allowable UPP deductions. This will effectively exempt from tax rebatable pensions and annuities up to about $17 000 per year.

- Previous inconsistencies between the tax treatment of pensions and annuities will be removed.

4.19 The alternative route using compulsion is attractive in its apparent simplicity but would lead to some complications nevertheless. A 100 per cent pension requirement would not yield worthwhile income supplements if the capital sums were small. An arbitrary figure of, say $20 000, under which lump sums could be drawn, would be required. One could then expect the development of schemes to prevent marginal entitlements from exceeding the cut-off figure. Beneficiaries with entitlements just above the minimum would receive no lump sum at all and would no doubt feel aggrieved.

4.20 A 100 per cent requirement would also rule out the use of superannuation benefits to pay out housing loans and other debts. If exceptions were to be made, questions would arise as to what, if any, upper limit would be

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[13] Sub 195, p 37

[14] The Government's latest proposals are set out in *Security in Retirement*, John Dawkins, Canberra, June 1992

appropriate and how should debts incurred in anticipation of a lump sum benefit should be dealt with.

4.21 Partial requirements, for example 50 per cent in pension and 50 per cent in a lump sum, would offer more flexibility but would still create problems at the margin. If $20 000 is regarded as minimum worthwhile investment, then the lump sum restriction would cut in at $40 000, whereas a retiree with a $39 000 benefit could take the whole as a lump sum. No doubt phasing-in arrangements could be devised to lessen problems of this nature but the result could well be the introduction of a new wave of complexity in an already over-complex area.

4.22 On balance, the Committee endorses the policy of encouraging pensions and annuities through the tax system and welcomes the simplification measures announced in *Security in Retirement.* However, it believes that, in conjunction with the research into retirement ages and double dipping recommended in Chapter 3, the extent and application of lump sum benefit payments should be monitored with a view to the imposition of specific regulation if the taxation measures should prove to be ineffective.

Allocated Pensions

4.23 According to the DSS, fewer than one per cent of retirees use their lump sum benefits to purchase lifetime annuities, notwithstanding their official encouragement.[15] The low figure is no doubt a reflection of the perceived disadvantages of annuities, notably their relatively low return and consequent high cost, and the lack of residual value, even in the case of early death. In response to these perceptions, a market has developed over the last six years for a less rigid form of annuity known as an allocated pension or cash-back pension.

4.24 These pensions may be purchased from ETPs or rollover funds and take the form of individually managed investments which may be drawn down at rates determined annually by the beneficiaries, but within stipulated minima and maxima, determined as follows:

- Minimum drawing – $\dfrac{AB}{PVF}$
- Maximum drawing – $\dfrac{AB}{PVF/80}$

[15] Sub no 127, p 16

where:

- **AB** is the individual's fund balance as at 1 July each year;

- **PVF** is the Pension Valuation Factor published by the ISC for the age of the person each 1 July, that is , the annuity factor for a CPI-indexed, 85 per cent reversionary annuity payable for life; and

- **PVF/80** is the annuity factor for a non-indexed, non-reversionary annuity payable to age 80.

4.25 If the pensions meet these standards, they are treated as superannuation funds, in that the investment income is not taxed as such, but is treated in the same way as annuity income when drawn.

4.26 Allocated pensions thus have the taxation and professional management advantages of annuities and any undrawn balances on death can be disposed of by will. There is no provision for a guaranteed rate of return and no indexation to compensate for inflation, consequently returns tend to be higher than for annuities. They are thus a half-way house between privately managed investments and purchased lifetime annuities and have been growing in popularity. According to AM Corporation, one of the main providers of allocated pensions, allocated pensions have now captured more than half of the total annuity market, as shown in Table 4.1.

Table 4.1 RETIREMENT INCOME STREAMS – NEW BUSINESS AND TYPE[16]

Income Stream Type	Quarter Ending 31/3/92	% of Market	Quarter ending 30/6/92	% of Market	Quarter ending 30/9/92	% of Market
Term annuity	31.31	16.62	26.34	15.14	23.20	11.56
Term Annuity with RCV	70.72	37.54	76.60	44.04	60.94	30.36
Total term annuities	102.03	54.16	102.94	59.18	84.14	41.92
Lifetime Annuity	19.36	10.28	12.34	7.09	12.49	6.22
Total Annuities	121.39	64.44	115.28	66.27	96.63	48.14
Allocated pensions	66.98	35.56	58.67	33.73	104.12	51.86
TOTALS	188.37	100.00	173.95	100.00	200.75	100.00

[16] Sub no ST 17, attachment

4.27 As allocated pensions further the Government's objective of using superannuation benefits for the provision of regular income streams, the taxation advantages attaching to pensions and annuities have been extended to them.[17]

4.28 The rationale behind the Government's thinking was amplified by an ISC Assistant Commissioner at a recent superannuation conference. Among his observations, the following are significant:

- The marketing of allocated pensions coincided with policy decisions by Government in 1989 and 1990 to send clear signals to the industry that it preferred benefits to be taken more in income stream form.
- The dimension that allocated pension brought to the policy problem was to force policy advisers to address the question as to what is acceptable as an income stream for retirement income purposes.
- To confine the meaning of income streams to a traditional pension or annuity would be to unnecessarily narrow it *to the detriment of policy* [emphasis added].
- The definition [of a retirement income stream] ... should be general in its application.
- The key characteristics [of a retirement income stream] are that the payments must be made at least annually ... must be greater than a prescribed minimum ... and ... less than a prescribed maximum [see paragraph 4.24].
- Providing the payments satisfy these requirements, they would be considered a superannuation pension or rollover annuity and, accordingly, a retirement income stream.
- This approach ... encompasses both traditional pensions and annuities as well as income streams where the future pension or annuity payments are not defined at the time the pensions commence to be paid.[18]

4.29 The Government has thus taken a positive decision to define annuities in a manner which embraces allocated pensions in furtherance of its policy of encouraging income streams in preference to lump sums. The definition would be brought into effect through the tax system.

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17 *Security in Retirement*, op cit, p 10

18 Mike O'Neill, *Allocated Pensions: Are they Set to Boom?* address to ASFA National Superannuation Conference, October 1992, pp 1-2

Allocated Pensions and Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)

4.30 Under the proposed amendments to the *Social Security Act* the Government will treat both unrealised capital gains and income applying to the assets underlying allocated pensions as earned income for the age pension means test, notwithstanding their exemption from income tax in the same way as the supporting assets for annuity incomes. Furthermore, the capital value of allocated pensions will be included in the assets test, whereas that of annuities is disregarded.

4.31 The Department of Social Security (DSS) rationale for the revised treatment is:

- it brings the treatment of allocated pensions into line with other types of similar investments;
- it is consistent with the principle that the decision to defer receipt of income until a later date is a personal one, rather than one which should be supported with a higher rate of pension; and
- continuing to assess allocated pensions on a receipts basis when the investor can vary the payments and determine when income is received could encourage investors to defer receipt of income.[19]

4.32 DSS further contended that the main impact of the legislation would be that, for those with investments below the assets test thresholds, it would bring forward the assessment of income to when it is earned, rather than when it is received.[20]

4.33 In clarifying its position regarding the treatment of term annuities compared to the proposed changes in treatment of allocated pensions, DSS stated that it would be reviewing the treatment of the former by the end of January 1993.[21] The Committee will maintain an interest in this review process.

4.34 Under the operation of the income test, each $200 per year of assessed income above the threshold has the effect of reducing the age pension by $100 and, under the assets test, each $1 000 of assets above the threshold brings a

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[19] Sub no ST 17, p 2

[20] ibid

[21] ibid, p 39

pension reduction of $104 per year. DSS estimated that the change in the treatment of allocated pensions would save about $2 million in a full year.[22]

4.35 DSS also told the Committee that it was 'not necessarily the case' that the tax and social security treatments of particular investments needed to be identical. Although allocated pensions had many features in common with complying superannuation pensions, they should, on balance, be subject to the standard social security procedure of treating income on an accrual basis.[23] 'What we are attempting to do is provide neutral treatment vis-a-vis other similar sorts of investments.'[24] The justification for the change given in the Explanatory Memorandum accompanying the Bill was that, as drawings were variable, allocated pensions operated 'in a similar way to a bank account ... at the recipient's discretion'.[25]

4.36 AM Corporation submitted to the Committee a schedule showing how each retirement income vehicle would be affected by the new rules (See Table 4.2). According to AM, the Bill would reduce the pension entitlement of certain persons by over $2 600 per year.[26]

4.37 AM Corporation proposed an amendment for the legislation which, amongst other things, excluded allocated pensions and annuities from the new definition of 'managed investment' as proposed in the Bill, that is, allowing these products to be treated in the same way as all other superannuation products and annuities in respect of both taxation and social security treatment.[27]

4.38 In a supplementary submission, DSS estimated that the cost of AM's proposal, relative to the provisions of the Bill, would be between $13 million and $20 million by 1996-97, giving a cost over the next five years of between $50 million and $77 million.[28]

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[22] ST evidence, p 34

[23] ibid, p 38

[24] ibid p 41

[25] Social Security Legislation Amendment Bill (No 3) 1992, Explanatory Memorandum, p 76

[26] Supplementary evidence, sub no ST 17

[27] ST evidence, pp 30-34

[28] Sub no ST 18, supplementary submission of 3 December 1992. DSS used rates of return of seven and ten per cent in making these estimates and assumed that the allocated pension market would continue to grow at current rates.

Table 4.2

RETIREMENT INCOME STREAMS

DSS TREATMENT

An Example

An individual commences an annuity or allocated pension using the following superannuation benefit:

	$
Pre Component	50 000
Post Component	50 000
Total Rollover	100 000

Life expectancy is say 15 years and the allocated pension earns 10% investment income. A pension or annuity or drawn-down payment of $8 000 is made in the first year.

Retirement Income Stream	Assets Test	Income Test	DSS Pension
	$	$	$
Allocated Pensions/Annuities			
Current rules	Nil	4 667	6 737
Proposed rules	100 000	10 000	4 085
Life Annuities			
(Current rules)	96 667	1 133	7 959
Term Annuities (15 years, nil RCV)			
(Current rules)	96 667	1 333	7 959
Term Annuities (15 years, 100% RCV)			
(Current rules)	100 000	8 000	5 073
ADF Drawdowns (pre age 65)			
Current rules	100 000	10 000	4 085
Proposed rules	Exempt	800	7 959

Unrealised Gains and the Income Test in Relation to the Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)

4.39 The Government proposes to amend the Social Security Act to provide that net unrealised capital gains on listed securities, other than bonds and debentures, should be brought to account in the income test in the same way as now applies to managed investments. Losses on similar investments accruing during the same period will be allowable as an offset against these profits.

4.40 In foreshadowing this change to the 1992-93 Budget papers stated that:

> The assessment of income for income testing purposes will be expanded to include accruing capital gains and losses made *during the previous twelve months* on listed shares and other securities (hitherto only dividends have been assessed)... [emphasis added][29]

4.41 A concurrent statement by the Department of Social Security stated that: 'Capital growth on shares will be included under the income test ... any losses ... will be allowed to be offset against any gains on shares.'[30] A subsequent press statement by the Minister, Dr Blewett, stated that the proposed change 'treats the capital growth of shares as income and enables shareholders 'to offset capital losses against gains'.[31]

4.42 The Committee believes that a reasonable interpretation of these statements is that:

- the dollar amount of capital gain over the twelve months prior to assessment date is to be treated as income, together with any ordinary distributions, which are already assessable;
- where two or more different investments are held, the net capital gain from the portfolio as a whole, together with total distributions, is assessable;
- capital losses may be offset against dividend income;
- if, over a period, there is no net capital gain, there should be no assessment of income; and
- changes in values prior to acquisition, or prior to the holder becoming a pensioner, whichever occurs later, are disregarded.

4.43 The Committee believes that this interpretation is fair, logical, simple and equitable, given the acceptance in principle of the assessment of unrealised gains. It requires no calculation beyond simple addition and subtraction and implies no assumptions about the future.

4.44 The decision is being put into effect by amendments to the *Social Security Act* 1991, contained in Division 18 of the Social Security Legislation

[29] *Budget Statements 1992-93: Budget Paper No 1*, p 3.97

[30] DSS *1992-93 Budget Information*, p 57

[31] Minister for Social Security *Media Release No 46/92*

Amendment Bill (No 3) 1992. Clause 116 of the Bill sets out the formula to be used in assessing the gains and losses for the purposes of the means test.

4.45 The Council on the Ageing (COTA) raised several objections to the proposal:[32]

- Fixed interest investment provides pensioners with the bulk of their private income and, as no capital growth accrues to such investments, they cannot be compared with shares.
- Pensioners should have the right to invest in shares as a hedge against inflation.
- While unrealised gains result in pension loss, there is no penalty if the shares are sold and the growth realised.
- If unrealised growth exceeds dividends, a pensioner will have a negative cash flow.
- It is unfair to assess a benefit which may never eventuate.
- Applying an income test to what is obviously an increase in capital is unacceptable.
- It is inequitable not to include an inflation adjustment.
- Unrealised losses can be set off only against gains in the same period but, as share prices usually move up and down together, there will be very limited opportunity for offsets.
- The formula exaggerates gains and understates losses, so that, even if these cancel out over an investment period, assessable income is deemed to have occurred.

4.46 The Australian Stock Exchange and the Institute of Actuaries tendered similar criticisms.[33]

4.47 The DSS responded to the effect that:

> ... shares are just being brought into line with other forms of investments which are assessed on an accruing basis;

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[32] Sub no ST 22

[33] Sub no ST 23 and ST 25

> Real estate is far more difficult ... unlisted securities are an administrative problem ... shares are much easier to address; and
>
> [If there is a general rise in share prices but no change in dividends] the person is then in a situation of needing to make a choice ... whether just to let things go or whether he needs to recoup that in some other way, perhaps by utilising other assets or selling some proportion of his shares.[34]

4.48 In relation to the timing of valuations of securities held by part pensioners, DSS advised that the Department would be 'doing reassessments every quarter. That will be done automatically...' on the basis of data purchased indicating movements in share prices.[35]

Income Test and Income Taxes

4.49 Eligibility for the age pension is subject to meeting means tests on both income and assets. The tests are applied independently and the amount of pension is governed by whichever test produces the lower pension.

4.50 The income test, as applying at 30 June 1992, provided that each dollar of weekly income in excess of $42 (single) or $74 (couple) resulted in a reduction of 50 cents in the pension. The effect of this test on pensions is shown in Table 4.3.

Table 4.3 – Effect of Income Test on Age Pensions[36]

	Single Person		Married Couple	
	$ per	$ per year	$ per week	$ per year
Full pension:	153.05	7 959	255.30	13 276
Allowable non-pension income:	42.00	2 184	74.00	3 848
Means test threshold:	195.05	10 143	329.30	17 124
Pension ceases at non-pension income of:	348.00	18 096	584.00	30 368

4.51 Thus, increases in non-pension income, for example from annuities or investments, within the allowable limits, are fully reflected in the disposable income of pensioners. Using multipliers derived from current annuity rates (see Table 4.4 below), it can be shown that means-test free incomes may be derived

[34] ST Bills evidence, pp 34, 35

[35] ST Bills evidence, p 35

[36] Source: Department of Social Security

from investments of up to about $26 000 (single male), $33 000 (single female) and $60 000 (married couple).

Table 4.4 : Immediate Annuities per $100 000[37]

	Single Life Guaranteed 10 years CPI Indexed		Joint life and survivorship (85% payable to survivor) Guaranteed 10 years CPI Indexed
	Male 65 $ pa	Female 65 $ pa	Male 65/ Female 60 $ pa
AMP	8 035	7 094	6 282
Friends'	8 416	7 480	6 695
L&G	7 762	6 844	6 010
Mercantile Mutual	7 929	6 669	5 575
National Mutual	6 762	5 797	4 342
Norwich	8 099	7 208	6 493

4.52 Using the same multipliers, it will be seen that the pension cut-off points will be reached with investments of about $220 000 (single male), $270 000 (single female) and $480 000 (married couple).

4.53 It is therefore clear that, for the foreseeable future, the great majority of retirees will continue to be eligible for, and can be expected to apply for, age pensions, whether full or part. They will be affected by, and sensitive to, the income means test, which reduces any increase in non-pension income above the threshold by 50 per cent through pension reductions.

4.54 The Government announced in 1989 that, by 1995, all age pensioners, both full and part, will be exempt from income tax. Until then, the following provisions[38] will continue to apply:

- Age pensions, along with other incomes, are subject to tax.
- Full pensioners receive a tax rebate equal to the tax otherwise payable on incomes up to the means test threshold, effectively making such incomes tax free.
- Income in excess of the thresholds is subject, firstly, to a pension reduction equal to 50 cents for each dollar. The remaining 50 cents is subject to income tax at 20 per cent, or ten cents.

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37 Source: *Personal Investment* December 1992, p 68

38 Rates used for illustration are those applicable to the 1991/92 financial year

- The pensioner tax rebate is reduced by 12.5 per cent of the additional net income, or 6.25 cents of each 50 cents increase net of means test.

- Initial income in excess of the thresholds is therefore subject to a combined pension withdrawal and tax rate of 50c + 10c + 6.25c per dollar, or 66.25 per cent.

- When non-pension income reaches $5 561 (single) or $7 691 (couple), Medicare levy becomes payable at a phase-in rate of 20 per cent, or ten cents of each 50 cents remaining after the means-test pension reduction.

- This phasing-in of the Medicare levy raises the withdrawal and tax rate to 76.25 per cent.

- At non-pension incomes of $7 127 (single) and $10 229 (couple), the Medicare levy reverts to the standard rate of 1.25 per cent,[39] or .625 cents out of 50 cents, bringing the withdrawal and tax rate down to 66.875 per cent.

- The pensioner rebate cuts out at $17 102 (single) and $23 624 (couple), reducing the withdrawal and tax rate to 60.625 per cent, a rate which is maintained until the pension cuts out at $18 096 (single) and $30 368 (couple).

4.55 The foregoing summary illustrates firstly, the great complexity of the taxation of part pensions, secondly, the abrupt changes in impact and, thirdly, the high combined impact of pension withdrawal and taxation. These range from 60.625 per cent to 76.25 per cent on non-pension incomes above the means-test threshold and average 67.3 per cent over the whole range of part pensions. This contrasts with the marginal tax rates, including Medicare levy, payable by general taxpayers of 21.25 per cent for incomes up to $20 700, and 39.25 per cent on additional income up to $36 000. The maximum marginal rate for general taxpayers is 48.25 per cent for that part of income which exceeds $50 000.

4.56 Many pensioners, faced with the loss of two-thirds of any investment income through the combined effects of the means test and income tax, are likely to be deterred from making investments to supplement their pensions. There will be a strong temptation to organise their affairs in a manner which maximises their pension incomes.

[39] The Medicare levy was raised to 1.4 per cent in the 1992/93 Budget

4.57 In announcing the proposed tax exemption for part pensioners, the Government stated that its purpose was 'to remove disincentives to individuals undertaking retirement savings and thereby to encourage greater self-provision in retirement'[40] and commented that the combined effects of pension withdrawal and income tax:

> ... not only distort savings and investment behaviour of pensioners and those saving for retirement, but also cause resentment, confusion and compliance difficulties for pensioners facing two separate systems of administration.[41]

4.58 The Committee endorses this view and welcomes the decision to exempt all age pensioners, both full and part, from income tax. However, it should be noted that, even then, those pensioners will still be confronted with the pension withdrawal rate of 50 per cent, a rate which could discourage self-provision for retirement.

4.59 Incomes of those of pensionable age immediately above the pension cut-off point of around $18 000 would, in the absence of special provisions, be subject to tax of about $2 500. In order to smooth out the taxation rates on incomes above the pension limit, it will be necessary to phase out the rebate until it reaches zero and the ordinary tax scale is reached. This need was acknowledged by the Treasurer in a written reply to a question in the Senate.[42]

4.60 If the rebate is phased out at a rate which maintains the marginal tax rate at the pension withdrawal rate of 50 per cent, the ordinary tax scale would not be reached until a taxable income of about $47 000, an unacceptably high figure. As ordinary tax rates (including Medicare levy) rise from 21.25 per cent to 39.25 per cent at $20 700, it might be appropriate to increase the marginal tax rate to 60 per cent at that point. In this event, the rebate would cease at around $30 000, or roughly AWE.

4.61 The position with regard to married couples is a little more complex, but clearer if attention is directed towards the desired outcome rather than the process of reaching it. Each partner receives a pension somewhat lower than single pension and each is taxed separately. Pensions cease to be payable when combined income is a little over $30 000, or $15 000 each. Assuming non-pension income is equally spread, the application of the formula suggested above would commence at about $15 200 and the rebate phase out at $23 500. Complexities arise when non-pension income is unequal, where the income of

[40] Budget Paper No 1, 1989-90, p 4.9

[41] ibid, p 4.10

[42] Senate *Hansard*, 12 October 1992, p 1619

one partner may exceed the top of the second taxation bracket and where spouse rebates may be involved. However, it should be possible to ensure an outcome for married couples consistent with the formula.

Recommendation 4.2

The Committee recommends that the Government proceed with its announced intention to rebate all income tax otherwise payable by age pensioners.

4.62 Whilst implementation of the Government's proposal supported by these measures would certainly result in an immediate loss of revenue, to the extent that they encourage the generation of additional non-pension income, revenue would benefit by 50 per cent of that additional amount through savings in pension payments.

Means Test — Assets

4.63 A means test is also applied to assets, other than the principal residence, of pension applicants and recipients. Assets in excess of $110 750 (single) and $157 500 (married) have the effect of reducing the pension at the rate of $104 per year for each $1 000 of assets. Higher limits are set for non-homeowners: $190 250 (single) and $237 000 (married).

4.64 The same pension reduction – $104 per year – results from an increase in income of $208 per year as results from an increase in assets of $1 000. The implicit earning rate on assets is therefore 20.8 per cent. This rate is unrealistic when government bond rates are around eight to nine per cent, cash management funds around five per cent and bank term deposits around six to seven per cent. The deeming rate on bank balances for age pension purposes is currently five per cent.

4.65 The holding of assets is thus heavily penalised in contrast with their income equivalent. As the test least favourable to the pensioner is applied, once assets exceed the means test threshold, the assets test will be the determinant of pension eligibility. Is this designed to encourage annuities as against bequests?

4.66 So severe is the test that investments over the threshold amount of $110 750 will actually cost more in reduced pension than the income earned, except in the unlikely event that returns exceed 10.4 per cent.

4.67 Some commentators have argued that the means-test threshold is very generous and that, in consequence, the pension attrition rate must of necessity be steep to prevent access to pensions by the wealthy. But if that is the case, the proper course of action would be to reduce the threshold to a level comparable to the income threshold, with an additional allowance for household and personal possessions which cannot be expected to earn income.

4.68 If that could be achieved, it would then be both possible and desirable to link the income and assets tests via a realistic interest rate – for example, the deeming rate on bank balances. Where assets included bona fide investments in income-earning ventures, such as farms, small businesses or equities which were actually yielding less than the deeming rate, such lower earning could be the amount subject to the test.

Recommendation 4.3

The Committee recommends the assets test be aligned with the income test via the application of realistic, market-related interest equivalents, subject to:

(a) a reasonable allowance, for example $50 000, for personal and household possessions; and

(b) inclusion of actual income on bona fide income-earning assets.

Tax Inconsistencies

4.69 To the recipient of a part pension, reductions in net income, whether by way of pension attrition through the means test or by way of income tax, attrition of pensioner rebate or Medicare levy are identical in impact – all transfer income from the pensioner to the Government. It follows therefore that a smooth transition from dependence on the age pension to fully self-funded retirement will be facilitated where definitions, concepts and practices are consistent as between the taxation and social security legislation.

4.70 For example, tax law treats each individual separately: the incomes of husband and wife are taxed independently, although a rebate is allowed for dependent spouses and any unused pension rebate is transferable. By contrast, for age pension means test purposes, all income and assets are allocated equally to husband and wife, irrespective of the actual income earner or asset owner. This difference makes financial planning more complex and can lead to

inequities where, for example, a married superannuation pensioner may be fully taxed on a single income, whereas an age pensioner couple on the same income might pay lower, or even no, tax.

Recommendation 4.4

The Committee recommends that the Treasurer and the Minister for Social Security form a working party to examine income tax and social security legislation with a view to maximising the consistency of definitions and treatment of matters of common concern to the two systems and that the report be tabled in Parliament by the end of 1993.

CHAPTER 5 : TAXATION – INTRODUCTION

Overview

5.1 Taxation has a range of purposes with respect to superannuation. First, it is a means of raising revenue. Second, in the absence of a more appropriate head of power under the Commonwealth Constitution, it is the Federal Government's primary means of regulating the industry.[1] Third, it is a means of encouraging outcomes consistent with the Government's retirement incomes policy.[2] Fourth, the granting of tax concessions increases the attractiveness of saving through superannuation.[3] Finally, tax concessions are a means of concentrating savings and retirement income provision into a medium over which the Government can exercise some control.[4]

5.2 The easiest way to consider the taxation of superannuation is by reference to the clearly identifiable stages that wealth passes through in the superannuation process. There are essentially three phases through which this wealth passes and at which taxes may be levied and tax expenditures provided, namely:

- prior to entry to the superannuation fund;
- in the fund – as it generates investment income; and
- after it leaves the fund.

5.3 In general, the approach adopted in Australia compared to overseas is unique. Australia's approach:

- provides tax incentives (through a mix of deductions and rebates) for member and employer contributions to superannuation funds and taxes deductible (but not rebatable) contributions upon entry to funds;

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1 First Report of the Senate Select Committee on Superannuation *Safeguarding Super* 1992, Chapter 3

2 ibid, see Chapter 2 for a review of Government Retirement Incomes Policy.

3 ASFA sub no 89, p 12

4 ibid

- taxes the investment income (including capital gains) of the fund at concessional rates (and allows offsetting credits); and
- taxes end benefits at concessional rates.

5.4 Professor Knox provided a useful illustration of the tax treatment of superannuation in other countries at Table 5.1.[5] It can be seen from this that the usual approach is to levy taxes on end benefits.

Table 5.1 A Summary of the Taxation of Occupational Pensions in some Developed Countries.[1]

Country	Contributions[2]	Investment Income	Benefits[3]
Australia	Employer: deductible Employee: limited deductible 15% tax on deductible contributions	Tax at 15% less offsets	LS 0% to $68 628 15% over $68 628 P: taxable minus 15%
Canada	Employer: deductible Employee: deductible	Tax exempt	LS: unavailable P: taxable
France	Employer: deductible Employee: deductible	Not applicable[4]	LS: unavailable P: taxable
Ireland	Employer: deductible Employee: deductible	Tax exempt	LS: tax free up to 1.5 x salary P: taxable
Japan	Employer: deductible Employee: uncommon	Low tax rate	LS: 50% tax free P: taxable
New Zealand	Taxable	Taxable	Tax exempt
South Africa	Employer: deductible Employee: deductible	Tax exempt	LS: taxable P: taxable
United Kingdom	Employer: deductible Employee: deductible	Tax exempt	LS: tax free up to 1.5 x salary P: taxable
USA	Employer: deductible Employee: no deductible	Tax exempt	LS: taxable P: taxable

Notes:

1. Almost all countries have upper limits on the contributions or benefits permitted. These have not been shown as they normally affect only a small proportion of the workforce. Further, they do not alter the taxation approach adopted.
2. The term 'deductible' under contributions means that the employer, and in some cases the employee, can claim tax deductions or rebates for their contributions. That is, the contributions are paid from pre-tax income and the tax is deferred.
3. Abbreviations used: LS – lump sum payments; P – pension payments.
4. The French pension system is funded on a pay-as-you-go basis which means that a fund of significant size is not established.

[5] Knox D *Options for Taxing Super* sub no 52, p 13

5.5 It should be noted that almost all tax concessions are granted for complying superannuation funds. A complying superannuation fund is generally a fund that has met the Occupational Superannuation Standards Regulations (OSS Regulations). Where a fund has satisfied the Insurance and Superannuation Commissioner that it should be granted complying status, the Commissioner will issue a certificate to this effect.[6] There is also provision for the Commissioner to grant complying status at his discretion where special circumstances exist.[7] The taxation treatment of a non-complying superannuation fund is generally not concessional but similar to a normal investment vehicle. As such, most of the discussion in this report will focus on the taxation of complying superannuation funds. The Committee observed in its first report, *Safeguarding Super*, that the penalty for failure by trustees to comply with OSSA (i.e. loss of complying status and therefore loss of concessional tax treatment) is unsatisfactory.[8] Furthermore, the Committee approves of the move towards sanctions and penalties being applied to trustees and managers rather than fund members.

5.6 The extent of government support for superannuation should be made clear from the outset. The Treasury maintained that:

> The superannuation tax concessions have a substantial impact on the Budget. In 1990-91 the superannuation tax concessions amounted to $3.6 billion in revenue foregone, which was the Government's largest tax concession.[9]

The Committee's Approach

5.7 This chapter outlines and defines the elements of an effective system for taxing superannuation while the following three chapters analyse each phase of the superannuation flow, namely, contributions, fund earnings and end benefits. The approach adopted in each of the next three chapters is to provide a brief overview of the current taxation regime, the reforms proposed in Taxation Laws Amendment (Superannuation) Bill 1992, a synthesis of the evidence received by the Committee and recommendations.

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6 *Occupational Superannuation Standards Act 1987* Section 12

7 *Occupational Superannuation Standards Act 1987* Section 13

8 *Safeguarding Super*, First Report of the Senate Select Committee on Superannuation, page 24, para 3.14

9 Sub no 195, p 4

Criteria for the Taxation of Superannuation

5.8 The Committee sees the essential elements for the system of taxing the superannuation flow as equity, simplicity and efficiency. These terms require definition.

5.9 By equity the Committee means both 'horizontal' and 'vertical' equity. Horizontal equity is seen here to mean fairness, or equality of overall treatment, amongst taxpayers in similar financial circumstances. The Committee sees vertical equity as requiring the better off to bear a greater proportional share of the tax burden. A further element is added to this definition of equity to acknowledge the retroactive effect of prospective amendments to the law in this area. That is, where possible, the arrangements affecting certain groups of taxpayers should not be altered in a way that drastically reduces their anticipated benefits.

5.10 By simplicity the Committee desires a system which is easily understood and has acceptable 'compliance' costs. In referring to compliance costs, the Committee is concerned with the total cost in money and effort expended by taxpayers (and their agents) and tax administrators. For example, a 'simple' system may allow taxpayers to determine the tax payable on their annuity payments without the assistance of tax agents. Furthermore, a simpler system may involve a different paper trail between members and fund trustees with respect to the 'contributions' tax or between a member, the Australian Taxation Office and the Insurance and Superannuation Commission with respect to Reasonable Benefit Limits.

5.11 The Committee acknowledges the relationship between equity and simplicity. It is fairly common to hear that equity concerns have led to the array of grandfathering provisions which abound in the *Income Tax Assessment Act* (ITAA) and have made the taxation of superannuation extremely difficult to understand. But equally, and more importantly for the future, an overly complex system will cause unnecessarily large administrative costs for funds which will reduce the level of benefits to members, particularly low income earners. It can be seen by the foregoing that the Committee is concerned not only with 'substantive' aspects of tax law, but also 'procedural' requirements.

5.12 By efficiency, or economy and efficiency, the Committee is concerned that the present concessions allowed for superannuation achieve the ends encompassed in the Government's retirement incomes policy. Efficiency demands that 'deadweight' expenses incurred in administering and complying with the law are kept to a minimum. 'Neutrality' is also an important part of efficiency. Put simply, neutrality requires that two transactions of equal economic substance should have equal taxation consequences. An example of

a lack of neutrality in the current regime has been the differing tax treatments of superannuation pensions and annuities.

Administration

5.13 The Committee observes that superannuation is subject to some of the most complex taxation laws in Australia and that there is a large amount of revenue involved. It also observes that the Australian Taxation Office has established a number of specialist technical units known as 'cells' dealing with complex subjects as capital gains tax, insurance, property development and banking & finance among others.

Recommendation 5.1:

The Committee recommends that a specialist unit, known in the Australian Taxation Office as a 'cell', be established within the ATO to clarify taxation law and practice for the superannuation industry.

CHAPTER 6 : TAX TREATMENT OF CONTRIBUTIONS

6.1 This chapter covers the current arrangements for encouraging superannuation contributions, the Committee's evidence on those arrangements and recommendations for reform. In addition, the Government's reforms in the Taxation Laws Amendment (Superannuation) Bill 1992, and evidence received thereon, will be examined.

Current arrangements

Employer Contributions

6.2 The rules governing these deductions are found in Subdivision AA, Division 3 of Part III of the *Income Tax Assessment Act 1936* (ITAA). Employers receive an income tax deduction for making contributions for the benefit of their employees or their employees' dependants.[1] The deduction is allowed where the contribution is made to an 'eligible' superannuation fund[2] which is defined to include either a complying or a non-complying superannuation fund.[3]

6.3 Two important constraints on this deduction are the two-fund rule and the Maximum Deductible Contribution Limit (MDCL). The 'two-fund rule' states that a deduction is not allowable where the employer contributes to more than two funds in respect of an employee.[4] It has applied since 1 July 1990 and was introduced in order to make the RBL contribution limits simpler and more effective. The 'two-fund rule' provides a *de facto* control over the amount of deductible employer contributions that can be made on a person's behalf. However, in very limited cases, an employer may contribute to three funds.

6.4 Under the MDCL rules, employers should take care not to make excessive contributions for their employees. Where an employer makes contributions in excess of an employee's MDCL, the fund becomes *prima facie* non-complying by breaching Regulation 18B of the OSS Regulations. The

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1 Section 82AAC(1)

2 Section 82AAC(1)

3 Section 267

4 Section 82AAC(3)

MDCL of an employee is calculated with reference to a complex formula designed to cap the level of employer contributions. Where the cap is exceeded, and the fund becomes non-complying, the excess (when a benefit is finally paid out of the fund) is taxed at the member's marginal rate. Where an employer makes contributions in excess of the MDCL, the contributions are still allowable as a deduction to the employer. Furthermore, an employer may choose to make contributions in excess of the MDCL and not claim a deduction – thus not jeopardising the complying status of the fund.

Member Contributions

6.5 In addition to employer contributions, some members receive tax incentives for superannuation contributions. Certain types of members may be eligible to claim a deduction for contributions to complying superannuation funds. Where members cannot claim such a deduction, they may be able to claim a rebate but it should be noted that many employees cannot claim either. In particular, many public servants are not eligible for either.

6.6 Before looking at the tax incentives for member contributions, it is useful to look at the difference between a deduction and a rebate, shown in Example 6.1. A deduction is subtracted from a taxpayer's assessable income to arrive at taxable income. Tax rates are then applied to the taxable income to determine tax payable. A rebate is subtracted from tax otherwise payable.

Example 6.1 : Rebates and Deductions at Work
- Pre Taxation Laws Amendment (Superannuation) Bill 1992

Peter Brown receives award only superannuation. He contributes $1 000 to a personal superannuation fund for which he is entitled to a deduction. His assessable income is $33 000. Therefore:

Taxable income = $33 000, less $1 000 = $32 000
Tax Payable (at 1992/93 rates) = $7 354 (plus medicare levy)

Mary Monaghan is entitled to a rebate for personal superannuation contributions. Assume she is entitled to a rebate of 25 per cent of her contributions, which are $900. Her assessable income is $28 000 and she has no allowable deductions. Therefore:

Taxable income	=	$28 000
Tax (at 1992/93 rates)	=	$ 5 834 (plus medicare levy)
less		$ 225 (rebate : 25% of $900)
Tax Payable		$ 5 609 (plus medicare levy)

Member Contributions – Deductions

6.7 The rules governing the deductibility of member contributions are found in Subdivision AB, Division 3 of Part III of the ITAA.

6.8 From 1 July 1990 the deductibility of member contributions hinged on whether a member fell into one of the following categories:

- unsupported persons (including self-employed and substantially self-employed);
- award-only persons; or
- other than award-only persons.

6.9 Unsupported persons are referred to in the ITAA as 'unsupported eligible persons' and are entitled to a deduction for contributions made to complying superannuation funds.[5] The deductible amount is the lesser of:

- $3 000 plus 75 per cent of contributions in excess of $3 000; or
- the amount required to fund a benefit equal to the member's reasonable benefit limit (RBL). RBLs are examined in Chapter 8 of this report.

6.10 Recipients of award-only support are members whose only employer support consists of contributions made pursuant to an award . These are referred to in the ITAA as 'superannuation agreement contributions' and members are entitled to a deduction of up to $3 000 for personal superannuation contributions.[6]

6.11 Members who receive employer support may be entitled to a rebate from 1 July 1990. 'Employer support' in this instance does not include contributions made pursuant to an award.

Limit on contributions : Maximum Deductible Contribution Limit (MDCL)

6.12 Members may not receive a deduction for contributions made in excess of their MDCL. The formula for determining a member's MDCL is complex and depends on the accumulated market value of investments in the fund, the number of years to retirement and the member's maximum funding limit. The member's maximum funding limit is, in turn, dependent on the member's

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[5] Section 82AAT(2)

[6] Section 82AAS(1)

pension RBL (which is dependent on their highest average salary), age, and age at which they joined the fund.

Member Contributions – Rebates

6.13 Members who do not qualify for a deduction may be eligible for a rebate. Thus members of funds who receive no employer support or receive award only support are ineligible. The rebate provisions are contained in Subdivision AAC, Division 17 of Part III of the ITAA.

6.14 To be entitled to a rebate a member must belong to an 'eligible' scheme. An eligible scheme will be defined by the trustees of the fund to be either the whole of the membership of the fund, a subset of fund membership or even one member of the fund. The crucial characteristic of the group is that the average level of employer contributions does not exceed $1 600 per person.[7] The determination of the level of employer support depends upon the nature of the scheme. There are different rules for accumulation funds, funded defined benefit schemes and unfunded defined benefit schemes.[8] In order for a group of members to qualify as an eligible scheme, the trustee must notify all such members that the scheme is an eligible scheme in the particular year of income. Such notices must generally be supplied within 90 days of the end of the fund's previous year of income. It is important to note that an eligible scheme can only be associated with a complying superannuation fund.

6.15 Interestingly, membership of an eligible scheme does not oblige the member to make all of their superannuation contributions to that scheme. Once in an eligible scheme, the member can claim a rebate in respect of personal contributions to any complying superannuation fund.

6.16 A taxpayer who is eligible is entitled to a rebate of 25 per cent of all personal superannuation contributions of up to $3 000 per year (that is, a rebate of up to $750). Example 6.2 illustrates how this rebate works. The maximum level of rebatable contributions ($3 000) is reduced by 50 cents for each $1 the taxpayer earns over $25 000. Thus the rebate cuts out completely where the taxpayer earns $31 000. As such, the rebate is the lesser of:

- 25 per cent of ($3 000 minus one half of assessable income over $25 000); or
- 25 per cent of rebatable contributions.

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[7] Note: employer support does not include contributions made under an award or an industrial agreement

[8] Sections 159TE to 159TJ

Example 6.2 : Rebates at Work
- Pre Taxation Laws Amendment (Superannuation) Bill 1992

Hugo has an assessable income of $28 000 and contributes $800 to an eligible scheme. He is entitled to a rebate of:

(a) 25% of [$3 000 - {0.5 x (28 000 – 25 000)}]
= 25% x [$3 000 – $1 500]
= 25% x $1 500
= $375

OR

(b) 25% of $800
= $200

The rebate is $200, it being the lesser of (a) and (b)

The Committee's Evidence

6.17 The evidence presented to the Committee suggested overwhelming dissatisfaction with the current deductibility/rebatability arrangements. This dissatisfaction can be grouped under three broad headings, namely; inequity, insufficient incentive and complexity.

Inequity

6.18 There are essentially two strands to this argument:

- by allowing deductions (as opposed to rebates) an unfair advantage is provided to wealthier contributors; and
- it is inequitable to treat the various classes of contributors differently.

The Committee notes that it is suggested that there is inequity in the treatment between low and high income earners and among the various classes of contributors.

6.19 In particular, the Australian Council of Social Service (ACOSS) submission noted that, in addition to a deduction being prima facie unfair, the insufficient tax concession granted to low income earners must be reduced by 50 per cent 'to reflect the impact on their age pension entitlements'.[9] Noble Lowndes also noted that by offering a rebate (instead of a deduction) much of

[9] Sub no 31, p i

the bias created by the progressive tax system in giving a greater tax break to higher paid employees would be broken.[10] It was also suggested by Mr Barry Thompson, the Northern Territory Commissioner of Superannuation, that a rebate system would provide greater tax relief to low income earners.[11] LIFA suggested that rebates are easier to understand.[12] Another approach recommended that all employer and member contributions should attract a tax deduction, but that additional rebates could be paid to identified low income earners who contribute to superannuation funds.[13] National Mutual recommended that all personal contributions be rebatable up to the RBL limit.[14]

6.20 Ms Barbara Smith, a Lecturer in Accounting at the Phillip Institute of Technology, suggested that the current system 'seemingly defies logic'.[15] In her opinion:

> Current tax benefits ... favour the high income earner who is either self-employed or who can negotiate a flexible salary package to take advantage of the current legislation.[16]

6.21 The problem that Ms Smith alluded to occurs under what is called a 'salary sacrifice' arrangement whereby an employee whose superannuation is provided as a flexible element in an overall remuneration package can choose to trade salary for employer superannuation contributions. For example, instead of the employee making contributions out of salary (and maybe not being entitled to a rebate or a deduction), the employee may elect to receive less salary and make no contributions, but have the employer contribute. The effect of this is that the employee can effectively achieve full deductibility for what are member financed superannuation contributions. The Committee is concerned at the spread of salary sacrifice arrangements as the benefits appear to be enjoyed only by high-income earners. Further, it notes that such arrangements have the potential to offend the principles of vertical equity.

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[10] Sub no 80, p 4

[11] Sub no 77, p 7

[12] Sub no 114, p 11

[13] Alexander Consulting Group sub no 61, p 10

[14] Sub no 100, p 14

[15] Sub no 37, p 2

[16] Sub no 37, p 8

Recommendation 6.1:

The Committee recommends that the Government monitor and examine the use of salary sacrifice arrangements with a view to ensuring that their use does not undermine the equity aims of the Government's retirement incomes policy.

6.22 It was also suggested in evidence that the current system is inequitable and anomalous in that it discriminates between classes of contributors.[17] The Alexander Consulting Group submitted that the current four classes of contributors be replaced by a universal scheme of rebates.[18] National Mutual pursued a similar line on simplification grounds.[19]

6.23 The Investment Funds Association of Australia (IFAA) claimed there would be merit in making concessions more consistent across different categories of members.[20] The Institute of Actuaries recommended that, subject to revenue constraints, the Government should aim for greater consistency between types of member and employer contributions and that there should be deductions or rebates for all contributions.[21]

6.24 The Government Employees Superannuation Board (GESB) indicated that 'as a general principle, all member and employer contributions should be treated the same for taxation purposes' and 'that there is no apparent rationale for different treatment'.[22] ASFA noted that, under the SGC, the level of employer support enjoyed by a member will no longer be an appropriate criterion for determining whether members can obtain tax concessions for their contributions.[23]

6.25 There appeared to be some support for treating not only all member contributions identically but all member and employer contributions the same way. This was particularly evident in the recent report of the Committee for Economic Development of Australia (CEDA), *Superannuation and Retirement Incomes,* which concluded that member and employer contributions should both

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[17] ASFA sub no 89, p 18

[18] Sub no 61, p 10

[19] Sub no 100, p 14

[20] Sub no 154, p 10

[21] Sub no 108, p 3

[22] Sub no 84, p 4

[23] Sub no 89, p 18

be deductible up to aggregate limits.[24] It supported the aggregate limits suggested in *Security in Retirement* (see paragraph 6.39) acknowledging that this would expand the Government's superannuation tax expenditure and suggested that:

> To contain the impact on the revenue, the deductibility of employee contributions should be phased in over the period to 2000.[25]

6.26 Similarly, Noble Lowndes suggested a rebate of 39 cents in the dollar for member contributions to bring them into line with the company tax rate.[26]

6.27 It was noted that the introduction from 1990 of the rebate for some limited contributions is a significant improvement for low income earners.[27] However, a move towards across-the-board rebatability has two undesirable effects. ASFA notes that for contributing employer-supported members (eg public servants in compulsory contributory schemes) the extension of concessions would effect no behavioural change but would constitute a windfall gain for those members. This would lead to a drop in public savings with no increase in private saving.[28] Finally, and by no means unimportantly, ASFA suggests that full deductibility has been costed at over $1 billion per annum.[29]

6.28 The Commonwealth Bank called for a system whereby concessions could be received for contributions up to Average Weekly Earnings per annum made by employers and employees as per their own agreement.[30]

6.29 As indicated in the Committee's Second Report, *Super Guarantee Bills*, the question of allowing tax relief for contributions for those outside the workforce was not extensively canvassed by witnesses. Most of those who did comment pointed out that the main beneficiaries of such a rule would be the relatively wealthy who, in addition to financing ample, tax-subsidised superannuation for themselves, would be able to do the same for their spouses and even other relatives.[31]

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[24] Committee for Economic Development of Australia (Strategic Issues Forum) *Superannuation and Retirement Incomes*, October 1992, p 17

[25] ibid, p 21

[26] Sub no 80, p 4

[27] ASFA sub no 89, p 16

[28] ibid

[29] ibid (The Treasury estimate suggested)

[30] Sub no 173, pp 6-7; sub no 235, pp 3-4

[31] *Super Guarantee Bills* second report of the Senate Select Committee on Superannuation, paragraph 5.59, p 36

Why is a rebate fairer than a deduction?

Deductions are a regressive way of distributing superannuation tax concessions. This is because the concession provided by a deduction is dependent on the person's marginal tax rate. A rebate such as provided to members of eligible schemes is more equitable because it provides the same taxation concession to everyone who is eligible, irrespective of their marginal rate. A $1 deduction is worth 47 cents (plus medicare levy) to a taxpayer on the top marginal rate. However, the same $1 deduction is only worth 20 cents (plus medicare levy) for a taxpayer on the lowest marginal rate. It also offers a substantial simplification in that it can be set on a net of the contributions tax basis, relieving funds of the responsibility of taxing contributions. (See Chapter 7.)

Insufficient incentive

6.30 The second concern is that there is insufficient incentive via the taxation system to contribute to superannuation. This manifested itself in calls for more generous concessions for those contributing larger sums as they near retirement.

6.31 The joint submission of the Australian Society of Certified Practising Accountants (ASCPA) and the Institute of Chartered Accountants in Australia (ICAA) suggested that where minor provision had only been made to date greater tax concessions should be given for members nearing retirement.[32] This point is supported by Mr Peter Griffin of Rothschild Australia Asset Management Ltd, who suggested that the level of allowable contributions should be determined by the age of the beneficiary at the time of contribution. (Mr Griffin advised that this could facilitate the removal of the entire RBL system.[33])

6.32 There was a clear call for the concessions to be sufficient to attract employee contributions.[34] LIFA suggested that, as a minimum, all employees should be eligible for a tax deduction for up to $3 000 on contributions, whereas self-employed people should be entitled to deductions for all contributions.[35]

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[32] Sub no 119, p 9

[33] Sub no 133, p 6

[34] Victorian Automobile Chamber of Commerce sub no 140, p 11;
Australian Chamber of Manufactures sub no 95, p 8;
National Farmers Federation sub no 83, p 7

[35] Sub no 114, p 10

6.33 The AM Corporation proposed an overall limit on tax deductible contributions for members on the following basis:[36]

Age of Member	Maximum Proportion of Current Year Salary
up to 30	20%
30 to 39	30%
40 to 49	40%
over 50	50%

Simplicity

6.34 It was a common theme in evidence that the complexity of current arrangements deters members from contributing. The ACTU noted that in the voluntary contributory schemes with which they are involved, complexity is one of the principal reasons why fund members do not take the opportunity to contribute.[37]

6.35 The Australian Taxation Office (ATO) noted some of the areas where the application of the tax law is uncertain and difficult to administer:

(a) the provisions explaining the circumstances in which a person is deemed to receive employer support for deduction purposes are difficult to understand, and can require close scrutiny of an employee's individual circumstances and intentions with regard to his or her employment. In some cases the value of the tax deduction foregone far exceeds the level of superannuation support. Therefore, situations can arise where a person would be financially better off by not having employer superannuation support;

(b) eligibility for a rebate for personal superannuation contributions depends on the satisfying by the member's superannuation fund of certain notification requirements to members, which funds find difficult to satisfy. A fund's failure to fulfil the requirements prevents its members from receiving the rebate; and

(c) due to confusion about their entitlements, many taxpayers are either incorrectly claiming both a deduction and a rebate for their superannuation contributions, or they may not be claiming their full entitlement.[38]

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[36] Sub no 96, p 2

[37] Sub no 106, p 17

[38] Sub no 155, pp 6-7

The Committee notes that the rebate arrangements introduced by the Bill overcome this deduction/rebate confusion.[39]

6.36 The general thrust of the ATO submission on taxation was also supported by National Mutual (NML). In particular, NML submitted that the 1990 tax concessions were implemented via some of the most complex legislation yet enacted, covering:

- five conditions for member's eligibility for a rebate;
- four conditions for 'eligible scheme' status; and
- nine alternative methods of determining employer support.[40]

6.37 Noble Lowndes suggested that members have difficulty deciding which category they fall into, if indeed they fall into any, and that the concepts of 'unsupported persons' (for member deductions) and 'eligible schemes' (for member rebates) are also too complex. They proposed that a rebate replace the current deduction and rebate arrangements.[41] This was supported by LIFA who indicated that rebates are easier to understand and often easier to administer.[42]

Summary

6.38 Some broad themes can be discerned from the above survey. First, there was a call for concessions to be sufficient to attract member contributions. This also included a call for age-based scales. Second, there was a desire a more equitable apportionment of the government's tax expenditure amongst all contributors. It was widely suggested that a rebate should replace the current deductions available for member contributions. However, there also appeared to be a desire to retain deductibility. Third, greater consistency of concessions was requested. Suggestions ranged from parity in the treatment of all employers and members to parity between all members. Some evidence pointed to the need for a different concession for self-employed, employee and employer contributions. Finally, there was a unanimous call for a simpler regime.

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[39] see paragraph 6.39.

[40] Sub no 100, p 14

[41] Sub no 80, p 4

[42] Sub no 100, p 11

Taxation Laws Amendment (Superannuation) Bill 1992

6.39 The changes announced in the Treasurer's *Security in Retirement* Statement are reflected in Taxation Laws Amendment (Superannuation) Bill 1992. In particular, Divisions 2 and 3 of Part II of the Bill deal with employer and member contributions respectively. These changes go some way to addressing community concerns about the need to implement a more simple, equitable and efficient system of concessions for superannuation contributions and include:

- Employer and self-employed member contributions will be limited by an age-based scale. This allows for the removal of the two-fund rule and the MDCL. The limits on concessionally taxed contributions will be:

Age of Member	Limit on Contributions
under 35	$ 9 000
35 to 49	$25 000
50 and over	$62 000

  The deduction limit for a self-employed person from the 1994-95 year of income will be the lesser of:

  - $3 000 plus 75 per cent of the amount of the contributions exceeding $3 000; or
  - the person's age-based limit on deductible superannuation contributions.

  Employers with more than ten full-time employees may elect to use the 'standard employee contribution limit'. Where employers so elect, the limit on deductions contributions, for the 1994-95 income year, will be based on the following formula:

  (Number of full year employee positions) multiplied by $25 000

- For 'award-only members' and those employees entitled to the rebate, a new rebate will be introduced. This rebate will be ten per cent for up to $1 000 of personal contributions to any complying superannuation fund. The maximum level of contributions will be reduced by 25 cents for each dollar of assessable income in excess of $27 000 and fully phased out at $31 000.

Evidence on the Bill

6.40 Senator the Hon. Bob McMullan stated that the Bill introduces measures which:

> respond to longstanding calls from the superannuation industry and the community to make superannuation simpler, and that the announced measures have been widely endorsed by the superannuation industry as achieving that goal.[43]

However, he stressed that the Bill must be taken as a whole and that 'it is simply not possible to mix and match individual measures and still achieve a coherent policy package'.[44]

6.41 Senator McMullan anticipated attack on some measures in the Bill, namely, the reduction in levels of concessions for member contributions and the lack of notice regarding those changes. He stated that the new rebate arrangement is:

- simpler – because it replaces the mixed system of deductions and rebates;
- more equitable – employees in similar circumstances will be entitled to the same treatment;
- better targeted – it is designed to give assistance to low and middle income earners; and
- fiscally responsible – in combination with the RBL changes the Government expects to save $230 million in 1993/94 which will help offset the anticipated $400 million cost associated with the introduction of the Superannuation Guarantee Charge (SGC).[45]

6.42 The Committee received several responses to the Bill and took evidence at a public hearing. Most written submissions expressed dissatisfaction with the rebate proposals and recommended alternative approaches.

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[43] ST Bills evidence, p 3

[44] ST Bills evidence, p 1

[45] ST Bills evidence, p 1

The ASFA Approach

6.43 ASFA first intimated its disfavour with the new rebate proposal contained in the *Security in Retirement* Statement stating that 'the Government could have been more generous in relation to the tax treatment of member contributions'.[46] ASFA clarified its submission by calling for 'an extension of the proposed new concessions for member contributions' advocating that the Government should, in order of priority:

> (a) lift the rebate to, say, 20 per cent;
>
> (b) lift the maximum qualifying contribution to, say 5 per cent of Average Weekly Earnings (approximately $1500); and
>
> (c) lift the income cut-off point to, say, 150 per cent of Average Weekly Earnings (approximatley $45000).[47]

6.44 The thrust of ASFA's submission is that while 'very supportive of the package overall and of the rebate system for member contributions' they were 'disappointed at the limits that were imposed'[48] and hence they sought 'more generous concessions for the targeted group before seeking any extension to the group itself'.[49]

The LIFA Approach

6.45 LIFA believed that the level and scope of the new rebate arrangements 'can and should be improved'.[50] They were surprised at the low level of incentive and stated that

> Reducing or eliminating this tax incentive appears to be quite contrary to the message that individuals need to save for their own retirement.[51]

LIFA contended that the lack of incentive provided by the new arrangements will immediately make 1.2 million member contributors worse off and affect up to 2 million contributors.[52] LIFA proposed the following, in order of priority:

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[46] ST Bills evidence, p 2115

[47] ASFA supplementary sub no 89, 21 September 1992

[48] ST Bills evidence, p 15

[49] ibid

[50] Supplementary sub no 114, p 5

[51] ST Bills evidence, p 17

[52] ibid, p 2

(a) increase the $1 000 limit to $2 000;

(b) increase the 10 per cent rebate to 20 per cent; and

(c) increase the $27 000 salary threshold to $35 000.[53]

6.46 In support of their submission, LIFA asserted that the $2 000 limit on contributions 'would encompass the majority of employee contributions and encourage those who can afford to save more for their retirement to do so'.[54] Furthermore, they suggested that a 20 per cent rebate is crucial to stimulating voluntary employee contributions and is 'closer to the effective existing incentive'.[55] They recommended $35 000 as an appropriate salary threshold as that is 'the level where salary packaging arrangements become more common'.[56]

6.47 Alternatively, LIFA argued that the reduced personal incentives could be phased in according to the following timetable:[57]

Year	Rebate Level	Maximum Rebatable Contributions
1992 – 93	25 %	$3000
1993 – 94	20 %	$2500
1994 – 95	15 %	$1500
1995 – 96	10 %	$1000

6.48 Senator McMullan opposed the call for the new rebate to be phased in, stating that there would be a cost to revenue and that it would lead to 'an extremely complex and confusing situation'.[58] He added that a phasing scale would merely 'create an illusion of comfort'.[59]

6.49 As indicated earlier in this chapter, CEDA supported the aggregate limits on deductible employer contributions set out in the *Security in Retirement* Statement but suggested that members should be entitled to make deductible contributions to these limits.[60]

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53 ibid, p 5

54 ibid

55 ibid

56 ibid, p 6

57 ibid, p 4

58 ST Bills evidence, p 9

59 ibid

60 CEDA op cit, p 21

6.50 The question of how many people would be affected by the new rebate provisions was also canvassed by Treasury officials. The Treasury provided evidence that of the 1.3 million members claiming a deduction for contributions, one million would lose their entitlement. Furthermore, 1.2 million people will be eligible to claim the new rebate of which 300 000 claimed the old rebate (and were better off under that arrangement). Overall, Treasury reported that the Australian Tax Office had established that 'one million people would be worse off'.[61]

6.51 Evidence was also provided to the Committee that the saving to revenue from abolishing the deduction would be $325 million and the cost to revenue of the rebate reform would be $95 million in 1992/93. Thus, the overall savings of these measures would be $230 million. This is intended to offset the expected $400 million cost to revenue of the Superannuation Guarantee package in its first year of operation.[62]

6.52 The Treasury were asked to demonstrate that the current generation of low income earners would be better off than if they had simply received the age pension. The Treasury responded immediately with material it had previously presented to the Committee which showed that low income earners can be expected to have a higher retirement income under the SGC regime than if they relied solely on the age pension.[63]

The Institute of Actuaries Approach

6.53 Mr Colin Grenfell representing the Institute stated that it still had three main concerns, namely: the tax incentives are not universal, are too low and are not preserved.[64] With respect to universality, the Institute reiterated its call for equality in treatment of member and employer contributions.[65]

Conclusions

6.54 The Committee considers that reform of this area of taxation is overdue. The changes envisaged in the Bill go a considerable way to addressing calls for a more simple, equitable and efficient system of tax concessions for contributions.

[61] ST Bills evidence, p 4

[62] ibid

[63] ST Bills sub no 31, p 1

[64] ST Bills evidence, p 16

[65] ibid

Employer Contributions

6.55 The rules applying to employer contributions are simpler than those applying to member contributions. Replacement of the two-fund rule and Maximum Deductible Contribution Limit with simple age-based scales enhances the simplicity of the arrangements.

Member Contributions

6.56 The Bill simplifies arrangements providing member contribution incentives. Despite the strong criticism of the lack of incentive provided for with the new rebate, the Committee considers that in light of the Superannuation Guarantee Charge and the new RBL arrangements, anything higher would be unnecessary and fiscally irresponsible.

6.57 In terms of equity, the Bill forms an integral part of an equitable policy which has as its foundation the Superannuation Guarantee Charge. Finally, in terms of efficiency, the Bill restores neutrality between taxpayers in similar circumstances.

Future Considerations

6.58 With respect to areas for future reform, the Government still has a number of areas to consider. With regard to the self-employed, the Government will need to reconsider its position when it decides to bring them within the ambit of the Superannuation Guarantee Charge. Equally, the Government may need to revisit the question of member tax incentives when it tackles the question of how to raise total employee superannuation support from nine to twelve per cent of earnings.

CHAPTER 7 : TAXATION OF FUND INCOME

7.1 This chapter examines the taxation of contributions from their entry to a fund to their exit. This includes an overview of the current arrangements for taxing complying and non-complying superannuation funds, complying and non-complying Approved Deposit Funds (ADFs) and Pooled Superannuation Trusts (PSTs). Evidence presented to the Committee is examined and suggestions for possible reform canvassed. The Taxation Laws Amendment (Superannuation) Bill 1992 does not directly impact on this phase of superannuation.

Current Arrangements

Contributions Tax

7.2 The 15 per cent contributions tax was introduced in the May 1988 Economic Statement. Until then, superannuation had been taxed at only one stage – a 30 per cent tax on end benefits. The then Treasurer explained the tax as being a temporal adjustment – bringing forward tax revenue that would have been collected some years later:

> ... it will allow the Government to bring forward nearly $1 billion of its own tax money – now lying in superannuation funds – without diminishing end benefits by one cent.[1]

7.3 It is not strictly correct to differentiate between a fund earnings tax and a contributions tax. The reforms in 1988 merely brought 'deductible contributions' into the assessable income of a fund. There is no requirement for a fund to immediately deduct 15 per cent tax from contributions upon receipt. A fund has the option of waiting until the end of the income year and then paying 15 per cent tax on the contributions plus investment earnings less deductions, rebates and credits. The Committee notes that the timing of notional tax adjustments to member accounts may affect the earnings on contributions. The system which would best meet the criteria of equity and simplicity would involve all fund members having the contributions tax deducted at a uniform juncture.

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[1] Paul Keating *Economic Statement*, May 1988, AGPS Canberra, p 14

7.4 The amounts that are taxable contributions are essentially those for which the contributor (whether member or employer) has received an income tax deduction. It is important to note that contributions for which a member received a rebate are not subject to the 15 per cent contributions tax. Also, all member contributions must be treated as taxable unless various notices are given to the fund in respect of the member.

7.5 Members who are not entitled to, or choose not to, claim a deduction for their contributions should give a section 82AAT(1A) notice to the trustee of the fund so indicating. In the case of an employer sponsored fund, the employer may give a section 274(4) notice to indicate that fund members are not entitled to an income tax deduction for their contributions.[2] Where such notices are given, the relevant contributions are not subject to the 15 per cent contributions tax.[3]

7.6 Where a complying superannuation fund or complying ADF has investments in a life insurance company, a registered organisation or a PST, the fund may transfer the tax liability on its taxable contributions to the other body.[4] This provision is largely for the benefit of smaller funds who are wholly managed by a life assurance company or PST. It is administratively easier for the fund to be able to transfer its liability to the other body.

7.7 Where a complying superannuation fund was 'underfunded' at 30 June 1988, contributions paid to it to cover that 'shortfall' can be excluded from assessable income by the application of pre-1 July 1988 Funding Credits. A complex formula is laid own in the ITAA indicating the extent of these Funding Credits.[5]

7.8 Chart 7.1 shows the relationship between the 'contributions' tax and the tax incentives outlined in Chapter 6 of this report.

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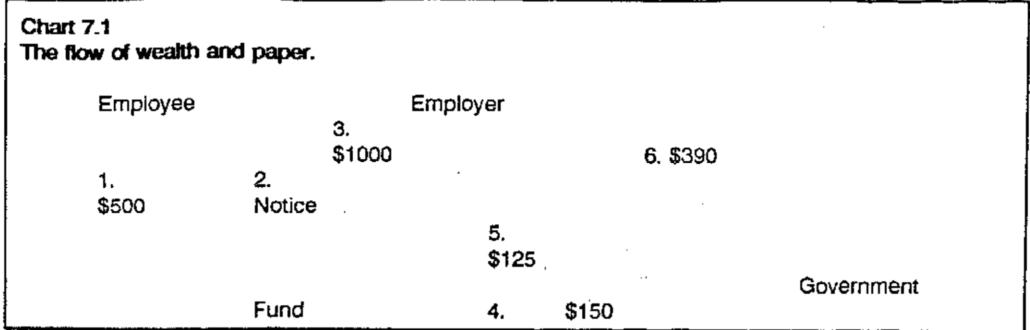
2 PAYE deductions can also be varied to reflect tax concessions, (see Appendix I)

3 Section 274(2)

4 Section 275

5 Sections 275A, 275B



Notes

1. Employee contributions of $500, for which the employee is entitled to a rebate of 25 per cent
2. Section 82AAT(1A) Notice from employee to fund trustee;
3. Employer contribution of $1,000, which is to be included in the assessable income of the fund;
4. Contributions tax of $150 to Government in respect of $1000 employer contribution;
5. Rebate to employee of $125 for their $500 contribution
6. Reduction in company tax payable by employer of $390 for their $1000 contribution on behalf of employee.

Taxation of Earnings

7.9 The 15 per cent tax on fund earnings was introduced in the May 1988 Economic Statement. The then Treasurer announced that the intent was to bring superannuation funds within the full ambit of the imputation system, giving them access to dividend tax credits.[6] Prior to the introduction of this measure, superannuation funds could not fully share in the profits of Australia's major corporations and, as such, Australia's public companies were being denied the full investment support of the nation's superannuation funds.[7]

7.10 As far as the earning of income and incurring of expenses goes, the law governing superannuation funds is similar to that which applies to normal businesses. There are specific exemptions for complying superannuation funds for income accruing prior to 1 July 1988[8], income from non-reversionary bonus on life assurance policies[9] and bonuses received on the payout of life policies.

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6 May Economic Statement, op cit, p 14.

7 ibid

8 Section 282

9 Section 282A. A non reversionary bonus is generally an amount received annually by way of bonus representing the growth in value of a life assurance policy investment provided that the bonus is not actually paid over to the policy holder

7.11 An important exemption is that applying to income derived from a fund's current pension assets. There is an exemption in the Act for income derived from segregated current pension assets and an exemption of a proportion of income attributable to non-segregated current pension liabilities.

7.12 Where a fund sets aside a pool of assets for the sole purpose of enabling a fund to discharge in whole or in part its current pension liabilities, the income from those assets, including capital gains on disposal of those assets, is exempt from tax.[10] Current pension liabilities are defined as those liabilities the fund has in respect of pensions currently payable. For the exemption to apply, an actuary's certificate must be obtained indicating the value of the current pension liabilities every three years. Certain arrangements apply where trustees transfer assets in and out of the segregated current pension assets portfolio.

7.13 Where a fund does not set aside segregated current pension assets, an exemption may still be available.[11]

7.14 The exemption is broadly calculated as a proportion of the fund's normal assessable income, this proportion being:

$$\frac{\text{Unsegregated Current Pension Liabilities}}{\text{Unsegregated Superannuation Benefit Liabilities}}$$

7.15 An actuary's certificate must be obtained certifying the above amounts. There is provision for an interim calculation to be made where a full actuarial investigation has not been performed in a particular year.

Capital Gains Tax (CGT)[12]

7.16 Whilst the general CGT provisions only apply to assets acquired after 19 September 1985, CGT applies to assets of complying superannuation funds, complying ADFs and PSTs, irrespective of when they were acquired.

7.17 CGT is in essence, a tax on the disposal of an asset. The definition of asset is quite wide but there are two important exemptions for certain funds, namely: policies of life assurance; and units in a PST.

7.18 The cost base rules for assets owned by complying superannuation funds, complying ADFs and PSTs are different to those applying to other taxpayers. Where a fund disposes of an asset that it owned at 30 June 1988, regardless of

[10] Section 282B

[11] Section 283

[12] Division 10, Part IX, ITAA

when it was acquired, the cost base of the asset is either the cost of the asset or the market value of the asset at 30 June 1988 whichever yields the lowest gain or loss. Furthermore, there are complex indexation provisions for assets owned for more than one year.

7.19 Where a State government is the trustee of a superannuation fund, it is not liable for capital gains tax on the disposal of assets held by the fund. Such trustees are, however, liable for tax on interest income earned on the property of a trust.[13]

Special and Standard Components of Taxable Income

7.20 Superannuation funds are subject to tax at the highest personal marginal rate on 'special income', essentially that income derived from non-arm's length transactions. All other fund income is known as 'standard income' and is taxed at the rate of 15 per cent.

Deductions

7.21 The ITAA provides for certain deductions which are applicable to all taxpayers. The Act also contains specific provisions in relation to superannuation funds, dealing with deductions for:

- **Death and disability benefits.** Where a complying fund offers death or disdability benefits, it is entitled to a deduction for insurance policy premiums. Where such a fund self-insures it is entitled to a deduction for the arm's length cost of such a premium.

- **Benefits paid to a member's dependants.** A fund is allowed a deduction for the amount of past taxable contributions that form part of the death benefit, provided the whole benefit is passed on to the beneficiary.

- **Repatriation of surplus to employer sponsors.** Where a fund makes a payment to an employer sponsor who has been allowed a deduction for contributions to the fund, the amount paid is assessable to the employer[14] and deductible to the fund[15]. The Government has foreshadowed its intention to remove this deduction from 1 July 1995.

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[13] Section 114 of the Commonwealth Constitution; see the recent High Court decision of *The State of South Australia & Anor v The Commonwealth of Australia & Anor* (1992) 105 CLR 171

[14] Section 82AAQ

[15] Section 279C

Rebates

7.22 As part of the reforms announced in the May 1988 Economic Statement, complying superannuation funds, complying ADFs and PSTs are able to take advantage of franking rebates under the imputation system. In essence, the imputation system eliminates the effective double taxation of income earned by a company. An important point to remember is that because superannuation funds pay a lower rate of tax than companies, franking rebates are proportionately of more value to superannuation funds. A fund is entitled to a franking rebate equal to the lesser of the total imputation credits relating to franked dividends received by the fund, or the total tax payable by the fund. Example 7.1 illustrates the operation of dividend imputation.

Example 7.1 : Dividend Rebate in Practice

The Ace Superannuation Fund is a complying superannuation fund which receives $122 in fully-franked dividends in the income year. It had other assessable income of $150. Its tax payable is as follows:

Dividend Income	122.00
Add imputation credit (122 x 39/61[16])	78.00
Other assessable income	150.00
Taxable income	350.00
Tax on taxable income (15% of $350)	52.50
Less franking rebate (lesser of imputation credit or tax payable)	78.00
Tax Payable	0.00

Note: Dividend rebates cannot be carried forward or backward through income years.

Taxation of Pooled Superannuation Trusts (PSTs)[17]

7.23 A PST is a unit trust that invests the assets of complying superannuation funds and complying ADFs. The PST is essentially an investment vehicle for these funds and is formed to enable such funds to pool their assets for investment purposes, and hence maintain a diversity of investment. To qualify as a PST, an entity must be a unit trust and meet the criteria for a PST laid down in the OSS Regulations.[18] A PST must only be used for investing the assets of: a complying superannuation fund, a complying ADF, the assets of the superannuation business of a life insurance company, other PSTs and certain tax exempt entities.

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[16] The dividend income of $122 must be 'grossed-up' to its before-tax value. This is done by multiplying it by 39/61 (that is, 39 represents the percentage rate of company tax, and 61 is equal to 100 less 39)

[17] Division 7 part IX, ITAA

[18] See generally Part IIIA, OSS Regulations

7.24 PSTs are generally subject to tax at the same concessional rates as superannuation funds and approved deposit funds. Generally, the income of a PST is not distributed to unitholders, but is reflected in an increase in the value of units. The sale of units in a PST by a unitholder is specifically exempt from capital gains tax.

7.25 Where a complying fund invests in a PST, the PST is entitled to an exemption from tax on a portion of its income, based on the average proportion of units held in the fund during the year that represent current pension assets of complying superannuation funds which are unitholders in the PST. The value of the tax exemption will generally be passed on to the relevant superannuation fund in the form of extra units of equivalent value.

Taxation of Approved Deposit Funds (ADFs)[19]

7.26 An ADF is a fund created to receive eligible termination payments (ETPs) where retirees wish to defer their benefit to a future time. This is achieved by the taxpayer rolling over an ETP into an ADF. No tax is paid on the ETP at the time of rollover.[20] ETPs rolled over into a complying ADF generate income which is taxed at the concessional rate of 15 per cent per annum. Income earned by a non-complying ADF is taxed at the highest personal marginal rate (currently 47 per cent). An ADF is assessed on income in much the same way as other taxpayers, but is subject to a number of specific provisions, for example, golden handshakes and unfunded retirement payments are included in their assessable income where the 15 per cent tax on contributions and earnings has not been paid.

Fixed Interest ADFs

7.27 An ADF is entitled to an exemption in respect of income relating to certain deposits which it held at 25 May 1988. Where the ADF derives at least 90 per cent of its income in the form of interest, and has been a continuing complying ADF since the beginning of 1 July 1988, the income which is earned on deposits which were held by the ADF at 25 May 1988 that were made by 'relevant depositors' is exempt from tax. A relevant depositor must have been either aged 55 or over at 25 May 1988 or aged 50 or over at 25 May 1988 and have previously rolled over into the ADF all or part of an ETP containing a concessional component.

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[19] For complying ADFs see Division 5, Part IX, ITAA and for non-complying ADFs see Division 6, Part IX, ITAA

[20] See Chapter 8, Taxation of Benefits

Committee's Evidence

7.28 The Committee received evidence that the method of taxing contributions and fund earnings was inequitable by virtue of its regressivity.[21]

7.29 ACOSS suggested a system which would involve:

> Assessment of contributions and fund earnings as part of individuals members' taxable income; (and) provision of 'tax rebates' up to a standard limit, which could be offset against taxes paid by members on contributions and fund earnings.[22]

7.30 This evidence accorded with that of the Women's Economic Think Tank who suggested that, for example, one third of women workers earn less than $15 000 (which is where they suggest total tax payable is equal to 15 per cent of earnings).[23] Further support is evidenced by the submission of the Superannuation Economics Research Group of the University of New South Wales which suggested that:

> Ideally, superannuation flows should be taxed once only at the contributor's marginal rate of income tax. This would eliminate perverse tax-induced impacts on retirement consumption, to the extent that it is financed by superannuation benefits. It would also be equitable, in the sense that the progressive marginal income tax schedule is applied to all superannuation contributions.[24]

7.31 However, the idea of levying a contributions tax at the members marginal rate, and then applying a rebate to it, was largely rejected by industry representatives.[25] Such a proposal is usually raised in conjunction with a proposal for a universal rebate. As Mr Brian Scullin of ASFA noted:

> It is not a matter of it being difficult or costly, but just straight out impossible. Even if we then go round and round and try to find some obtuse way, we cannot see that you are going to have anything but a marginal gain in equity at a massive loss of efficiency.[26]

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21 AFCO sub no 139

22 Sub no 35, p iii

23 Sub no 126, p 8

24 Sub no 150, p 9

25 It should be noted that such proposals normally involve a 'notional' rebate in the sense that it does not flow back to the member but merely reduces the tax payable on contributions.

26 Evidence, 22 July 92, p 2127

7.32 This stance was also supported by Mr Ken Robinson of LIFA,[27] Mr Iain Ross of the ACTU,[28] and Mr Colin Grenfell of the Institute of Actuaries.[29]

7.33 Most comment on this section can be divided into two areas, namely, the 15 per cent 'contributions tax' and the 15 per cent 'fund earnings tax'.

Contributions Tax

7.34 The Committee notes a divergence of opinion as to whether the contributions tax should be retained. It was submitted that Australia is virtually alone in the western world in taxing superannuation contributions and investment earnings.[30] However, it was also conceded that to abolish the tax would have serious budgetary consequences.[31] Those parties who advocated the removal of the fund income tax generally preferred to see taxes levied on benefits.[32] Another comment in this vein was that there is considerable consumer resentment to this tax.[33] In addition, it was noted that the tax on contributions is an 'undesirable complication' and that it 'hides the true level of taxation'.[34]

7.35 Alternatively, there were those who advocated maintaining the contributions tax as part of a package centred on abolishing or reducing the end benefit tax[35] or as part of a package containing greater incentives for contributions.[36] Alternatively, there were those who advocated reducing incentives for contributions but abolishing the contributions tax.[37]

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[27] Evidence, p 2126

[28] Evidence, p 2123

[29] ST Bills evidence, p 19

[30] AM Corporation sub no 96, p 6

[31] ibid

[32] Dr John Knight sub no 171, p 1; Rothschild Australia Asset Management Ltd sub no 141, p 2; Australian Friendly Societies Association sub no 136 pp 5-6; Mr Peter Griffin sub no 133, p 4; ASCPA/ICAA sub no 119, p 8

[33] Westpac Banking Corporation sub no 132, p 7; Australian Friendly Societies Association sub no 136, p 5

[34] Government Employees Superannuation Board (WA) sub no 84, p 4

[35] Alexander Consulting Group sub no 61, p 4; Noble Lowndes sub no 80, p 11

[36] Commonwealth Banking of Australia sub no 173, p 11; Peter J Vere Pty Ltd sub no 241, p 1

[37] Metway Corporation sub no 117, p 1; Australian Friendly Societies Association sub no 136, p 4

7.36 It was also noted that the differing categories of member contributor, the notice requirements and the contributions tax all combine to create an unfair, complicated and expensive regime. As a result, it was suggested that the current deductions be replaced by rebates which reflect the current contributions tax. This would allow the contributions tax to be dropped and would have the advantage of removing the obligation of trustees to remit the tax to the Government.[38]

7.37 The problem was also brought to the attention of the Committee by the Australian Taxation Office. In short, the requirement for funds to ascertain which members will claim a tax deduction for their contributions – and the requirement for contributions to be deductible in the event of uncertainty – produces a situation where more contributions tax is paid than should be.[39]

7.38 There was a call for the rate of 15 per cent to be changed to reflect reductions in personal income tax rates, and for this to be a continuing process.[40]

Recommendation 7.1:

The Committee by majority believes that the contributions tax should be retained for 'deductible' contributions and the exemption for 'rebatable' contributions should also be maintained.

Recommendation 7.2:

The Committee believes that the contributions tax, with respect to employer contributions, should be withheld by the employer instead of the fund trustee. This would substantially reduce the administrative complexity of the current arrangements and lead to less loss of benefits through inadvertence. In other words, employer and self-employed contributions (which have been subject to the 15 per cent tax) should be excluded from the assessable income of the fund.

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[38] Prudential sub no 43, p 3. It should be noted that the rebate reform contained in the Taxation Laws Amendment (Superannuation) Bill 1992 largely overcomes the confusion faced by trustees as to the nature of member contributions.

[39] ATO sub no 155, p 7

[40] LIFA sub no 114, p 41; Institute of Actuaries sub no 108, p 6; ASCPA/ICAA sub no 119, p 7

Fund Earnings Tax

7.39 Many submitters acknowledged the purpose behind taxing fund income. However, the Superannuation Economics Research Group (UNSW) focussed the Committee's attention on the deleterious impact of the taxation of fund earnings:

> The impact on the accumulation at retirement can be very great, because the longer the time horizon of the investment, the more important is the power of compound interest to the accumulation. Earnings taxes can seriously threaten the goal of adequate replacement in retirement.[41]

7.40 LIFA, AM Corporation Ltd and the Taxation Institute of Australia expressed the view that imputation credits were insufficient to offset the full tax on income. In particular the AM Corporation noted that:

> ... a superannuation fund must invest up to nearly half the fund's investments in shares in order to eliminate fully the income tax. This level would generally be considered to be an unwise level of equity investment in a long term investment portfolio for an accumulation style of fund.[42]

7.41 The ASCPA/ICAA noted that investment managers do not determine exposure to shares in their portfolios by tax breaks but by prudential considerations.[43] The Taxation Institute noted that this measure discourages investment by superannuation funds in new industry (as new industry is unlikely to pay franked dividends in the short term).[44] Westpac and the IFAA Ltd noted that the tax on investment income is variable due to the variable performance of markets and investment vehicles.[45] Westpac also warned that if the rate were to increase, market biases between different investments could be created.[46] The Committee notes that there is a possible conflict between this and the ASCPA/ICAA submission and is inclined to consider the merits of the latter.

7.42 A novel suggestion was profferred by Dr John Knight who suggested that investment earnings should be tax free to a certain level (he nominated

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41 Sub no 150, p 10

42 AM Corporation sub no 96, p 6

43 Sub no 119, p 8

44 Sub no 124, p 6

45 Westpac sub no 132, p 7; IFAA Ltd sub no 154, p 11

46 Sub no 132, p 7

4 per cent) with the balance being split between the fund and the member for the purposes of tax incidence.[47]

7.43 Another common theme in submissions was the lack of clarity in the deductibility or otherwise of scheme expenses.[48] The problem alleged is that section 51(1) of the ITAA (the general deductibility provision) does not extend to superannuation funds as they are not engaged in profit-making.[49] The ASCPA/ICAA submission indicated that the Commissioner of Taxation should release guidelines on the subject.[50] Noble Lowndes agreed that 'this is a very grey area for superannuation fund trustees and administrators' and preferred the insertion of a specific provision into the ITAA to extend the general deductibility provision to superannuation funds.[51] There was a suggestion by LIFA that all expenses whether of a private or capital nature should be tax deductible and that complying funds should not be treated in the same manner as other taxpayers.[52] ASFA tendered correspondence between themselves and the ATO indicating that there is some confusion as to the deductibility of certain expenses for fund trustees.[53] ASFA suggested that, for example, expenses incurred in amending trust deeds are not deductible but are often due to changes in legislation. The Committee notes that the Commissioner of Taxation has recently issued *Taxation Ruling* IT 2672 which indicates that deductions will be allowed for some deed amendments. ASFA calls for the availability of tax deductions for all operating expenses arising from the operation of the fund.[54]

Recommendation 7.3:

The Committee by majority recommends that the fund earning tax should be maintained at its current concessional rate and that it should retain its concessional character by being reduced in line with other reductions in personal income tax rates.

[47] Sub no 171, p 1

[48] Noble Lowndes sub no 80, p 7; ASCPA/ICAA sub no 119, p 8; ASFA sub no 89, p 18; LIFA sub no 115, p 11

[49] Which would put them in breach of the sole purpose test.

[50] Sub no 119, p 8

[51] Sub no 80, p 7

[52] Sub no 115, p 11

[53] Sub no 89, p 18

[54] Sub no 89, p 24

Recommendation 7.4:

The Committee recommends that the Commissioner of Taxation should clarify, by way of Taxation Rulings and Determinations, the allowable deductions available to superannuation fund trustees. Further, where appropriate, the position of superannuation funds should be aligned with normal businesses.

Recommendation 7.5:

The Committee recommends that any expenses incurred by trustees in complying with legislative and regulatory changes, some of which will flow from its series of reports, be completely tax deductible for fund trustees.

Capital Gains Tax (CGT)

7.44 The Committee notes the concern of some submitters regarding the *prima facie* inequity of the CGT treatment of assets held by superannuation funds. Mr Bannon of Duesburys Chartered Accountants referred to the arrangements as a '"cash and grab" situation by the Government'.[55] Mr Bannon, referred to the injustice of this arrangement due to superannuation funds not being permitted to index the original cost of assets for the years those assets were held prior to 30 June 1988; and that fund trustees must incur costs of market valuing all assets held before that time. The Taxation Institute noted that superannuation funds may be subject to CGT in respect of the disposal of some assets for which other taxpayers would not.[56]

7.45 LIFA suggested that CGT should not apply where there is a deemed disposal due to a change of trustees arising from fund amalgamation or restructuring.[57] ASFA alerted the Committee to the fact that fund mergers may be an increasing trend.[58]

7.46 In a similar vein, Commonwealth Funds Management (CFM) raised an anomaly in the current CGT treatment of assets held by unit trusts. CFM noted that it is common for superannuation funds, ADFs and PSTs to invest in unit

[55] Sub no 57, p 2

[56] Sub no 124, p 5

[57] Sub no 114, p 11

[58] Supplementary sub no 89

trusts to diversify and obtain investment economies of scale. While indexation of the cost base of an asset is available for superannuation funds, ADFs and PSTs, 'it is open to the Commissioner of Taxation to treat gains or losses on the realisation of assets by the unit trusts on revenue account and thereby deny indexation benefits'.[59] They suggested the indexation allowed for complying superannuation funds, ADFs and PSTs be extended to include unit trusts where '100 per cent or the vast majority (say, 90 per cent) of the units in that unit trust are held by a complying superannuation fund, complying ADF or PST'.[60]

Recommendation 7.6:

The Committee recommends that the Treasury consider whether there is scope to correct any anomalies that may exist in the application of Capital Gains Tax (CGT) to fund trustees. The Treasury should specifically consider the application of CGT to units in unit trusts, the application of CGT to pre-September 1985 assets and the application of CGT in fund amalgamations.

Current Pension Liabilities

7.47 The complexity of the exemption for current pension liabilities (paragraphs 7.11 to 7.15 above) was brought to the attention of the Committee. The ATO suggested that the application of this formula 'is unclear and subject to dispute'.[61] Equally, National Mutual indicated that this is one of the areas of taxation that 'requires complex actuarial calculations which place significant cost burdens on fund trustees'.[62] The joint submission of the ASCPA and the ICAA agreed that these provisions 'are very complicated, and expensive to administer'[63] and suggested that they be abandoned and replaced with an increase in the pension rebate from 15 per cent to 30 per cent to compensate for the 15 per cent tax on earnings of the pension assets.[64]

[59] Sub no 102, p 2

[60] ibid

[61] Sub no 155, p 7

[62] Sub no 100, p 13

[63] Sub no 119, p 9

[64] ibid, p 11

Recommendation 7.7:

The Committee recommends that the Treasury examine the arrangements applying to current pension liabilities to find a less complex regime. Regard should also be had to the complexity of the taxpayer rebates.

Transfer of tax liability

7.48 ASFA raised a concern about the transfer of tax liability on contributions. Under current arrangements, a fund trustee may send to a life office a notice to the effect that the life office must pay the contributions tax rather than the fund trustee. ASFA noted that these notices may often arrive after a life office has already paid an instalment of its own tax liability, 'thus payment is required before the institution is in a position to accurately calculate the appropriate amount to be paid'.[65] The Committee observes that the ability to transfer tax liability eases the administrative burden on small funds.

Recommendation 7.8:

The Committee recommends that the Treasury examine whether there is scope to overcome the confusion surrounding the transfer of tax liability provisions.

Section 290A

7.49 The Committee also received evidence from a fund member concerning an apparent unintended consequence of the operation of the exemption granted under section 290A.[66] The legislation limits eligibility of the concession by making the ADF elect to obtain the exemption. This need to elect has apparently meant that at least one ADF has decided to not claim the exemption, and hence deny the benefit to the relevant members, because of the administrative effort required. This has meant that members who should have benefited from the exemption were forced to pay increased tax.

[65] Sub no 89, p 19

[66] Mr V.D. Williams, sub no 283

Recommendation 7.9:

The Committee recommends that the Government review section 290A to determine whether there are impediments to ADFs claiming the exemption, and, if so, to remove such impediments to ensure that the exemption is enjoyed by those who are entitled to it.

Conclusion

7.50 The Taxation Laws Amendment (Superannuation) Bill 1992 makes no amendment to the taxation of fund income. This accords with the generality of the Committee's evidence, which was more concerned with the level of tax concessions for contributions and the taxation of benefits. There are, however, a number of matters that the Government should address. Foremost of these is the requirement that fund trustees withhold the contributions tax. The Committee believes that the tax would be more efficiently withheld by employers.

7.51 The Government should clarify the deductions available to superannuation funds, aligning them with the treatment of normal businesses. Furthermore, the apparent anomalies listed above relating to capital gains tax and transfers of tax liability should be examined.

7.52 In addition, the Committee considers that any expenses incurred by trustees in complying with changes flowing from its series of reports should be completely tax deductible for fund trustees.

CHAPTER 8 : TAXATION OF BENEFITS

8.1 This phase of the superannuation cycle is probably the most complex and confusing. A large number of witnesses put it to the Committee in the plainest of terms that the complexity of the regime was undermining the Government's retirement incomes policy. In particular, the push for greater use of income-stream products rather than lump sums was being stymied.

8.2 The Committee received evidence that one of the greatest causes of complexity here is the array of grandfathering provisions that abound in the ITAA. The use of grandfathering provisions is essentially designed to overcome the otherwise retroactive effect of changes to tax law. This is one example of the conflict between equity and simplicity.

8.3 The changes introduced since 1983 have brought with them a raft of convoluted phraseology. Particular care has been taken to explain this area in a clear and simple manner – but reference to the glossary which is appended to the report should still be made.

8.4 This chapter begins by looking at the current arrangements applying to superannuation benefits. This includes the notions of 'Eligible Termination Payments' and 'Reasonable Benefit Limits'. The tax consequences of superannuation pensions, annuities and allocated pensions are then examined as are the tax consequences of rolling-over a benefit.

8.5 The Committee's detailed and instructive evidence is then outlined. Despite the confusion in this area, the Committee received some novel and thoughtful suggestions for future arrangements.

8.6 The quality evidence that has been received by the Committee during its on-going inquiry, and the public debate this has generated have in part prompted Government action with respect to simplification. Taxation Laws Amendment (Superannuation) Bill 1992 seeks to remedy many of the concerns raised by a number of witnesses. The key objectives of the Bill include:

- simplification of some of the more complex areas (for example RBL);
- removal of some of the unintended distortions caused by the tax law (for example pension v annuities);
- strengthening the integrity of the system by closing off some areas of abuse (for example redundancy payments, roll-over arrangements).

However, the Committee considers that notwithstanding the significant reforms contained in the Bill, more could have been achieved. In particular, the pre-July 1983 and post-June 1983 issue could have been tackled.

8.7 Also, this chapter reviews the submissions and evidence given during the public hearing on the taxation Bill held on Thursday, 26 November 1992. The evidence received was both informative and generally supportive of the proposed changes.

8.8 Finally, some conclusions are made about the Bills and about reform of this aspect of superannuation.

Current Arrangements

8.9 This section starts with an outline of the elements of an 'Eligible Termination Payment'(ETP) – essentially a payment on departure from an employer. Upon receipt of an ETP, a member may either take the lump sum, park it in a roll-over vehicle (and defer the payment of tax on it), or purchase an immediate annuity. In addition, members can often change from one option to another. All options have various taxation consequences.

Eligible Termination Payments and their Taxation

8.10 The 1983 changes to superannuation introduced the concept of an 'Eligible Termination Payment' (ETP). An ETP may include:

- a lump sum payment from a superannuation plan including commutation of a pension and refund of member contributions;
- a payment for redundancy or unused sick leave made on retirement or retrenchment;
- an ex-gratia payment or golden handshake; or
- a payment from an Approved Deposit Fund or Deferred Annuity.

8.11 These are the only sums that can be rolled over. Sums which are not ETPs (and hence cannot be rolled over) include payments for annual leave or long service leave and payments made to the dependants of deceased former employees/members (that is, death benefits).

8.12 For taxation purposes, an ETP may be broken down into the following components:

- **Undeducted contributions** are those contributions that were made by a member from 1 July 1983 but for which no tax deduction was allowed. Contributions for which a member received a rebate are also included in undeducted contributions. No tax is payable on this component. Where this component is rolled over it still retains its tax-free status.

- The **non-qualifying component** may arise where an immediate annuity is commuted into a lump sum. Where the annuity was purchased partly with an ETP and partly with other savings, the income portion of the commutation relating to the non-ETP proceeds is referred to as the 'non-qualifying component'. The non-qualifying component is fully assessable as income in the year of receipt. Taxpayers simply include this component in their income tax return and pay tax on it at their marginal rate. The non-qualifying component cannot be rolled over.

- The **concessional component** enjoys favourable tax treatment. It includes bona fide redundancy payments, payments from 'approved early retirement schemes' and invalidity payments. Taxpayers must include five per cent of the concessional component in their assessable income in the year in which it is received and pay tax on it at their marginal rate.

- The **excessive component** is essentially the amount of the ETP which is in excess of the member's Reasonable Benefit Limit (RBL).[1] The full excessive component is included in the taxpayer's assessable income in the year in which the ETP is received.

- The **pre-1 July 1983** component of a benefit is that part of the benefit related proportionately to any part of the 'eligible service period' which predates 1 July 1983. Any concessional, non-qualifying and excessive components are excluded for the purposes of calculating the pre-July 1983 component. Hence the pre-July 1983 component is normally calculated using the following formula:

$$(\text{ETP} - \text{CC} - \text{NQC} - \text{EC})$$

multiplied by

$$\frac{\text{Pre-1 July 1983 Period}}{\text{Total Eligible Service Period}}$$

Taxpayers include five per cent of the pre-July 1983 component in their assessable income in the year in which the ETP is received.

[1] RBLs are covered at paragraph 8.13

Example 8.1

Richard Hunter started with XYZ Pty Ltd on 1 January 1979 and became a non-contributory member of the employer's superannuation scheme. He resigned on 30 June 1988 and received $8 000 from the superannuation scheme. What is the pre-July 1983 component?

Pre-1 July 1983 component =

(ETP – CC – NQC – EC) multiplied by $\frac{\text{Pre-July 1983 Period}}{\text{Total period}}$

= ($8 000 – 0 – 0 – 0) multiplied by $\frac{1\,642}{3\,469}$

= $8 000 multiplied by 0.4733

= $3 786.40

where:

ETP = Eligible Termination Payment
CC = Concessional Component
NQC = Non-Qualifying Component
EC = Excessive Component

- The **post-30 June 1983** component is the residual of the ETP after the other components have been subtracted from it. The post-June 1983 component is further divided into taxed and untaxed elements which are subject to different rates of tax.

- **Post-30 June 1983 (Taxed element).** Where the ETP is paid from a taxed source, the post-June 1983 component is a taxed element. A 'taxed source' is one which consists of a funded benefit which has been subject to the 15 per cent tax on its earnings and contributions. The maximum rate of tax payable on the taxed element depends on the age of the recipient, the year in which the payment is received and the period of fund membership. These tax rates are set out in Table 8.1.

- **Post-30 June 1983 (Untaxed element).** Where the ETP is not paid from a taxed source, the post-June 1983 component will be an untaxed element. 'Untaxed' sources refer to items such as 'golden handshakes' and also payments from most government superannuation funds. For taxpayers under the age of 55, this amount is included in their assessable income and taxed at a maximum rate of 30 per cent. Where recipients are 55 years of age and over, the full amount is included in assessable income, with the amount up to the low-rate threshold ($76 949 for 1992/93) taxed at a maximum rate of 15 per cent and the amount over that taxed at a maximum rate of 30 per cent.

Table 8.1. Taxation of 'Taxed Element' of Post-30 June 1983 Component

Age	Year				
	1988/89 %	1989/90 %	1990/91 %	1991/92 %	1992/93+ %
1. Fund membership commencing before 1 July 1985					
Pre-55	28	26	24	22	20
55 plus:					
◆ 0 to threshold*	12	9	6	3	0
◆ over threshold*	27	24	21	18	15
2. Fund membership commencing in period 1 July 1985 to 30 June 1986					
Pre-55	27	24	20	20	20
55 plus:					
◆ 0 to threshold*	10	5	0	0	0
◆ over threshold*	25	20	15	15	15
3. Fund membership commencing in period 1 July 1986 to 30 June 1987					
Pre-55	25	20	20	20	20
55 plus:					
◆ 0 to threshold*	7	0	0	0	0
◆ over threshold*	22	15	15	15	15
4. Fund membership commencing on or after 1 July 1987					
Pre-55	20	20	20	20	20
55 plus:					
◆ 0 to threshold*	0	0	0	0	0
◆ over threshold*	15	15	15	15	15

* For 1988/89 the threshold was $60 000. For later years it is indexed to Average Weekly Ordinary Time Earnings. The indexed threshold is $64 500 for 1989/90, $68 628 for 1990/91 and $73 776 for 1991/92. If the payment is made to the estate of a deceased taxpayer, the relevant age is the age of the deceased at the time of death.

8.13 The threshold applies once for each taxpayer. If a taxpayer is aged 55 or over he receives a payment with a post-June 1983 component of less than the threshold, then the balance may be applied to the post-June 1983 component of any subsequent payment. In any event, where the threshold is increased by indexation after one payment has been made, the amount of the increase is available for a later payment either in addition to any unused balance or, if there is no unused balance, on its own.[2]

[2] CCH, *Master Tax Guide* February, 1992

Reasonable Benefit Limits

8.14 An RBL is a limit on the amount of concessionally taxed superannuation a member may receive. Prior to the May 1988 tax reforms, the limit restricted the lump sum benefits that a fund could pay a member to seven times average salary in the final three years of employment and annual pension benefits to 75 per cent of average salary for the same period. Where funds paid a benefit in excess of these amounts, they jeopardised their complying status.

8.15 The May 1988 reforms revamped the RBL. A progressive RBL scale, effective from 1 July 1988 (see Table 8.2) was introduced and a person's undeducted post-30 June 1983 contributions were excluded from the RBL base. Transitional arrangements were introduced to ensure that any accrued entitlements were protected.

8.16 From 1 July 1990 a lower threshold of $175 000 was established for the lump sum RBL and $282 500 for the pension RBL; so that where a member's RBL is calculated as a lower figure the threshold applies. The RBLs were indexed to AWOTE and are now $196 360 and $315 560 respectively.

Table 8.2 Reasonable Benefit Limit Scales[3]

Salary Thresholds (a)	Lump Sum RBL Scale (b)	Pension RBL Scale (b)
First $44 850	7	0.75
$44 850 to $83 280	5	0.55
Over $83 280	3	0.35

(a) Indexed annually to movements in AWOTE.

(b) Marginal RBL scales. For example, the lump sum RBL for a person with salary of $100 000 is: ($44 850 x 7) + ($38 430 x 5) + ($16 720 x 3) = $556 260
or 5.56 times salary.

8.17 Currently, responsibility for administering RBLs lies with the ISC. In fact, the rules pertaining to the RBL regime are found in Part IA of the OSS Regulations. Briefly, a retiring fund member requires an RBL determination before lodging a tax return. These determinations (both interim and final) are made by the ISC and the member sends them to the Australian Tax Office with their return.

[3] Source: Australian Taxation Office

Pensions and Annuities

8.18 An annuity is an income stream which has been purchased with a lump sum amount (for instance by rolling over an ETP). A pension is generally purchased from a superannuation fund by contributions over a period of time.

8.19 The amount of a pension or annuity is included in a taxpayer's assessable income, excluding an annual 'deductible amount' which represents the purchase price of the pension or annuity for which no previous tax concession has been granted (the undeducted purchase price), allocated over the remaining expected life of the recipient. Accordingly, rebatable amounts are taken into account for the purposes of calculating the undeducted purchase price.

8.20 For purchased roll-over annuities, in addition to undeducted contributions and any concessional component, any pre-July 1983 component of an ETP counts towards the undeducted purchase price (UPP).

8.21 In contrast, for pensions the UPP will generally include only a person's contributions post-June 1983 to the extent that no deduction has applied (plus a person's contributions pre-July 1983 for which no deduction or rebate has applied).

8.22 A tax rebate is currently available for certain roll-over annuities and pensions (but not tax paid annuities). Generally, a recipient is entitled to a 15 per cent rebate (from the 1992/93 year) on the assessable component attributable to fund membership after 30 June 1983. The rebate was introduced in the 1988/89 year at three per cent to compensate recipients for the taxation of contributions from 1 July 1988 and was phased in at three per cent per year.

8.23 The rebate does not apply to a pension where the payments are funded by continuing employer contributions and the fund trustee elects to exclude those contributions as taxable contributions and gives written notice to the recipient that the pension is non-rebatable. For example, this may occur with unfunded government schemes.

Roll-overs

8.24 Upon receipt of an ETP, a departing member under the age of 65 has the following alternatives: first, take the lump sum and pay tax on it in the year of receipt; and second, roll-over all or part of the lump sum and defer the payment of tax.

8.25 There are basically four roll-over options available for a recipient of an ETP, namely:

- purchasing an immediate annuity;
- rolling over benefit into a new plan;
- rolling over benefit into an Approved Deposit Fund; and
- rolling over benefit into a Deferred Annuity.

8.26 An ETP will not be included in assessable income where it is rolled over. Roll-overs must be made within 90 days of payment of the ETP and can proceed by way of either direct payment from the payer or by deposit by the payee within the required time.

8.27 A rolled over payment will be subject to tax in the hands of the roll-over institution to the extent that the ETP came from an untaxed source (for example a golden handshake).

8.28 The concessional components and undeducted contributions of an ETP are preserved on roll-over with the same tax consequences arising on ultimate withdrawal. On withdrawal, the retiree can elect to receive the concessional and or undeducted contribution amounts separate from the pre-July and post-June 1983 components. On withdrawal of the pre and post components, the amounts are apportioned over the time of service including the time of deposit in the roll-over fund. Accordingly, the pre-July 1983 period will remain fixed while the post-June 1983 proportion will grow with the passing of time. However, it should be noted that any undeducted contributions will reduce the post-June 1983 component after the appropriate apportioning has been completed.

Committee's Evidence

8.29 The Committee noted considerable sentiment that the end benefit stage should be the sole or predominant stage of taxation of superannuation.[4] The IFAA Ltd recommended that:

4 Westpac Banking Corporation, sub no 132, p 9; IFAA Ltd, sub no 154, p 7; Dr John Knight, sub no 171, p 1; Rothschild Australia Asset Management Ltd, sub no 141, p 2; Australian Friendly Societies Association, sub no 136; Mr Peter Griffin (Managing Director, Rothschild Australia Asset Management Ltd), sub no 133, p 3,4; County Natwest, sub no 98, p 26; ASFA, sub no 89, p 23; Government Employees Superannuation Board (WA), sub no 84, p 4

> Taxing superannuation on exit can act as a self-balancing mechanism. Distinct age group bubbles (such as baby boomers) will all retire together. Tax on exit will help pay the social security expenses of those without sufficient means.[5]

8.30 Other advantages of taxing end benefits solely include the increased attractiveness of the initial investment,[6] increased ability to accrue investment earnings[7] and reducing the complexity of administration.[8]

Eligible Termination Payments

8.31 It was overwhelmingly acknowledged that the system of taxing end benefits is extremely complex[9] and some witnesses even advanced this as a reason for abolishing the tax on end benefits altogether.[10] It was also suggested that the concessional nature of income tax imposed at this juncture has gradually waned due to the reductions in personal and corporate income tax since 1983.[11]

8.32 However, it was also indicated that many of these complications have arisen from the equitable policy of preserving rights accrued at the dates of various changes[12] and that to remove them would be a breach of faith.[13]

8.33 The Australian Taxation Office provided an excellent summary of why taxpayers experience difficulty in complying with the taxation of ETPs. They indicated that the following factors create problems:

(a) the tax rates applicable to an ETP are dependent on a number of variables including:

- the source of the payment;

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5 Sub no 154, p 11

6 IFAA Ltd, sub no 154, p 12; Westpac Banking Corporation, sub no 132, p 9

7 IFAA Ltd, sub no 154, p 12; Westpac Banking Corporation, sub no 132, p 9

8 IFAA Ltd, sub no 154, p 12; Westpac Banking Corporation, sub no 132, p 9

9 ASCPA/ICAA, Sub no 119, p 8; Bankers Trust, sub no 105, p 5; LIFA, sub no 115, p 6-12; Metway Corporation, sub no 117, p 1; South Australian Employers Federation, sub no 185, p 14; CEDA, *op cit*, p 17; Mr Barry Thompson (Northern Territory Superannuation Commissioner), sub no 77, p 2; Taxation Institute of Australia, sub no 124, p 2

10 ASCPA/ICAA, Sub no 119, p 8; CEDA, op cit, p 17

11 ASCPA/ICAA, Sub no 119, p 8

12 GESB, sub no 84, p 4

13 Australian International Pilots Association, sub no 134, p 4-7

- the components (up to seven different components) of which it is comprised;
- the year in which it is received;
- the receipt of an ISC determination;
- the year in which employment or fund membership commenced;
- the age of the recipient; and
- the recipient's income level.

(b) the receipt of ETPs having a partly taxed and partly untaxed source (such as payments from government superannuation funds);

(c) the determination of an eligible service period which is used as the basis for dividing the ETP into its pre-July 1983 and post-June 1983 components;

(d) difficulties in identifying payments which qualify for concessional treatment as bona fide redundancy payments or approved early retirement scheme payments;

(e) the number of forms that have to be completed by payers and recipients for the ATO and the ISC, some of which involve a duplication of information.[14]

8.34 In addition, an earlier submission from the ATO suggested that:

- The concessional tax treatment extended to redundancy payments is open to abuse. Instances have occurred where termination payments of millions of dollars have received highly concessional tax treatment.
- There is scope under the current provisions of the income tax law to change the incidence of tax on an ETP by the use of tax effective investment decisions.
- Compliance costs are unduly high because of the difficulty in understanding the legislative requirements.[15]

8.35 National Mutual contended that the ETP system is too complex and offered the following as evidence:

- The source of payments affects the tax treatment (there are 16 types of ETPs);

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[14] Sub no 155, p 4

[15] ibid, p 2

- An ETP may consist of up to six separate components, depending upon the type of payment, with different taxation treatment applying to each component;

- The post-June 1983 component may consist of a taxed and an untaxed element, which are taxed differently;

- The rebatable amount is determined by sixteen separate items;

- A single ETP can include more than one taxed element, depending on the source and start date of previous benefits rolled over into the fund;

- Calculations of a concessional component for an approved early retirement scheme and bona fide redundancy payments have become increasingly complex as a result of Income Tax Rulings, so much so that the topic is a minefield; and

- Problems are encountered in determining a member's 'eligible service period' for differentiating between pre-July 1983 and post-June 1983 purposes.[16]

8.36 Most of the above points were also suggested by LIFA.[17]

8.37 Mr Barry Thompson, the Northern Territory Superannuation Commissioner, suggested that the components of a lump sum should be reduced from the current number to three, namely; undeducted contributions, benefits from a taxed source and benefits from an untaxed source. Tax would only be levied on the final component (taxes having been paid on the other two). He further advised that this would involve eliminating the pre-July 1983 and post-June 1983 components.[18] Mr Thompson also recommended that ETPs be restricted to superannuation benefits while other benefits (such as redundancy and unused sick leave) could be dealt with elsewhere in the ITAA.[19] Similarly, he advocated amendments to the concessional component of the ETP. Noble Lowndes suggested that the concessional components also be removed as 'there is no logical reason why such members should be actively encouraged by the taxation system to take a lump sum benefit'.[20]

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[16] Sub no 100, p 15

[17] Sub no 114, pp 11 and 12

[18] Sub no 77, p 2-7

[19] Sub no 77, p 5

[20] Sub no 80, p 7

Eliminating the pre-July 1983 and post-June 1983 components of benefits.

8.38 A cause of great complexity with respect to ETPs is the partitioning of pre-July 83 and post-June 83 benefits. The division applies to many taxpayers and due to the stark advantage of having a benefit characterised as mainly pre-July 83, it invites taxpayer manipulation. However, due to the perceived retroactive impact of any attempts to assimilate the treatment of pre-July and post-June 83 benefits, simplification in this area has stalled.

8.39 The Committee received a number of novel suggestions for removing this distinction which attempted to retain the overall position of a taxpayer with pre-July 83 benefits. Mr Thompson advised that this could be done quite simply suggesting that if the Government wished to tax end benefits (from taxed sources) at fifteen per cent, then this could be phased in by starting at a rate of ten per cent and increasing it by 0.5 per cent every year. He said 'this would militate against the retrospective impact while at the same time allowing a uniform tax rate to be applied to all benefit payments in a particular year'.[21] A similar approach was recommended by the AM Corporation who indicated that a flat rate of ten per cent could be applied to the entire lump sum benefit up to the maximum RBL, increasing by five per cent over the next five to ten years.[22] Although existing members (with large pre-July 1983 components) would be taxed more heavily, a higher RBL (of $750 000) should minimise any disadvantage 'and this, in turn, will provide further incentives to take a pension or annuity'.[23]

8.40 Noble Lowndes suggested a unique method of overcoming any possible community resentment to abolishing the pre-July 1983 component over a longer time frame. They submitted that at a particular point in time, fund trustees should determine the pre-July 1983 component of a member's entitlement and this amount would be frozen. These pre-July 1983 credits could be paid to members free of tax. They acknowledged, however, that there may be a small cost to revenue.

8.41 A similar proposition was advanced by the Government Employees Superannuation Board (WA) who suggested that end benefits be subject to concessional but progressive tax rates, for example the first $100 000 would be exempt, the next $100 000 taxed at ten per cent, and the third $100 000 at 20 per cent. They went on to suggest:

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[21] Sub no 77, p 3

[22] Sub no 96, p 9

[23] Sub no 96, p 10

> As a way of phasing out the pre-July 1983 component it may be possible to have a substantial part of a lump sum benefit tax exempt for a given period of time and then introduce a rate of taxation on the first component at some future date.[24]

8.42 The application of progressive tax rates to end benefits was also recommended by the Hon Frank Blevins MLA, South Australian Minister for Finance.[25]

8.43 The Metway Corporation also supported phasing out the distinction between pre-July 1983 and post-June 1983 components, possibly over five years.[26] Similarly, the Taxation Institute supported phasing out the division of such benefits.[27] Alternatively, Mr David Rolleston, suggested converting all accrued pre-July 1983 service benefits into undeducted contributions with an appropriate tax payment being made by the fund at the time of adjustment.[28]

Reasonable Benefit Limits

8.44 The RBL system came under strong and widespread attack being described as 'cumbersome and confusing'[29] and 'complicated and confusing'.[30] The Treasury conceded that:

> Notwithstanding the reforms over recent years, the current RBL arrangements have attracted some criticism. Linking RBLs to salary and measuring an individual's RBL over their full working life imposes a very substantial record-keeping and administrative task. In addition, the open-ended nature of the RBLs (ie the absence of a maximum dollar limit) has been questioned on equity grounds by some sections of the community.[31]

8.45 The Treasury also intimated that 'the determination of a person's entitlement to concessionally taxed benefits under the RBLs is an area of considerable complexity'.[32] The Insurance and Superannuation Commission

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[24] Sub no 84, p 5

[25] Sub no 122, attachment

[26] Sub no 117, p 1

[27] Sub no 124, p 6

[28] Sub no 129, p 4

[29] AM Corporation, sub no 96, p 7

[30] LIFA, sub no 114, p 12

[31] Sub no 195, p 10

[32] Sub no 195, p 18

submitted that the complexity of the RBL rules is mainly due to 'reliance upon the historical practice of expressing benefits as multiples of salary'.[33]

8.46 The salary-based nature of RBLs came under attack from ACOSS who suggested that a uniform RBL rather than a sliding scale should be adopted.[34] Alternatively, if that policy was unsuitable, they suggested that a mix of requirements curtailing the benefits for high income earners may be appropriate.[35] Similarly, the ACTU supported a review of the RBL system particular in relation to an upper ceiling of maximum tax-assisted benefits.[36]

8.47 Jacques Martin advised that where tax concessions are limited at the contributions phase (through an age-based scale for tax-assisted contributions), the need for an RBL on end benefits would 'disappear'.[37] This approach was also preferred by the AM Corporation.[38] Similarly, Mr David Rolleston suggested, as part of a package of measures, the abolition of the RBL[39] as did the Government Employees Superannuation Board (WA).[40]

8.48 There was strong support for the imposition of a flat-dollar RBL.[41] The main advantages of such a limit were seen as the removal of the whole RBL determination system,[42] the Highest Average Salary (HAS) figure from the calculation,[43] and its ease of understanding by the general public.[44] The AM Corporation suggested a limit of $750 000 plus non-deductible contributions (without earnings).[45]

8.49 However, there was concern expressed that the introduction of a flat-dollar RBL would:

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33 Sub no 151, p 23

34 Sub no 35, p iv

35 ibid

36 Sub no 106, p 17-18

37 Sub no 90, p 5

38 Sub no 96, p 7

39 Sub no 129, p 4

40 Sub no 84, p 4

41 For example Metway Corporation, sub no 117, p 2; Mr Barry Thompson, sub no 77, p 4; University of NSW Superannuation Economics Research Group, sub no 150, p 13

42 AM Corporation, sub no 96, p 8

43 AM Corporation sub no 96, p 8

44 AM Corporation, sub no 96, p 8

45 Sub no 96, p 7

achieve nothing other than an increase in tax revenue and would be inequitable to those whose retirement planning and contributions were based on the present, or earlier, provisions.[46]

8.50 In light of this sentiment, the obvious challenge for the Government would be to select a flat-dollar limit which would take account of expectations based on past arrangements.

8.51 Suggestions for the dollar level of the RBL ranged widely. The AM Corporation suggested $750 000,[47] the Taxation Institute $750 000 to $1 million,[48] and CEDA $800 000.[49] As Mr Barry Thompson indicated, however, 'the level at which such a maximum benefit should be set (and indexed) is a matter of judgement'.[50] He went on to suggest a limit based on the lump sum value at age 60 of a CPI indexed and reversionary pension equal to 200 per cent of Average Weekly Earnings – approximately 30 times the annual value of the AWE.[51]

8.52 Peter J. Vere suggested that the current lump sum and pension RBLs be replaced with a flat dollar limit of $750 000, with a maximum of $187 500 being taken as a lump sum.[52]

8.53 With respect to indexation, the AM Corporation submitted that the RBL should be adjusted with changes in AWOTE 'but only when the application of this rate exceeds a $25 000 multiple [thus avoiding] the rather cumbersome approach of using the precise AWOTE figure which leads to unusual and unnecessary precision'.[53]

RBLs – Administrative issues.

8.54 OSSA provides for ten different notices which may be required for administration of RBLs:

- Notice to ISC from payer re 15 February 1990 roll-over balances;

- Notice to ISC from payer re payments made;

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46 Australian International Pilots Association, sub no 134, p 5

47 Sub no 96, p 8

48 Sub no 124, p 6

49 CEDA, op cit, p 21

50 Sub no 77, p 5

51 ibid

52 Sub no 241, p 1

53 Sub no 96, p 8

- Notice to recipient from payer re payments made;
- Notice to ISC from payer re payments made between 15 February 1990 and 30 June 1990;
- Notice to ISC from recipient re roll-over;
- Notice to ISC from payer re commutation of pension or annuity;
- RBL interim determination to recipient from ISC;
- RBL final determination to recipient from ISC;
- Amended determination to recipient from ISC; and
- Notice to life office or registered organisation from ISC re deemed commutation of pension or annuity.[54]

8.55 The Australian Taxation Office submitted that compliance concerns in relation to RBLs are:

(a) the calculation of the RBL is salary based and therefore very difficult to determine because no other party, other than the individual, has ready access to all the information;

(b) the determination process to advise people about their RBL entitlement and the tax consequences of their ETP can be onerous; and

(c) the RBL administrative arrangements require payers and recipients of ETPs to have dealings with both the ISC and the ATO.[55]

8.56 The Insurance and Superannuation Commission provided an explanation for the delays in processing RBL determinations received by people in the 1990/91 year stating that such delays were due to resource and software problems coupled with problems in data received from funds and employers.[56] The ISC also provided the following five options by which the RBL system could be simplified. In summary these were:

- revert to the pre-July 1990 arrangements under which funds were required to determine a member's RBL and were not allowed to pay out any amounts in excess of that;
- maintain current arrangements;

[54] National Mutual sub no 100, p 21

[55] Sub no 155, p 4

[56] Sub no 151, p 24

- maintain current arrangements but only send annual determinations to member's whose benefits exceed their RBL.

- replace the tapering scale based on HAS with a maximum money figure; and

- alter the composition of the ETP for RBL purposes.[57]

8.57 National Mutual (NML) lucidly detailed the complexity of the RBL system. They indicated that:

> RBLs are benefit specific. Therefore a person can have a different RBL for each benefit received. A consequence of this is that the order in which benefits are taken will affect the tax paid. This introduces unnecessary complications and further, members with the resources available to undertake effective financial planning can manipulate the system to their financial advantage – which of course disadvantages members who do not have those resources.[58]

8.58 In addition, with respect to benefit determination, NML noted that OSSA prescribes:[59]

- five situations in which the Commissioner must not make a determination;

- four situations in which a determination is to be revoked; and

- seven situations in which a determination is to be revised.

8.59 National Mutual further noted considerable delay in the issuing of interim and final determinations. They contended that 'this delay has created considerable confusion amongst taxpayers and unnecessarily delayed the lodgement of personal Income Tax Returns'.[60]

8.60 The ASCPA/ICAA submitted that the ATO should administer the RBL system and the payments of superannuation benefits, as:

> ... it has the administrative framework and resources; the computer infrastructure; and people with appropriate skills and experience necessary to manage such a task.[61]

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[57] Sub no 151, pp 9 & 10

[58] Sub no 100, p 20

[59] Sub no 100, p 21

[60] Sub no 100, p 21

[61] Sub no 119, p 9

RBLs – Highest Average Salary

8.61 NML noted that there are five situations (and methods) in which the HAS is indexed and three exceptions to these rules. They also noted that there is a glaring need for clear guidelines to be issued by the ISC on what it includes in HAS.[62] The AM Corporation described the HAS figure as 'hard to establish' and requiring 'maintenance of considerable records'.[63] The Taxation Institute submitted to the Committee a number of technical anomalies with the RBL rules. These generally involved the explanation of the term 'salary' in the OSS Regulations.[64]

Death Benefits

8.62 NML noted that the assessment of death benefits against RBLs is confusing, saying that whether benefits are counted against an RBL depends on to whom the benefit is paid and the timing of the payment. Similarly, they contended that complex actuarial calculations are necessary where part of a death or disability payment is 'self-funded' by the trustees of a scheme.[65] ASFA advised that there appeared to be some confusion within the ATO about the assessability of lump sum death benefits paid to child beneficiaries on trust and recommended that such benefits be exempt from tax.[66] The Treasurer in his *Security in Retirement* Statement has foreshadowed changes in the tax treatment of death benefits.[67]

Pensions and Annuities

8.63 The Australian Taxation Office provided an excellent exposition of some of the complexities in the area of pensions and roll-over annuities. These included:

(a) the difference in the undeducted purchase price calculation for pensions from a superannuation fund to which the taxpayer has contributed over a number of years and pensions or annuities purchased with the roll-over of an ETP;

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[62] Sub no 100, p 20

[63] Sub no 96, p 7

[64] It should be noted that the current RBL rules are overhauled by the amendments contained in the Taxation Laws Amendment (Superannuation) Bill 1992. See paragraph 8.76.*

[65] Sub no 100, p 13

[66] Sub no 89, pp 19 & 24

[67] John Dawkins *Security in Retirement* AGPS Canberra June 1992 p 13

(b) the different treatment of unused undeducted purchase price received on commutation of a pension entitlement and undeducted contributions received on the payment of a lump sum entitlement; and

(c) the difficulty in determining the entitlement to a pension and annuity rebate and the level of that entitlement.[68]

8.64 Noble Lowndes suggested that taxation of these two items has possibly become the most complicated area stating that anomalies in the treatment of the two have caused superannuants to prefer receiving a lump sum and then purchasing an annuity rather than taking a pension from their superannuation fund.[69] Support for more consistent treatment of pensions and annuity income also came from LIFA,[70] the AM Corporation,[71] Metway Corporation,[72] and CEDA.[73]

8.65 This incentive to purchase an annuity reflects the point made by the ATO at point (a) in paragraph 8.71, namely that the UPP of the two instruments differ. ASFA provided data (see Table 8.3) which succinctly illustrates this difference:[74]

Table 8.3 : Items Included in Undeducted Purchase Price

Benefit Type	Part of Purchase price paid before 1 July 1983.	Part of Purchase price paid after 30 June 1983.
Pension from Superannuation Plan	Non-deductible/ non-rebatable member contributions	Non-deductible member contributions
Annuity from roll-over superannuation lump sum	All	Non-deductible member contributions*
Annuity from superannuation lump sum on which tax has been paid	All	All

* Also eligible for a rebate. The rebate is higher for an annuity than a pension if any purchase price is paid before 1 July 1983.

68 Sub no 155, p 6

69 ibid

70 Sub no 114, p 12

71 Sub no 96, p 10

72 Sub no 117, p 2

73 CEDA, op cit, p 22

74 Sub no 89, p 20

8.66 The import of Table 8.3 is that the UPP of an annuity is greater than for a superannuation pension. As the UPP is deducted from the annuity or pension before it is included in assessable income, the tax on the superannuation pension will generally be higher.

8.67 The point was also made by National Mutual who suggested that this 'long standing' anomaly 'continues to accentuate the uneven playing field that exists in the area of purchasing a retirement income stream'. Furthermore, they suggested that the pension and annuity rebate provisions are 'exceedingly complex' and involve complicated calculations.[75]

Lump sums v. Income streams[76]

8.68 The use of the taxation system to encourage the taking of benefits as income streams was widely supported.[77] Equally, there was support for a cap on lump sum benefits with the balance being taken in income form,[78] or even that lump sum payments be banned altogether[79] or annuity purchase be mandated.[80]

8.69 Noble Lowndes proposed that all pension and annuity income be assessable, but that a 15 per cent rebate apply to the entire payment, regardless of its purchase source. They justified this extension of the rebate on the grounds that it would encourage the use of pensions and noted that there is currently no reason for a person to take a pre-July 1983 benefit in pension form.[81]

8.70 Noble Lowndes intimated that there are still substantial tax concessions for taking a benefit as a lump sum. The high tax-free threshold applying to the post-June 1983 component is the most visible attraction.[82] In discouraging lump sums, Noble Lowndes suggested a revolutionary approach. They recommend that lump sums (including the pre-July 1983 amount but less

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[75] ibid, p 16. It should be noted that the Taxation Laws Amendment (Superannuation) Bill 1992 remedies the divergent treatment of pensions and annuities.

[76] Chapter 4 of this report examines the basic policy considerations of this issue.

[77] Hon. Frank Blevins MP, South Australian Minister for Finance sub no 122, attachment; Institute of Actuaries, sub no 108, p 2-3; Department of Social Security, sub no 127, p 12-13

[78] AMP, sub no 120, p 66; Department of Social Security, sub no 127, p 12-13

[79] Mr Peter Griffin (Managing Director, Rothschild Australia Asset Management Ltd), sub no 133, p 4

[80] CEDA, op cit, p 17

[81] Sub no 80, p 5

[82] Sub no 80, p 5

undeducted contributions) received prior to age 60 be taxed at 25 per cent. Lump sums taken after that date could be taxed at 20 per cent above a threshold (they nominated $73 776 indexed).[83] They further advised that this would also solve the vexed pre-July/post-June 1983 issue. As part of the overhaul of lump sums, Noble Lowndes suggested that the 'concessional component' also be dropped. Upon disability, recipients of an ETP should take their benefits in pension form and be allowed the 15 per cent rebate.[84] Due to the revolutionary nature of these proposals, they suggested a three to five year transitional period.

8.71 CEDA's approach is that rather than providing incentives for income stream rather than lump sum benefits, 'it is more straightforward to mandate annuity purchase'.[85] This would facilitate the removal of the tax on end benefits from funded schemes (up to an RBL), and hence substantially assist simplification.[86]

8.72 Taking an alternative approach, the Westpac Banking Corporation suggested that non-compulsory means of encouraging income streams over lump sums should be used. This, they stated, could involve increasing the lump sum tax and reducing pension tax.[87] In addition, incentives including access to pensioner benefits could be spread to some superannuants.[88]

TAXATION LAWS AMENDMENT (SUPERANNUATION) BILL 1992

8.73 Most of the tax reforms announced by the Treasurer in his *Security in Retirement* Statement of 30 June 1992 are contained in the Taxation Laws Amendment (Superannuation) Bill 1992. The Bill contains five Parts of which only Part Two relates to amendments to the *Income Tax Assessment Act 1936.* Part Two, in turn, contains twelve divisions of which only Divisions 4 to 11 are germane to this chapter.[89]

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[83] Sub no 80, p 6

[84] ibid, p 7

[85] CEDA, op cit, p 17

[86] ibid

[87] Sub no 132, p 7

[88] ibid

[89] Divisions 2 and 3 were dealt with in chapter 5 of this Report. Division 1 simply notes that the 'principal Act' amended is the *Income Tax Assessment Act 1936.* Division 12 deals with amendment of assessments and is not discussed in the Report

8.74 Division 4 makes various amendments with respect to rebates for certain superannuation pensions and qualifying annuities. Division 5 makes amendments relating to the undeducted purchase price of annuities and superannuation pensions. In particular, it replaces the current definition of 'undeducted purchase price' with a new definition of UPP so that, for rebatable superannuation pensions and rebatable ETP annuities, the UPP consists only of undeducted contributions. Division 6 includes 'unused undeducted purchase price' within the definition of 'undeducted contributions' (and as such, within the definition of ETP). Division 7 inserts the definitions of 'pension' and annuity' in various parts of the Act. It also contains amendments to extend the meaning of pensions and annuities and to provide for minimum standards for certain annuities.

8.75 Division 8 relates to the practice of rolling-over and abolishes a taxpayer's ability to choose which parts of an ETP (other than undeducted contributions and concessional components) are rolled-over. It deals with the distinction between the pre-July 83 and post-June 83 components with respect to rolled-over benefits. The clauses add integrity to the roll-over system by assimilating the identity of benefits before and after roll-over. These clauses have the effect of smothering the ability of taxpayers to substantially reduce the tax payable on their ETP. In addition, Division 9 makes a slight change to the roll-over rules. The effect of Division 9 is that from 1 July 1994 benefits must be rolled-over directly from the source to the destination fund. Amendments to the OSSA will allow benefits to be retained by superannuation funds for 90 days during which taxpayers must decide what to do with their ETP.

8.76 Division 10 makes amendments relating to the components of ETPs known as bona fide redundancy payments (BFRPs), approved early retirement scheme payments (AERSPs) and invalidity payments. Broadly, the Division provides a limit on the concessionally taxed amount of bona fide redundancy payments and approved early retirement scheme payments and exempts amounts within that limit from tax. The tax-free amount will be excluded from the ETP definition, will not be able to be rolled over and will not count against the recipient's RBL. The excess over the tax-free limit will be treated as an ordinary ETP.

8.77 Perhaps the most significant reforms in the Bill are those relating to RBLs. The amendments made to the RBL regime are contained in Division 10 and may be summarised as follows:

- transfer administration of the RBLs from the ISC to the ATO;

- make the RBL a set dollar amount rather than a multiple of a recipient's highest average salary; and

- make other minor changes to simplify the treatment of the excessive amount of pensions and annuities for RBL purposes.[90]

Evidence on the Bill

8.78 The Committee heard evidence and received a number of written submissions on the Bill. Comment on the new benefit taxation arrangements was mostly favourable – particularly with respect to the RBL amendments.

8.79 In his introductory remarks to the Committee, Senator McMullan stated that:

> The new flat RBLs are simpler than the current salary linked limits. In addition, the new arrangements are far more equitable. The RBLs will no longer be open ended and will afford equal access to the superannuation tax concessions for everyone.[91]

8.80 Mr Ian Robinson of the Treasury submitted that approximately 95 per cent of employees would fall below the $400 000 lump sum RBL figure. In describing how the $400 000 limit was arrived at, Mr Robinson commented that 'it was a matter of judgement' and that no precise formula was used.[92]

8.81 Support for the new RBL arrangements came from Mr Scullin of ASFA,[93] Mr Ken Robinson of LIFA[94] and Mr Iain Ross of the ACTU.[95] Mr Scullin, noting that an RBL limit of $400 000 equates to a salary of approximately $60 000 per annum under the current arrangements, stated that

> We strongly believe that we did need to move away from the salary related RBLs to a dollar RBL so that then it became a matter of choosing the level. Our view is that the $400 000 limit is a reasonable trade-off in the situation.[96]

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[90] See Explanatory Memorandum, p 97

[91] ST Bills Evidence, p 4

[92] ibid, p 7

[93] ibid, p 20

[94] ibid, p 20

[95] Evidence, p 2141

[96] ST Bills evidence, p 20

8.82 ACOSS, however, argued that the $400 000 lump sum limit was too generous and suggested $200 000 being an amount 'sufficient to fund an annuity for life at about half average weekly earnings'.[97] In addition, they noted that 'an RBL of $800 000 for annuities' allows a superannuant to purchase an annuity of $60 000 per annum – approximately twice average weekly earnings.

8.83 The Taxation Institute of Australia made four points in relation to this part of the Bill, namely:

- the RBL should be indexed from 1 July 1992 rather than 1 July 1994.
- the RBL calculations required by Subdivision A of Division 14 are too complex;
- the amendments relating to taxpayer choice in rolling over an ETP should be take effect upon passing of the Bill rather than retrospective to 1 July 1992; and
- the upper dollar limit placed on bona fide redundancy payments and approved early retirement schemes should be linked to the earnings of the employee in receipt of the amount.[98]

Conclusion

8.84 The amendments proposed by the Bill with respect to this phase seem to have struck an appropriate balance between equity, simplicity and efficiency.

8.85 The amendments relating to pensions and annuities remedy an unsatisfactory situation on which the Committee had earlier received evidence. It is hoped that the removal of the previous anomalous situation will facilitate Government encouragement for income-streams over lump sums by increasing the demand for superannuation pensions

8.86 The reforms proposed for the concessional component are also welcomed as they will hopefully diminish the incidence of abuse and hence strengthen the integrity of the system.

8.87 Similarly, it has been overwhelmingly acknowledged that the current salary linked RBL must be changed to a flat dollar limit. Possibly the single greatest achievement of this Bill is that it makes considerable inroads into improving the

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97 ibid, p 25

98 Sub no ST 30, p 2

administration of RBLs. Importantly, the Government has retained a high figure for its pension RBL. As mentioned earlier, the challenge then becomes to select an appropriate level; satisfying everyone is impossible. The Committee received a number of submissions on this limit, ranging from $200 000 to $1 million. The $400 000 limit provided for in the Bill equates to an RBL pertaining to a salary of $60 000 under the current arrangements – or approximately twice average weekly earnings. However, it is to be remembered that the Bill must be looked at as a coherent package – not as a concoction of unintegrated proposals.

8.88 However, there are still some areas that the Bill leaves unaffected. In particular, amendments to the taxation of death benefits, announced in the Treasurer's *Security in Retirement* Statement, are noticeably absent. The Committee expects that these important reforms will follow shortly. Similarly, the Government has yet to tackle the pre-July 1983 and post-June 1983 problem. The Committee expects that progress will be made on this matter in 1993.

CHAPTER 9 : AMENDMENTS PUT TO THE COMMITTEE BY ORGANISATIONS AND INDIVIDUALS

Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive)

9.1 **AM Corporation, on behalf of five providers of allocated pensions**, made the following recommendations:

- that the current rules of allowing flexible commutation be continued. As long as the minimum pension is paid each year, individuals should have the right to elect to receive lump sum commutation. For administrative simplicity, such commutation should be limited to a minimum of, say, ten per cent of the remaining account balance (with corresponding adjustment to the Deductible Amount) and, say, one commutation per year; and

- that the proposed new treatment of allocated pensions should be held over until a full review of annuities and pensions be undertaken for consistent treatment[1]

The following proposed Social Security amendments were presented by AM Corporation to the Committee:

"INCOME" TEST

1. **Bill**	**Amendments**
Allocated pensions and annuities to be treated as "managed investments" from 25 March 1993 (subject to transitional rules)	Amend Bill to exclude allocated pensions and annuities from managed investments definition, but only if they comply with the proviso to the *revised* allocated pension/annuity definition. Those that do not comply will be treated as per Bill

[1] ST sub nos 15 and 17.

2. **Act**	**Amendments**
Annuities that are "roll-over annuities" qualify for a greater exclusion for income test purposes than pensions and other annuities via a modified definition of "deductible amount". (No change to this in the Bill.)	Amend Bill so that treatment for "Roll-over Annuities" is extended to "Roll-over Allocated Pensions", being superannuation pensions that are allocated pensions (as per the *revised* definition) purchased with rolled-over amounts.

"ASSETS" TEST

1. **Bill**	**Amendments**
Act currently excludes the value of superannuation pensions from the assets test. The Bill limits the exclusion so that it does not apply to a superannuation pension that is an allocated pension.	(No change to this, other than *revised* allocated pension definition.)

2. **Bill**	**Amendments**
The Act contains a special provision for valuing annuities. The Bill proposes that this should not apply to *allocated* annuities.	Amend Bill so that the annuity valuation provisions apply to superannuation pensions that are allocated pensions and so that allocated annuities are *not* excluded from the annuity valuation provisions. (Note *revised* definition of allocated pensions and annuities.)

DRAFT AMENDMENTS TO THE SOCIAL SECURITY LEGISLATION AMENDMENT (NO 3) BILL 1992

Brief Explanation of the Amendments

1. The amendments introduce a revised definition of what is an *allocated* pension or an *allocated* annuity. See amendment numbered (2).

2. The amendments exclude allocated pensions and allocated annuities that comply with the new definition from the definition of "managed investments" to be introduced from 25 March 1993 (and from the transitional rules to apply for the period to 25 March 1993). This will have the result that the income actually received under the allocated pensions or annuities will be treated as income for the income test, rather than the "deemed" earnings under the special rules for managed investments. Allocated pensions and annuities that do not comply with the new definition will be included as managed investments from 25 March 1993 and will be subject to the transitional rules. See amendments numbered (1) and (3).

3. The amendments modify the definitions relevant to the exclusion of the "deductible amount" for income test purposes to extend the treatment for roll-over annuities to "roll-over allocated pensions". A roll-over allocated pension is defined as a superannuation pension that is an allocated pension (as defined) purchased with roll-over amounts. See amendment numbered (2).

4. In relation to the inclusion of the value of allocated pensions and annuities for the purposes of the assets test, allocated superannuation pensions and allocated annuities are to be valued in accordance with the "Annuity Value Calculator" set out at the end of section 1119 for consistency with the treatment of other annuities. see amendment numbered (4).

Text of the Amendments

Clause 113

(1) Clause 113, paragraph (b):

(a) delete paragraph (g) from subsection (1B) and substitute the following paragraph (g):

"(g) a pension or annuity which does not meet the requirements set out in either of paragraphs (a) or (b) of the definition of an allocated pension or annuity st out in section 9(8), but which would otherwise be an allocated pension or an allocated annuity."

(b) delete the words "that is not an allocated annuity" from paragraph (f) of subsection (IC) and substitute the words "other than an annuity of the kind described in section 9(1B)(g)";

(c) delete the words "that is not an allocated pension" from paragraph (g) of subsection (IC) and substitute the words "other than a pension of the kind described in section 9(1B)(g)"; and

Clause 137

(2) Clause 137, omit paragraph (b), insert the following new paragraphs (b) – (g) (inclusive);

"(b) by inserting immediately after the words "an annuity" in the definitions of "purchase price", "relevant number" and "residual capital value" in subsection (1) the words "or a superannuation pension that is an allocated pension";

(c) by adding at the end the following subsection:

"(8) A pension or annuity is an allocated one if the provider of the pension maintains an account in respect of the pensioner or annuitant to which is credited earnings that relate to the

amount in the account and to which is debited annuity instalments or pension instalments that are paid to the pensioner or annuitant **PROVIDED THAT:**

(a) the rate of payment may only be varied once in any period of 12 consecutive months; and
(b) in the case of an allocated pension payable from a superannuation fund, the superannuation fund must have been a "complying superannuation fund" for the purposes of the Income Tax Assessment Act 1936 when the pension commenced to be paid."

(d) in the definition of "non-assessable purchase price" in subsection (1), by inserting the words "or a roll-over allocated pension" immediately after the words "roll-over immediate annuity" in paragraph (b) and by inserting the words "other than a roll-over allocated pension" immediately after the words "a superannuation pension" in paragraph (c);

(e) in the definition of "purchase price" in subsection (1), by inserting the words "or a superannuation pension" immediately after the words "an annuity";

(f) by inserting the following definition in subsection (1):

"roll-over allocated pension" means a superannuation pension that is an allocated pension, the purchase price of which consists wholly of a rolled-over amount or rolled-over amounts;"

(g) by deleting the definition of "roll-over purchase price" from subsection (1) and substituting the following definition of "roll-over purchase price":

"roll-over purchase price" in relation to a roll-over immediate annuity or a roll-over allocated pension means:

(a) except where paragraph (b) applies – either the sum of the following amounts:

(i) the amount that would, under Subdivision AA of Division 2 of Part III of the *Income Tax Assessment Act*, be the undeducted purchase price of the annuity or superannuation pension;

(ii) the amount that is the upper limit under section 159SG of the *Income Tax Assessment Act* for the year of income in which the annuity or superannuation pension was purchased;

or the purchase price of the annuity or superannuation pension, whichever is less; or

(b) where:

(i) more than one roll-over immediate annuity or roll-over allocated pension have been purchased using the same rolled-over amount or rolled-over amounts in the name of the same person or where both a roll-over immediate annuity and a roll-over allocated pension (or more than one of either or both) have been purchased using the same rolled-over amount or rolled-over amounts in the name of the same person; and

(ii) the roll-over purchase price of any other roll-over immediate annuity or roll-over allocated pension has previously been worked out under paragraph (a) for the purposes of this *Act;*

the amount that would, under Subdivision AA of Division 2 of Part III of the *Income Tax Assessment Act,* be the undeducted purchase price of the annuity or superannuation pension;

Clause 138

(3) Delete the words "allocated annuity or allocated pension" from section 1099A(1) and substitute the words "an annuity or a pension which does not meet the requirements set out in either of paragraphs (a) or (b) of the definition of an allocated annuity or pension set out in section 9(8), but which would otherwise be an allocated annuity or an allocated pension."

Clause 140

(4) Omit the clause, insert the following new clause:

140. Sections 1119 and 1120 are repealed and the following sections are substituted:

"Value of annuities and allocated pensions

1119. (1) Subject to subsection (2), in calculating the value of a person's assets for the purposes of this *Act* (other than subparagraph 263(1)(c)(iv) and sections 1125 and 1126), disregard the value of any annuity of the person.

(2) Subsection (1) does not apply to:

(a) a disposable or deferrable annuity; or

(b) an immediate annuity purchased on or after 15 August 1989; or

(c) an annuity that became presently payable on or after 15 August 1989.

Disposable or deferrable annuity

(3) For the purposes of subsection (2), an annuity is a **disposable or deferrable annuity** if:

(a) either:

(i) the annuity is able to be disposed of; or

(ii) a substantial part of the income under the annuity is deferred; or

(iii) a substantial part of the income under the annuity may be deferred; and

(b) the Secretary is satisfied that the annuity should not be disregarded under paragraph 1118(1)(e).

Value of allocated pensions and certain post-15 August 1989 annuities

(4) The value of:

(a) an immediate annuity (including an immediate annuity that is an allocated annuity) purchased on or after 15 August 1989; or

(b) an annuity (including an annuity that is an allocated annuity), that became presently payable on or after 15 August 1989; or

(c) a superannuation pension that is an allocated pension;

is worked out using the Annuity Value Calculator at the end of this section.

ANNUITY VALUE CALCULATOR

Overall value calculation

1119-1. This is how to work out the value of the annuity or pension:

Method statement	
Step 1.	Work out the residual capital value of the annuity or pension;
Step 2.	Work out the balance of the purchase price of the annuity or pension using pint 1119-2.
Step 3.	Work out the adjustment factor using point 1119-3.
Step 4.	Multiply the balance obtained under Step 2 by the adjustment factor obtained in Step 3: the result is called the adjusted balance.
Step 5.	Add the adjusted balance to the residual capital value: the result is called the adjusted value of the annuity or pension;
Step 6.	the value of the annuity or pension is the higher of the adjusted value and the residual capital value.

Note: for "residual capital value" see subsection 9(1).

Balance of purchase price

1119-2 The balance of the purchase price of the annuity or pension is:

purchase price − residual capital value

Note: for "purchase price" and "residual capital value" see subsection 9(1).

Adjustment factor

1119-3. The adjustment factor is:

$$\frac{\textbf{relevant number} - (\textbf{years elapsed} + \textbf{1})}{\textbf{relevant number}}$$

where:

relevant number is the relevant number for the annuity or pension;

years elapsed is the number of full years that have elapsed since the annuity or pension became presently payable.

Note: for "relevant number" see subsection 9(1).

Value of annuity or allocated pension − change of relevant number

1120. (1) If:

(a) a determination of entitlement is made in relation to a person; and

(b) the determination is made having regard to a relevant number for an annuity or a superannuation pension that is an allocated pension; and

(c) the number was determined as mentioned in paragraph (c) of the definition of "relevant number" in section 27H of the *Incomes Tax Assessment Act;* and

(d) the person appeals against the determination of the relevant number; and

(e) on appeal, a lower number is substituted for the original relevant number;

the Secretary must make a new determination of entitlement in relation to the person.

(2) In making a new determination under subsection (1), the Secretary must have regard to the lower relevant number for the annuity or allocated pension concerned.

(3) If the Secretary makes a new determination of entitlement in relation to a person under subsection (1), there is payable to the person the amount worked out using the formula:

new amount - actual amount

where:

new amount is the amount of pension, benefit or allowance that would have been payable to the person for the underpayment period at the new rate determined under subsection (1);

actual amount is the amount of pension, benefit or allowance that is paid to the person for the underpayment period;

underpayment period is the period that:

(a) starts either:

(i) if the appeal concerned is instituted within three months after the person is notified of the original determination of the relevant number – when that determination is made; or

(ii) in any other case – when the appeal is instituted; and

(b) ends when the new determination of entitlement takes effect.

9.2 **Equity Life Limited** recommended that 'with profit' annuities be treated in the same manner as allocated pensions and that a review of the proposed changes be undertaken.

Taxation Laws Amendment (Superannuation) Bill 1992

9.3 Association of Superannuation Funds of Australia Limited (ASFA)

ASFA submitted details of its Council resolution regarding the need for greater equity in taxation arrangements. Its goal, in order of priority, should be to:

(i) lift the rebate to, say, 20 per cent;

(ii) lift the maximum qualifying contribution to, say, five per cent of AWE (approximately $1 500); and

(iii) lift the income cut-off point to, say, 150 per cent of AWE (approximately $45 000)[2]

9.4 Life Insurance Federation of Australia (LIFA)

- LIFA recommended that the taxation rebates on superannuation be changed as follows in order of priority:

  (i) increase the $1 000 limit to $2 000;

  (ii) increase the ten per cent rebate to 20 per cent; and

  (iii) increase the $27 000 salary threshold to $35 000.

- In the event of rebates not being improved for all, a phased reduction for those who made deductible or rebatable contributions in 1991-92 should be allowed.[3]

9.5 Australian Council of Social Service (ACOSS)

- ACOSS submitted that changes be made to bring about the:

  - abolition of the current special tax concessions for contributions and fund earnings;

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[2] ST sub no 21.

[3] ST sub no 16.

- assessment of taxable contributions and fund earnings as part of the individual members' taxable income, with tax on superannuation component paid by the fund;

- provision of a uniform tax rebate, which could be offset against taxes paid by the fund in respect of contributions and fund earnings for each member; and

- abolition or substantial reduction of taxes on benefits, except for lump sums above $75 000 (indexed annually) and benefits withdrawn before age 60 (except in cases of hardship involving persons over 50 years of age)

The rebate could be calculated either on an annual or a life-time basis. An annual rebate could allow for a higher level of contributions for older workers with limited superannuation.

The rebate could be calculated either as a flat amount or as a percentage of taxable contributions and earnings up to a maximum level. This percentage should be no less than the lowest marginal rate of personal income tax.

9.6 ACOSS further submits that if the above proposal is not adopted, another option would involve:

- abolition of the current concessions for contributions;

- taxation of employer contributions at marginal rates and providing a uniform rebate to offset employer and personal contributions in full or in part; and

- fixing the RBLs at much lower levels than proposed.

9.7 **Captain C J Kaye** submitted the following amendments:

1. Any taxpayer who has a lump sum in excess of $400 000 RBL, or the $800 000 pension RBL on 30 June 1994, be permitted to have that sum transferred to a capital account under separate ADF or superannuation rules.

2. Any earnings, be it interest, dividends or rental, together with any future employer award payments, be paid into a separate and new fund from which, on retirement, only a pension can be paid.

3. That the value of the capital account be allowed to increase (or decrease) by the change in asset value of the account without attracting a penalty rate of the top marginal rate on withdrawal on retirement.

4. That mix of assets within the account be allowed to be varied as the fund managers see fit.

5. That these arrangements be permitted to continue after retirement, provided that both the capital account and the account for receiving earnings and paying a pension are BOTH transferred to an ADF under rules similar to pre-February 1990.[4]

9.8 **The Institute of Actuaries** submitted that the following amendments be made:

- in relation to the 1.7.94 simpler age-related maximum contribution rates, the Institute recommends that some discretion be allowed for defined benefits funds, for example, after a significant reduction in membership, a fund may need extra contributions to secure remaining benefits; and

- more significant tax offsets for member contributions are needed.

[4] Sub no ST 20, p 3

CHAPTER 10. : RECOMMENDATIONS

A. Social Security Matters

Social Security Legislation Amendment Bill (No 3) 1992
Divisions 16-19 (inclusive)

The Committee by majority recommends that the Social Security Legislation Amendment Bill (No 3) 1992 Divisions 16-19 (inclusive) be agreed to without amendment.

The Committee's On-going Inquiry

The Committee recommends the following in relation to its on-going inquiry into superannuation:

Recommendation 3.1

The Committee recommends that, as a matter of urgency, the Commonwealth should initiate discussions with the States with a view to facilitating portability between them and that these objectives be achieved by the end of 1993.

Recommendation 3.2

The Committee recommends that the Government take steps to provide for the mandatory vesting, as from a date to be determined, of a significant part of the employer-financed benefits in occupational superannuation funds accrued to that date but not otherwise vested. An example of a possible scheme is:

(i) The amount to be vested shall be not less than each member's contributions, plus fund earnings, to that date.

(ii) The amount should be vested over a ten year period.

(iii) Where existing rules would, if applied, result in a greater sum being vested in any member, those rules should apply.

Recommendation 3.3:

The Committee recommends that, in relation to Recommendation 3.2 regarding increased vesting requirements, the base date should be the date on which the Government announces the adoption of the policy in order to protect the

interests of then-existing members. Employees retrenched or dismissed after the announcement, but before the base date, should be entitled to whatever vesting they would have been entitled to if the base date had been the date of their termination.

Recommendation 3.4:

The Committee recommends that immediate vesting of all employer contributions subsequent to the vesting base date be compulsory.

Recommendation 3.5

The Committee recommends that the commencement date of the new rules to substantially increase the amount of benefits to be compulsorily preserved, as announced in *Security in Retirement*, should be reconsidered by the Government with a view to earlier commencement.

Recommendation 3.6:

The Committee recommends by majority that the preservation age be raised to 60 years in accordance with the phasing in proposals outlined in *Security in Retirement.*

Recommendation 3.7

The Committee further recommends that the Government should, as a matter of urgency, initiate research into all aspects of appropriate retirement ages and the extent of double dipping in Australia.

Recommendation 3.8:

The Committee recommends that the ISC, the organisation which it believes is best placed to administer this policy, work towards the achievement of the Committee's long term goal to eliminate early access to retirement benefits. The Committee also recommends that the ISC promulgate a policy to ensure consistency of treatment of applications and further recommends that the ISC develop a more limited set of rules setting out clearly the circumstances for hardship assistance.

Recommendation 4.1:

The Committee recommends that the Government investigate the possible expansion of long term debt instruments with a view to affording annuity providers greater opportunities to provide lower-cost indexed products.

Recommendation 4.2

The Committee recommends that the Government proceed with its announced intention to rebate all income tax otherwise payable by age pensioners.

Recommendation 4.3

The Committee recommends the assets test be aligned with the income test via the application of realistic, market-related interest equivalents, subject to:

(a) a reasonable allowance, for example $50 000, for personal and household possessions; and

(b) inclusion of actual income on bona fide income-earning assets.

Recommendation 4.4

The Committee recommends that the Treasurer and the Minister for Social Security form a working party to examine income tax and social security legislation with a view to maximising the consistency of definitions and treatment of matters of common concern to the two systems and that the report be tabled in Parliament by the end of 1993.

B. Taxation Matters

Taxation Laws Amendment (Superannuation) Bill 1992

(i) The Committee by majority recommends that the Taxation Laws Amendment (Superannuation) Bill 1992 and the amendments moved by the Government in relation to it be agreed to without amendment.

The Committee's On-going Inquiry

(ii) The Committee recommends the following in relation to its on-going inquiry into superannuation:

Recommendation 5.1:

The Committee recommends that a specialist unit, known in the Australian Taxation Office as a 'cell', be established within the ATO to clarify taxation law and practice for the superannuation industry.

Recommendation 6.1:

The Committee recommends that the Government monitor and examine the use of salary sacrifice arrangements with a view to ensuring that their use does not undermine the equity aims of the Government's retirement incomes policy.

Recommendation 7.1:

The Committee by majority believes that the contributions tax should be retained for 'deductible' contributions and the exemption for 'rebatable' contributions should also be maintained.

Recommendation 7.2:

The Committee believes that the contributions tax, with respect to employer contributions, should be withheld by the employer instead of the fund trustee. This would substantially reduce the administrative complexity of the current arrangements and lead to less loss of benefits through inadvertence. In other words, employer and self-employed contributions (which have been subject to the 15 per cent tax) should be excluded from the assessable income of the fund.

Recommendation 7.3:

The Committee by majority recommends that the fund earning tax should be maintained at its current concessional rate and that it should retain its concessional character by being reduced in line with other reductions in personal income tax rates.

Recommendation 7.4:

The Committee recommends that the Commissioner of Taxation should clarify, by way of Taxation Rulings and Determinations, the allowable deductions available to superannuation fund trustees. Further, where appropriate, the position of superannuation funds should be aligned with normal businesses.

Recommendation 7.5:

The Committee recommends that any expenses incurred by trustees in complying with legislative and regulatory changes, some of which will flow from its series of reports, be completely tax deductible for fund trustees.

Recommendation 7.6:

The Committee recommends that the Treasury consider whether there is scope to correct any anomalies that may exist in the application of Capital Gains Tax (CGT) to fund trustees. The Treasury should specifically consider the application of CGT to units in unit trusts, the application of CGT to pre-September 1985 assets and the application of CGT in fund amalgamations.

Recommendation 7.7:

The Committee recommends that the Treasury examine the arrangements applying to current pension liabilities to find a less complex regime. Regard should also be had to the complexity of the taxpayer rebates.

Recommendation 7.8:

The Committee recommends that the Treasury examine whether there is scope to overcome the confusion surrounding the transfer of tax liability provisions.

Recommendation 7.9:

The Committee recommends that the Government review section 290A to determine whether there are impediments to ADFs claiming the exemption, and, if so, to remove such impediments to ensure that the exemption is enjoyed by those who are entitled to it.

MINORITY REPORT – SENATORS ALSTON AND WATSON

1. The Committee's report brings together a number of important issues upon which we are broad agreement with the Government. However, the differences in basic philosophy of the Government and Opposition are well illustrated in the proposed amendments to the taxation and social security legislation. The Government believes that the answer to all problems of human behaviour lies in compulsion and if the problem is a financial one, this Government's answer will include higher taxes.

2. It is common ground that the aging of our population will place some strain on our resources from about 2010 onwards unless effective and timely counter-measures are taken. There is also general agreement that superannuation should play a much greater role in the provision of retirement income than it does now. The Government's response to this challenge is the blunt instrument of compulsion: firstly through its encouragement of award superannuation and, more recently, through the punitive Superannuation Guarantee Charge.

3. Australia has an appalling savings record, so bad indeed that the nation is totally dependent on foreigners for the maintenance of its living standards. If Australia cannot sell its few remaining prosperous companies for foreign currency, it goes cap in hand to the market and borrows what is needed. The reason why Australians are poor savers is that there is no incentive to save – the deadly scissor blades of taxation and years of endemic inflation have convinced a whole generation that it is not worth while to put money aside for the future.

4. The Government's reaction has been to abolish virtually all the remaining tax incentives to saving through superannuation, the very antithesis of what is required.

5. We set out below our points of dissent from the report.

Level of Pensions

6. In Chapter 2, the report notes without comment that 'welfare groups submitted that the current age pension is too low and needs to be increased.' It is now apparent that the Government is reluctant to countenance, let alone facilitate, any increase in the age pension.

7. In *Security in Retirement* (released by the Treasurer on 30 June) the Government said on page 23:

> To increase base pension levels significantly and to have the pension paid also increase with income ... would weaken further all the incentives that otherwise exist ... for private self provision. Given Australia's inadequate savings performance, that would be a perverse policy outcome and is one that has therefore been rejected by this Government.

8. Further, Labor Senator Nick Sherry, the Superannuation Committee's chairman, told the *Townsville Bulletin* on 5 August 1992 that:

> ... if we don't improve superannuation, we would not be able to pay the same amount (of the pension) we do now, simply because of the number of people over 65.

Taxation Treatment of Member Contributions

9. We do not consider that the changes to the tax treatment of superannuation contributions envisaged in the Bill will provide a more equitable system, as claimed in the Conclusion to Chapter 6. Currently there is a range of different taxation concessions for different categories of employees. For wage and salary earners the position is as follows:

- those with no superannuation cover can claim tax deductions on the same basis as the self-employed, namely $3 000 a year plus 75 per cent of excess contributions up to their RBLs;
- those with award superannuation only are entitled to a deduction of $3 000 a year; and
- those with incomes of less than $25 000 per year (tapering off to $31 000) and with modest levels of employer support (less than $1 600 per year) are entitled to a rebate of up to 25 per cent – a maximum rebate of $750.

10. The Bill will abolish the first two concessions and severely limit the third by replacing it with a uniform rebate of 10 per cent. The highest rebate under these proposals will be a token $100 to those on the bottom of the income ladder, provided they can scrape up a superannuation contribution of $1 000.

11. All other changes announced by the Treasurer on 30 June last had two years' lead time, but for the removal of tax deductions on personal contributions, the Government gave less than 24 hours' notice.

12. Apart from saving the Government an estimated $230 million in 1993-94, these proposed changes will dramatically and adversely affect an estimated 1.3 million individuals who are currently contributing to superannuation plans, particularly personal plans. These involve a contractual arrangement, usually for a set period of at least five years, and many such persons have already been confronted with the dilemma of effectively contributing a higher net amount or breaching their contracts.

13. There has been widespread speculation as to the Government's motives but it would seem quite consistent with its view that, unlike virtually every other industrialised country in the world, employers should bear the full responsibility for superannuation contributions and that employees should be effectively discouraged from helping themselves by making supplementary arrangements on their own account.

14. At a recent seminar in Perth, the Federal Labor's representative, the Member for Canning and Government Whip, George Gear, let the cat out of the bag when he told the audience 'with a compulsory superannuation system fully in place you don't need tax concessions'. It can only be a matter of time before the Government succumbs to irresistible temptation and abolishes the $3.5 million a year tax deductions on employer contributions.

15. This is totally unacceptable situation as the current generation of employees will receive nothing like an adequate level of retirement income under SGC timetable. On the Government's own calculations, for an individual on average weekly earnings to receive 40 per cent of AWE, there would need to be twelve per cent contributions made over a forty-year period. Most workers will not be in the workforce for anything like forty years, even if they are fortunate enough to be employed at the present time. The majority of the workforce are aged over thirty years and are still effectively encouraged to retire at age 55. Women also tend to work ten years less on a full-time basis than men.

16. The overwhelming majority of the current generation of the workforce will also not have the benefits of anything like 12 per cent of contributions whatever length of time they are in the workforce. Some 850 000 employees are not covered by awards and have therefore not been receiving the first 3 per cent award superannuation. A further 600 000 award employees have not received their entitlements as a result of employer non-compliance and a further 100 000 public sector employees have not been receiving award superannuation. As the SGC is to be phased in over a ten-year period, it follows that even those already receiving the first round 3 per cent will not reach 9 per cent until the year 2002, let alone the 12 per cent advocated by the Government. In these circumstances the immediate removal of any incentives to top up is not only callous and unnecessary but also extremely unfair.

Taxation of Employer and Self-Employed Contributions

17. We dissent from Recommendation 7.1, which supports the retention of the current contributions tax regime, which is unfair in the extreme. Being at a flat rate, it is highly regressive. As many welfare groups have urged on the Committee, it would be much fairer to bring in a variable tax on contributions, based on the member's marginal tax rate, less a 25 per cent rebate.

Taxation of Fund Earnings

18. We dissent from Recommendation 7.3, which supports the current rates of taxation on fund earnings. In fact a modest increase in the fund earnings tax, after allowing for dividend imputation, would enable a significant decrease in contributions taxes and the abolition of lump sum taxes – a much better and fairer mix than the current regime.

Pre- and Post-1983 Problem

19. The Bill does not address the significant and unnecessary complexities of the pre- and post-1983 problem. This probably has much to do with a lack of political will on the part of the Government. The Coalition will abolish this complex regime by abolishing taxes on the lump sums taken after preservation age.

Vesting of Employee Contributions

20. The Government has now been dithering for more than three years over its policy on the vesting of employer contributions. Meanwhile, many employees continue to walk away from even long standing employment with a single employer with little more than employee contributions plus interest.

21. This is a quite unsatisfactory and unfair outcome, especially as many employees in these circumstances, often women, end up with quite inadequate retirement income arrangements.

22. We do not believe the recommendations in Chapter 3 go far enough and urge the Government to adopt the Coalition's policy of immediate vesting for accumulation funds and a progressive five-year vesting regime for defined benefit funds.

Preservation Age for Superannuation Benefits

23. We dissent from Recommendation 3.6. While we welcome the Government's belated decision to raise the preservation age to 60, despite the continued intransigence of the ACTU, we cannot understand why such a simple and urgently needed change should take 24 years to commence and 32 years to complete. The Treasurer's announcement of the Government's decision on 30 June 1992 gave no reasons for the delay, other than to observe that the change would not upset existing plans for retirement. This decision is an extreme example of fiscal irresponsibility. We believe that the program can be brought forward by 20 years without depriving anyone of any reasonably held right or expectation, and urge adoption of the Coalition's Fightback proposals, which are set out below:

DATE OF BIRTH	PRESERVATION AGE
before 1 January 1940	55 years
1 January 1940 – 30 June 1940	55 years and 6 months
1 July 1940 – 31 December 1940	56 years
1 January 1941 – 30 June 1941	56 years and 6 months
1 July 1941 – 31 December 1941	57 years
1 January 1942 – 30 June 1942	57 years and 6 months
1 July 1942 – 31 December 1942	58 years
1 January 1943 – 30 June 1043	58 years and 6 months
1 July 1943 – 31 December 1943	59 years
1 January 1944 – 30 June 1944	59 years and 6 months
after 1 July 1944	60 years

24. The Government's continued refusal to commission detailed statistics on the nature and extent of double dipping is to be deplored. Its preservation proposals are an open invitation to double-dipping and demonstrate its total subservience to the union movement, which regards superannuation as a mixture of deferred holiday pay and an employer-financed housing subsidy.

Social Security Legislation — Allocated Pensions

25. We dissent from the support, expressed in Chapter 4 of the report, for the proposed treatment of allocated pensions in Division 19 of the Bill. However, we strongly support the need for a more flexible pension and annuities regime. In this context, allocated pensions have a vital role to play and we therefore believe that the current provisions are likely to diminish the attraction of allocated pensions and hence undermine an effective retirement incomes policy.

26. For some time now, the Government has been giving lip service to the need for retirees to use their superannuation benefits to produce a steady retirement income stream instead of dissipating lump sums as so many now do.

27. There are aspects of conventional lifetime annuities which make them unattractive to some potential purchasers – they are inflexible, relatively low-yielding, and do not have a residual value to be passed on.

28. Allocated pensions were developed to fill a market gap and, eventually, received the Treasurer's commendation in *Security in Retirement* last June. The ISC has developed rules which expand the definition of annuities in such a way as to include allocated pensions.

29. The proposed amendments to the Social Security legislation, by denying allocated pensions the same treatment already given to annuities in the income and assets tests, are likely to undo all that good work and fly in the face of the stated policy of encouraging allocated pensions.

30. The only reason given by the Government is the rather pathetic assertion that allocated pensions are more like bank accounts than annuities, despite the change in definitions with the specific objective of encouraging their use by treating them as annuities for tax purposes.

31. We deplore the obvious failure of the two departments involved to get their act together and co-operate in the development of a sensible retirement incomes policy.

32. In the absence of retailed information as to the current usage of allocated pensions, it is difficult to understand the Government's haste to kneecap this form of retirement income stream.

33. As there is only about $2 million of revenue involved, we propose that the provisions should not take effect until the completion of a further inquiry by an appropriate Senate Committee, or 1 October 1993, whichever is the later.

34. There are many problems associated with the proposal to include unrealised capital gains in the Social Security income means test and we are disturbed that this was not the subject of a coordinated review to ensure equity of treatment.

MINORITY REPORT – SENATOR KERNOT

Taxation Laws Amendment (Superannuation) Bill 1992

1. Whilst the package of measures in the Taxation Laws Amendment (Superannuation) Bill 1992 is generally supported by the Australian Democrats, there are two areas which should be modified.

Elimination of tax deductions for personal superannuation contributions

2. The Committee has received many submissions on the Government's proposal to eliminate, from 1 July 1992, the tax deduction for employee contributions. Universally the evidence has been that the proposal will detrimentally affect many existing members of superannuation schemes, in excess of one million people, and that this is unfair in most circumstances.

3. There is no dispute that the Government must take budgetary considerations into account in determining superannuation policy, and that the Government has a right to make prospective decisions concerning access to tax concessions. However, the proposal in the legislation to terminate all concessions for those earning in excess of $31 000 per year (that is average weekly earnings), with no prior warning, is unfair and discriminates against those already locked into binding contractual obligations. It is almost unbelievable that a Government could publicly advocate, and increase the tax concessions for, employees 'topping up' their employer's contributions with personal contributions and then capriciously terminate these tax concessions. This decision contradicts a statement by the then Treasurer, The Hon P J Keating, MP, in the May 1988 Statement at page 12:

> As a further encouragement to people to provide for their retirement, the limit on tax deductions for contributions to small business and related superannuation funds will be doubled to $3 000 a year.

4. The inability of current compulsory arrangements to provide adequate retirement incomes is the reason why 'topping up', especially for those over 50, is important.

5. The Government has claimed that it has targeted the employee contribution concessions very equitably by limiting the maximum concession – $100 per annum – to those earning less than $27 000.

6. Whilst this is superficially accurate, the reality is that those in a position to do so will simply cease making employee contributions and will enter into a salary sacrifice arrangement to ensure that the contributions formerly made by the employee will be made by the employer, and hence continue to qualify as a tax deduction. That is, many – generally those in higher income and managerial positions – will simply be able to avoid the change in tax concessions by rearranging remuneration packages.

7. As a consequence, the Government's assertion of greater targeting of the concession is clearly ludicrous and the new proposals may indeed operate in a regressive manner for some income groups.

8. The second issue raised by the Government is that the introduction of the SGC means that it is now unnecessary to encourage people to 'top-up' their employer contributions. For people now entering the workforce, the SGC will provide a reasonable retirement income – however people in the latter half of their working lives, who only receive the minimum SGC amount, will not accumulate anything approaching an adequate amount to sustain retirement.

9. Indeed the Government actually recognises this issue in the Bill, by moving to a system of age-based employer contribution limits. This allows very large employer contributions for those employees aged over 50, up to $62 000 per year, to qualify as a tax deduction.

10. The fact remains that there are many hundreds of thousands of people who have entered into long term personal superannuation contracts mainly on the basis of being eligible for taxation relief for their contributions. They did so on the basis of the urging of Treasurer Keating and they are now looking at having to continue their contributions without taxation relief or ceasing to contribute and incurring substantial penalties. There should be a phase out of the deduction for those people who have entered into a contract before 1 July 1992 as the SGC contribution rate increases.

11. The behaviour of the Opposition in this matter has been extremely disappointing and irresponsible. The initial response of the Coalition was to oppose the cessation of the deduction outright. However, because of the recent announcement of the Prime Minister concerning the GST, the Opposition has decided to acquiesce and support the elimination of the concession so as to present a stark policy contrast to the electors in the forthcoming election.

12. To treat over one million Australians as political pawns is an act worthy of condemnation, and it makes a mockery of the role of the Senate as a house of review. I urge the Coalition to reconsider their decision, so as to protect the superannuation fund members who will now unnecessarily incur costs and charges if they discontinue their personal superannuation policies.

Recommendation 1 – Senator Kernot:

It is therefore recommended that the provisions removing deductibility be amended to allow a phase out of the concessions to complement the increase of SGC minimum contribution for those people who have entered into a binding superannuation contract prior to 1 July 1992.

The revised Reasonable Benefit Limits arrangements

13. The legislation proposes to introduce, from 1 July 1994, a flat rate RBL which will apply to all superannuation fund members irrespective of their level of remuneration. The Australian Democrats support the move to a common RBL as it provides an absolute, and equal, limit on the amount of tax concession which each person can obtain through superannuation.

14. Hence a reasonable flat rate RBL will increase the equity of the distribution of the $4 billion tax expenditure – that is the foregoing of collection of revenue – which the Commonwealth provides to superannuation fund members every year.

15. Unfortunately, the legislation before the Committee does not propose to set an appropriate RBL. The RBL is proposed to be set at $400 000 (indexed) for lump sums and to be double that amount (that is initially $800 000) where at least 50 per cent of the benefit is taken as a pension.

16. Evidence given to the Committee by Treasury officials indicates that about 95 per cent of people retire on benefits below $400 000. That is, the proposed new lump sum RBL will encompass 95 per cent of all retirees in the future. This means that 95 per cent of persons will not be influenced by the RBL in their choice of either a lump sum or some form of income stream.

17. This can be contrasted with the current system of differing salary based RBLs of seven times highest average salary for lump sums and 11.25 where at least half is taken as a pension or annuity. Taking a person on $30 000 annual income (for example approximately average weekly earnings) as a typical example, the effect of this change will be to increase the lump sum threshold from $210 000 to $400 000.

18. Clearly this will eliminate any incentive provided by the RBLs for retirees on average weekly earnings to opt for an income stream. This situation can only lead to the increase in 'double dipping', that is the use of superannuation moneys for purposes other than providing retirement income. The obvious implication of such a scenario is a reduction in the level of future budgetary

savings (due to clawbacks from social security) which the Government estimated would flow from the introduction of the SGC. The cost of this is potentially enormous and must be considered in any rational analysis of this legislation.

19. That this provision regarding reasonable benefit limits is contained in the same Bill as the flawed proposal to remove tax deductibility for contributions from ordinary battlers, on the basis of budgetary constraints, would be hilarious if it were not so serious.

20. The worst aspect of the RBL proposal is that the Government has allowed political motives to interfere with the proper setting of policy in this area. The Opposition, in its *Fightback!* superannuation package proposes that -

- any amount up to twice average earnings (about $60 000) will be able to be taken in lump sum form; and
- where the entitlement exceeds twice average annual earnings, the lump sum will be limited to $60 000 plus one half of the remaining benefit **subject to a total maximum lump sum benefit of $300 000 indexed.**

21. Clearly the Government's choice of the $400 000 limit is to enable it to go to the election promising a higher RBL than the Coalition. That the Labor Party would choose to deliberately make the taxation system less equitable for political purposes is regrettable, but unfortunately more commonplace – with the regressive *One Nation* income tax cut proposals being the most recent example of this disturbing trend.

Recommendation 2 – Senator Kernot:

It is recommended that the Bill be amended to reduce the lump sum RBL from $400 000 to $300 000. The 'pension' RBL of $800 000 should also be amended down to $600 000.

Social Security Legislation Amendment Bill (No 3) 1992

22. There are two areas in the Bill which should be modified.

A. Unrealised capital gains on listed shares

23. The Government is proposing to change the way in which pensioner investments in shares will be treated. At present, only the dividends paid to

shareholders are taken into account for the purposes of the income test for social security payments, while the actual capital value of the shares is included in the assets test. Until now, the capital growth on listed shares has been disregarded. Amendments to the *Social Security Act 1990* contained in the Bill provide for net unrealised capital gains on listed securities (other than bonds and debentures) to be taken into account under the income test. Losses accrued on listed shares (or similar investments) can be offset against the capital gain over the same assessment period, but cannot be carried forward. The Government says this brings listed shares into line with managed investments where capital growth on the investment is treated as income.

24. Several aspects of this proposed change are highly unsatisfactory.

- It continues the questionable practice in the social security area (which is at odds with taxation practice) of treating an unrealised accretion to capital as income, rather than assessing it under the assets test.

- It discriminates against shares as an investment, as similar treatment is not meted out to other investments (such as antiques, art work, collectibles and other less liquid investments upon which there could also be an unrealised capital gain which is not to be treated as income).

- Shareholder pensioners in similar assets and income positions will be treated differently because of the type of share asset owned. In a submission made to all Senators, the Chairman of the Australian Stock Exchange, Mr Laurence Cox, has argued that, under this proposal, shareholders in a publicly non-listed company (such as Linfox) will not be affected by the change, but investors in a listed company (such as TNT) will be.

- It is possible that investors will be encouraged to invest overseas and not in Australia, as those investments are unaffected by the proposed change. For example, Mr Cox has suggested investors may elect to invest in IBM shares listed on the New York Stock Exchange purchased through an Australian broker, rather than invest in BHP. Accordingly, this move may well discourage small scale investment in Australian companies at a time when such investment is desperately needed.

25. The likely outcome of the Government's move is that many, if not all, of the 85 000 pensioners presently holding share portfolios will sell their shares. I note that Mr Michael Heffernan, the Stock Exchange's chief economist, believes a 'significant number' of pensioners will sell, adding that he doubts the Government's ability to reach its projected savings of more than $85 million a year 'because no-one will have the shares.' (*The Age*, 5 December 1992).

26. Once again, it makes little sense to be discouraging investment in Australian companies at the present time.

- The flawed nature of the formula to be used in assessing gains and losses (set out in Clause 116 of the Bill) combined with the volatility of the share market will result in inequities, as illustrated by the following examples.

  - A share portfolio increases in value from $10 000 to $12 000 over the 12 month period prior to the day of assessment and pays a dividend of $500. The return (for social security purposes) is $2 500: the increase in capital value ($2 000) plus the distribution ($500). The return expressed as a percentage of the value of the asset at the start of the review year is 25 per cent. Under the formula, the past rate of return is applied to the current asset's value. So the past percentage value is applied to the asset value on the day of assessment – that is, 25 per cent of $12 000, or $3 000. So we end up with the situation where the DSS calculated income figure of $3 000 is $500 more than the actual return.

  - Where share prices fall, the dollar amount of the loss relates to the value of the assets at the start of the review year and the resulting percentage is applied to the lower closing price. For example, in the situation in 5.1 (above), if – in the subsequent year – the asset value reverts to $10 000, the $2 000 capital loss is related to the $12 000 opening value and the result is a negative rate of return of 16.67 per cent. That percentage is applied to the closing value of $10 000 and a negative return is calculated ($1 667) which may be offset against gains on other securities, but not other source of income.

  - These examples demonstrate that the formula magnifies gains and minimises losses. In the example above, a $2 000 gain was assessed as $2 500; however, a $2 000 loss attracted a credit of only $1 667. This becomes a problem where a shareholder has two parcels of shares, one of which rises in value and the other falls in value. If the shareholder's two parcels are each valued at $10 000 and one goes up by $2 000 and the other falls by $2 000 (assuming no dividends are paid), the shareholder's DSS calculated income will be $800 ($2 400 income offset by a $1 600 loss), despite the fact there was no capital gain across the entire portfolio. The greater the variation in the price, the greater the calculated income (irrespective of whether or not any actual gain has accrued).

In other words, pension losses caused by share price increases cannot be fully offset by the same drop in share prices.

- This particular problem in the formula also demonstrates the inequity in the treatment between a person with an 'individual' share portfolio and a person who has invested in a managed investment with an identical shareholding. Each gain and loss on the individual's shareholdings are going to be separately assessed and (as pointed out in 5.3) will result in assessable income even if there is no overall net change in the asset value. But the managed investment will have no assessable income where there is no net capital gain.

27. It is also quite clear that, unless DSS reviews are all carried out on the same day (and there has been no suggestion this will occur), pensioners with identical share holdings and the same dividend income could have markedly different pension outcomes.

28. The ability to offset losses is not as positive as it initially appears. This is partly because of the magnification of profits and minimisation of losses already mentioned and partly because of the requirement that losses can only be offset within the same time period against income from other shares or managed funds (not against income from other sources).

29. This makes a mockery of statements by the Government that the move is 'fair' because reductions in share values will be able to be offset against gains.

30. The measure has the potential to result in significant administrative costs for the Department of Social Security as it will be extremely difficult to keep track of market fluctuations.

Recommendation 3 – Senator Kernot

It is recommended that the proposed amendments in the Bill relating to unrealised capital gains on shares, as set out in Division 18, be rejected and the Department of Social Security be advised to re-examine the proposed formula.

B. Allocated Pensions

31. The Bill also changes the manner in which allocated pensions and annuities are assessed for the purposes of the income and assets tests. Under

the proposed amendments, both unrealised capital gains and income applying to allocated pensions will be treated as earned income for the purposes of the age pension assets and income tests. At present, allocated pensions are assessed under the income test only (using a different assessment method to that proposed by the amendments).

32. There is no problem with the move to have the pensions assessed under both tests. The problem in the application of the new income test being proposed by DSS.

33. At present, allocated pensions and annuities are assessed in the same way for the purposes of the income test, that is, DSS assesses the actual amount of income paid on these investments (less the tax concessions). Under the proposed amendments, DSS will assess the *earnings* of the allocated pension's underlying capital rather than the actual income drawn down.

34. DSS estimates this change will save about $2 million a year.

35. This measure is also highly unsatisfactory for several reasons.

- The vast majority of allocated pension holders will be assessed by DSS to be earning more income than they actually receive. They will have their pensions reduced even though their allocated pension income has not changed.

- It is inconsistent with moves in the taxation area where allocated pensions, annuities and other superannuation products are treated in an equal manner. Because of the withdrawal rates applied by DSS, the loss of $1 in income through the application of the income test is equal to a $1 increase in taxation. This cannot be seen as enhancing the integration of the taxation and social security systems.

- The Explanatory Memorandum states that, as the drawings from an allocated pension are variable, it would operate 'in a similar way to a bank account ... at the recipient's discretion.' This would seem to represent a fundamental misunderstanding of the nature of allocated pensions. Allocated pensions can only be opened while applicants are in employment and then only with rollover funds or ETPs, deposits are not permitted, drawings are restricted to government prescribed maximum and minimum limits and can only be made monthly, and most (if not all) allocated pensions only allow the pensioner to vary the amount to be drawn on an annual basis. Therefore, the pensioner's discretion in relation to the allocated pension is severely curtailed.

36. In evidence to the Committee, DSS said they were attempting to 'provide neutral treatment vis-a-vis other similar sorts of investments.' But an examination of the structure and purpose of the product suggests it is stretching both logic and equity to propose they be treated as ordinary investments.

- In fact, it makes considerably more sense to treat allocated pensions in the same way as annuities. This is particularly so in light of the Government's clear statements to the personal investment industry that it prefers retirement benefits to be taken more in income stream form.

37. In evidence to the Committee, DSS advised it accepted a 'similarity' between term annuities and allocated pensions. DSS went on to say: 'For that reason, we will be doing a review of the treatment of term annuities ... [to be] submitted to the Government by the end of January.' It makes little sense to proceed with these changes to the treatment of allocated pensions when a review of annuities is underway in the Department.

- Because an allocated pension is structured in order to build up an investor's capital in the initial stages of the life of the product, the income received during this period is less than what the underlying capital is earning. The likely outcome of the new rules is that people will increase the size of their allocated pension drawings, defeating the purpose of the product and possibly making allocated pensioners onto the age pension at an earlier stage.

- DSS made it quite clear to the Committee that it had no consultation with the providers of these products prior to introducing the changes to allocated pensions. The Insurance and Superannuation Commission has had extensive consultation with the industry on allocated pensions. Mr Michael O'Neill, Assistant Commissioner of the ISC, told the Committee the ISC had received submissions on allocated pensions as long as 12 or 18 months ago. He said 'There were some components of those submissions concerning DSS matters, but that was not our concern.'

Recommendation 4 – Senator Kernot:

It is recommended that the proposed amendments in the Bill relating to allocated pensions, as set out in Division 19, be rejected and DSS be advised to include an exploration of more equitable treatment between allocated pensions and annuities within its current review of term annuities.

Preservation Age

38. As part of the package of changes negotiated prior to the introduction of the SGC, the Democrats insisted that the Government address the question of an increase in the preservation age. We proposed that an appropriate phase-in period for this necessary change was 10-15 years.

39. This was not accepted by the Government because of external pressures, although the Government did agree to a much slower implementation timetable. This at least shows that the Government does acknowledge that a potentially large problem exists in this area – especially as Australia now has a uniform national superannuation system.

40. The relevant industry and professional bodies, namely ASFA, LIFA and the Institute of Actuaries, all welcome the Government's decision in this area. However, they are unsure as to why such a simple and overdue change should take place over a timeframe of over 30 years. I share these sentiments.

41. It is an absurd situation where the Government refuses to address an acknowledged flaw in its policy, which has serious long-term consequences, because of external pressures. The irony is that there is no political resistance to speeding up the changes; the resistance is industrial in nature.

APPENDIX A: TERMS OF REFERENCE

On 5 June 1991 the Senate established a Select Committee on Superannuation to inquire into, and report on, the following matters:

(a) the constitutional arrangements governing superannuation;

(b) the taxation arrangements which apply to superannuation;

(c) the adequacy of prudential control arrangements applying to superannuation funds;

(d) the implications for the financial system of the expected growth in superannuation fund assets;

(e) the investment of moneys by superannuation funds;

(f) the ownership of surpluses in defined benefit superannuation funds;

(g) the level and structure of fees and commissions charged in relation to superannuation fund membership and asset management;

(h) the information available to members of superannuation funds;

(i) the representation of fund members in trustee structures of superannuation funds;

(j) the dispute resolution mechanisms available to members of superannuation funds;

(k) the rules applying to contributions and the vesting and preservation of benefits;

(l) the appropriate means of providing adequate superannuation for part time and casual employees and the feasibility of providing superannuation for people outside the workforce;

(m) the rate of employer non-compliance with superannuation awards;

(n) the possibilities for simplifying superannuation;

(o) the feasibility of providing improved benefits to superannuation arrangements in lieu of increased contributions under superannuation awards in appropriate circumstances;

(p) the need for an appropriate target and timetable for the achievement of adequate levels of superannuation; and

(q) any other relevant matters, including superannuation arrangements existing in other countries.

APPENDIX B: LIST OF WITNESSES RE TAXATION LAWS AMENDMENT (SUPERANNUATION) BILL 1992

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Kirk, Mr Andrew, Legislation Committee, Association of Superannuation Funds of Australia, Level 8, MLC Centre, Sydney, New South Wales,

Scullin, Mr Brian, Executive Director, Association of Superannuation Funds of Australia, Level 8, 37 York Street, Sydney, New South Wales,

Shirlow, Mr David Stewart, Director of Policy Research, Association of Superannuation Funds of Australia, Level 8, 37 York Street, Sydney, New South Wales,

Maroney, Mr John, Superannuation Committee Convenor, Life Insurance Federation of Australia, 31 Queen Street, Melbourne, Victoria,

Robinson, Mr Kenneth Norman, Deputy Convenor, Superannuation Committee, Life Insurance Federation of Australia, 31 Queen Street, Melbourne, Victoria, and

Grenfell, Mr Colin Royce, Member, Retirement Incomes Policy Committee, Institute of Actuaries of Australia, 49 Market Street, Sydney, New South Wales.

Davidson, Mr Peter Andrew Geoffrey, Senior Policy Officer, Australian Council of Social Service, 24 Kippax Street, Surry Hills, New South Wales, and

McClelland, Ms Alison, Principal Economics and Tax Policy Coordinator, Australian Council of Social Service, 24 Kippax Street, Surry Hills, New South Wales.

APPENDIX C: SOCIAL SECURITY LEGISLATION AMENDMENT BILL (NO 3) 1992 DIVISIONS 16-19 (INCLUSIVE)

Donnellan, Mr Raymond Joseph, Canberra Liaison Officer, Council on the Ageing (Australia), 464 St Kilda Road, Melbourne, Victoria,

Nolan, Mr Lawrence Edward, Honorary Spokesperson on Retirement Incomes, Council on the Ageing (Australia), 464 St Kilda Road, Melbourne, Victoria,

Smith, Mr David Richard, Executive Chairman, AM Corporation Ltd, 70 Pitt Street, Sydney, New South Wales,

Tune, Mr David, Assistant Secretary, Retirement Programs Branch, Department of Social Security, Box 7788, Canberra Mail Centre, Canberra, Australian Capital Territory, and

Whitecross, Mr Andrew William, Director, Income and Assets Policy, Department of Social Security, Box 7788, Canberra Mail Centre, Canberra, Australian Capital Territory.

APPENDIX D: LIST OF SUBMISSION RE BILLS

Submission number	Organisation
ST 1	Australian Council of Social Service
ST 2	Laura Greco
ST 3	Kevin D Mulray
ST 4	James H Stevens
ST 5	Patricia Negus
ST 6	Ian J Brown
ST 7	R T Ashfield
ST 8	Adolph Greco
ST 9	Mrs L M Allcock
ST 10	E R Dukas
ST 11	Rae G Jones
ST 12	C Emmerick
ST 13	A R Friar
ST 14	Margaret K Pittaway
ST 15	Equity Life
ST 16	Life Insurance Federation of Australia Incorporated
ST 17	AM Corporation Ltd
ST 18	Department of Social Security
ST 19	Australian Road Transport Industrial Organisation
ST 20	Captain C J Kaye
ST 21	The Association of Superannuation Funds of Australia Limited
ST 22	Council on the Ageing
ST 23	Australian Stock Exchange
ST 24	J C McIntosh Financial Planning Pty Ltd

Submission number	Organisation
ST 25	The Institute of Actuaries of Australia
ST 26	N R J Wilson
ST 27	National Mutual
ST 28	N K Bull
ST 29	Colin Grenfell, Fellow, Institute of Actuaries of Australia
ST 30	Taxation Institute of Australia
ST 31	The Treasury
ST 32	The Alexander Consulting Group

APPENDIX E : LIST OF SUBMISSIONS RE ON-GOING INQUIRY

– IN NUMERICAL ORDER

Sub No	Name
No 1	Gynn, W J
No 2	Fisher F
No 3	Newman, C A
No 4	Liquor Trades Union, The
No 5	Perry, K F
No 6	Walsh, A
No 7	Buildings Union Superannuation
No 8	N E Renton & Associates
No 9	Serendip Publications
No 10	InterData Pty Ltd
No 11	Correspondence only
No 12	Trau, Dr J
No 13	McJannet, D
No 14	Davies, D
No 15	Garrett, P R
No 16	Samson, S W
No 17	Schwarz, D
No 18	Restuccia, V
No 19	Downs, B
No 20	Clayton Utz
No 21	Adams, G
No 22	Lucas, J M
No 23	Cartledge, O
No 24	Hearn, G
No 25	Foley, E
No 26	Civil Service Association of WA
No 27	Owens, E S & Co
No 28	Independent Schools Superannuation Trust
No 29	Burns, W G
No 30	**In camera**
No 31	ACT Council of Social Service Inc
No 32	Hughes, D
No 33	Shell Superannuation Rights Committee

No 34	Australian Salaried Medical Officer Association
No 35	Australian Council of Social Service
No 36	Belshaw, W J
No 37	Smith, B
No 38	Boffa, G
No 39	Arthur Andersen & Co
No 40	Williams, T
No 41	Prudential Life Underwriters Association (NSW)
No 42	Nipper, M R G and Weeks, P L
No 43	Prudential Assurance Company Ltd
No 44	Retired Associate Members' Branch Public Service Association of NSW
No 45	Myuna Pty Ltd
No 46	du Cros, N
No 47	Fisk, B
No 48	Trustee Companies Association
No 49	Australian Lifewriters Association
No 50	Australian Small Business Association
No 51	Long, P D
No 52	Knox, Professor D
No 53	Tribunal on Homosexuals and Discrimination
No 54	Chamen, P
No 55	Metal Trades Industry Association of Australia
No 56	National Association of Nursing Homes & Private Hospitals Inc
No 57	Duesburys
No 58	Morgan Stockbroking Ltd
No 59	IOOF Australia
No 60	Non-Government Schools Superannuation Fund
No 61	Alexander Consulting Group, The
No 62	Metal Manufacturers Limited
No 63	National Australia Bank
No 64	Women's Action Alliance (Australia)
No 65	Chamber of Commerce & Industry of WA
No 66	Melbourne Metropolitan Board of Works (MMBW) Employees' Superannuation Fund
No 67	Yann, R N
No 68	Secondary Colleges Staff Association
No 69	Ulverstone Chamber of Commerce
No 70	Belshaw, M
No 71	Wilson, The Hon Ian, MP
No 72	Crouch, W G
No 73	ANZ Bank
No 74	Independent Insurance & Superannuation Agencies
No 75	Cooley, L M

No 76 Australian Finance Conference
No 77 Northern Territory Superannuation Office
No 78 Lee, W A
No 79 Mercer Campbell Cook & Knight Inc
No 80 Noble Lowndes
No 81 Commonwealth Department of Industrial Relations
No 82 Klumpes, Dr P J M
No 83 National Farmers Federation
No 84 WA Government Employees Superannuation Board
No 85 Australian Government Employees Superannuation Trust
No 86 Smith, A W J
No 87 Turner, M
No 88 White, B
No 89 Association of Superannuation Funds of Australia Ltd, The
No 90 Jacques Martin
No 91 CSA Consulting Group
No 92 Mansfield, G
No 93 Civic Securities Pty Ltd
No 94 Australian Retirement Fund
No 95 Australian Chamber of Manufactures
No 96 AM Corporation Ltd
No 97 Taxpayers' Association of Tasmania, The
No 98 County NatWest
No 99 **In camera**
No 100 National Mutual
No 101 Chifley Superannuation Services
No 102 Commonwealth Funds Management Ltd
No 103 Coles Myer Ltd
No 104 National Association of Personnel Consultants Ltd
No 105 Bankers Trust Australia Limited
No 106 Australian Council of Trade Unions
No 107 Commonwealth Attorney-General's Department
No 108 Institute of Actuaries of Australia, The
No 109 Retirement Benefits Office
No 110 Motor Inn & Motel Association of Australia, The
No 111 Langley-Bates, D
No 112 NSW Farmers' Association
No 113 Motor Trades Assocation of Australia (MTAA) Superannuation Fund
No 114 Life Insurance Federation of Australia Inc
No 115 WA Minister for Productivity and Labour Relations
No 117 Metway Corporation
No 118 NSW Minister for Industrial Relations
No 119 Australian Society of Certified Practicing Accountants and

	The Institute of Chartered Accountants in Australia (joint submission)
No 120	AMP
No 121	Hanson, Mr J H
No 122	SA Minister of Finance
No 123	Moon, G
No 124	Taxation Institute of Australia, The
No 125	Australian Pensioners & Superannuants Federation and Combined Pensioners & Superannuants Association of NSW
No 126	Women's Economic Think Tank
No 127	Commonwealth Department of Social Security
No 128	Qld Director-General, Office of the Cabinet
No 129	Davey & Associates
No 130	Women's Electoral Lobby Australia Inc
No 131	de Visser, L
No 132	Westpac Banking Corporation
No 133	Griffin, P
No 134	Australian International Pilots Association
No 135	State Insurance Office of Victoria (SIO) Consumer Appeals Centre
No 136	Australian Friendly Societies Association
No 137	Whittimore-Hull, J
No 138	Trades and Labor Council of Western Australia
No 139	Australian Federation of Consumer Organisations
No 140	Victorian Automobile Chamber of Commerce
No 141	Rothschild Australia Asset Management Limited
No 142	Federated Ironworkers' Association of Australia
No 143	Jacques Martin - Reply to Tasmanian Taxpayers
No 144	National Association of Nursing Homes & Private Hospitals Inc
No 145	Trade Practices Commission
No 146	Shell Australia Contributory Pension Fund
No 147	Smith, Dr G F
No 148	Australian Association of Permanent Building Societies
No 149	Docker, A R
No 150	University of NSW Superannuation Economics Research Group
No 151	Insurance and Superannuation Commission
No 152	Commonwealth Department of Community Services & Health
No 153	Crawford, G J
No 154	Investment Funds Association of Australia Limited
No 155	Australian Taxation Office, Commissioner of Taxation
No 156	Langfield-Smith, I
No 157	Health Employees Superannuation Trust Australia
No 158	National Mutual - Nexis Proprietary Limited

No 159 Weijers, A J
No 160 Foster, W
No 161 Gierczycki, L M
No 162 Ramakrishnan, H
No 163 Permanent Trustee Company Limited
No 164 Industry Research and Development Board
No 165 Health Employees Superannuation Trust Australia Ltd (HEST)
No 166 Shell Superannuation Rights Committee
No 167 Shell Australia Contributory Pension Fund
No 168 Unity Action Group for Retired Persons
No 169 Crome, I
No 170 Campbell, B G
No 171 Knight, Dr J
No 172 Australian Council on Smoking and Health
No 173 Commonwealth Bank of Australia
No 174 Clothier, D P
No 175 Australian Government Employees Superannuation Trust
No 176 **In camera**
No 177 Selstay Pty Ltd
No 178 Mulhallen, J G & Sons (Vic) Pty Ltd
No 179 Armstrong, W J
No 180 Rutter, A
No 181 Australian Workers' Union
No 182 Sly and Weigall
No 183 **In camera**
No 184 **In camera**
No 185 SA Employers' Federation
No 186 Australian Securities Commission
No 187 Grey, P
No 188 Pacific Industrial Investments
No 189 CIG Employees' Superannuation Fund
No 190 Reserve Bank of Australia
No 191 Aitkin, J
No 192 Harrower E
No 193 Grace E
No 194 University of Melbourne, Dr Graham Smith
No 195 Commonwealth Treasury
No 196 SBC Dominguez Barry Ltd
No 197 Financial Planning Association of Australia
No 198 Commercial and International Finance Consultants Pty Ltd
No 199 Australian Eagle Superannuation
No 200 Ellis, M
No 201 Moore, E J
No 202 Morley, B
No 203 Tindal, B

No 204 Shell Australia Limited
No 205 Tasmania Treasury
No 206 Mathews, S R
No 207 Humann, D
No 208 Human Rights and Equal Opportunity Commission
No 209 **In camera**
No 210 Colonial Mutual Investment Management
No 211 Pollard, D
No 212 Advance Bank
No 213 Blanchard, W
No 214 Moore, A
No 215 Wilson, R
No 216 Banner, C
No 217 Cogger, R
No 218 Poole, R
No 219 Kelberg, J
No 220 Toohey, J P
No 221 Tickner, B C
No 222 Ushay, F
No 223 C S Superannuation Pty Ltd
No 224 Craig, W
No 225 Voeth, K
No 226 Koeth, Dr
No 227 Australian Consumers Association
No 228 **In camera**
No 229 Norrish, Rex M & Associates
No 230 **In camera**
No 231 Richardson, G D & H D
No 232 Browne, T J
No 233 Australia Post Superannuation Scheme
No 234 Sayers, K
No 235 CBA Financial Services
No 236 Shilton, N
No 237 Gorringe, K
No 238 **In camera**
No 239 Peppin Financial Centre
No 240 Skinner, A
No 241 Vere, P
No 242 ABCI
No 243 Abrahams, B
No 244 Intech Management Pty Limited, Mr Schaffer
No 245 Correspondence only
No 246 **In camera**
No 247 Bailey, R
No 248 Dewar, L

No 249 Greco, L
No 250 Mulray, K
No 251 Stevens, H
No 252 Negus, K
No 253 Brown, I
No 254 Ashfield, R
No 255 Greco, A
No 256 Allcock, L
No 257 Dukas, E
No 258 Jones, G
No 259 Emmenick, C
No 260 Friar, A
No 261 Pittaway, M
No 262 Housing Industry Association Limited
No 263 Allen Consulting Group
No 264 Cartledge, D
No 265 **In camera**
No 266 **In camera**
No 267 Matusek, P
No 268 **In camera**
No 269 Trotter, Mrs K; The Gap P&C Association
No 270 **In camera**
No 271 Financial Counselling Services (QLD) Inc
No 272 Kaye, Captain C
No 273 **In camera**
No 274 **In camera**
No 275 **In camera**
No 276 Equity Life Limited
No 277 AM Corporation Ltd
No 278 Queensland Arts Council
No 279 **In camera**
No 280 Department of Social Security
No 281 Wilson, B
No 282 Jasprizza & Co, E A
No 283 Williams, V D

APPENDIX E : LIST OF SUBMISSIONS RE ON-GOING INQUIRY

– IN ALPHABETICAL ORDER

Sub No	Name
No 242	ABCI
No 243	Abrahams, B
No 31	ACT Council of Social Service Inc
No 21	Adams, G
No 212	Advance Bank
No 191	Aitkin, J
No 61	Alexander Consulting Group, The
No 256	Allcock, L
No 263	Allen Consulting Group
No 96	AM Corporation Ltd
No 277	AM Corporation Ltd
No 120	AMP
No 73	ANZ Bank
No 179	Armstrong, W J
No 39	Arthur Andersen & Co
No 254	Ashfield, R
No 89	Association of Superannuation Funds of Australia Ltd, The
No 233	Australia Post Superannuation Scheme
No 148	Australian Association of Permanent Building Societies
No 95	Australian Chamber of Manufactures
No 227	Australian Consumers Association
No 35	Australian Council of Social Service
No 106	Australian Council of Trade Unions
No 172	Australian Council on Smoking and Health
No 199	Australian Eagle Superannuation
No 139	Australian Federation of Consumer Organisations
No 76	Australian Finance Conference
No 136	Australian Friendly Societies Association
No 85	Australian Government Employees Superannuation Trust
No 175	Australian Government Employees Superannuation Trust
No 134	Australian International Pilots Association
No 49	Australian Lifewriters Association

No 125	Australian Pensioners & Superannuants Federation and Combined Pensioners & Superannuants Association of NSW
No 94	Australian Retirement Fund
No 34	Australian Salaried Medical Officer Association
No 186	Australian Securities Commission
No 50	Australian Small Business Association
No 119	Australian Society of Certified Practicing Accountants and
No 155	Australian Taxation Office, Commissioner of Taxation
No 181	Australian Workers' Union
No 247	Bailey, R
No 105	Bankers Trust Australia Limited
No 216	Banner, C
No 70	Belshaw, M
No 36	Belshaw, W J
No 213	Blanchard, W
No 38	Boffa, G
No 253	Brown, I
No 232	Browne, T J
No 7	Buildings Union Superannuation
No 29	Burns, W G
No 223	C S Superannuation Pty Ltd
No 170	Campbell, B G
No 264	Cartledge, D
No 23	Cartledge, O
No 235	CBA Financial Services
No 65	Chamber of Commerce & Industry of WA
No 54	Chamen, P
No 101	Chifley Superannuation Services
No 189	CIG Employees' Superannuation Fund
No 93	Civic Securities Pty Ltd
No 26	Civil Service Association of WA
No 20	Clayton Utz
No 174	Clothier, D P
No 217	Cogger, R
No 103	Coles Myer Ltd
No 210	Colonial Mutual Investment Management
No 198	Commercial and International Finance Consultants Pty Ltd
No 107	Commonwealth Attorney-General's Department
No 173	Commonwealth Bank of Australia
No 152	Commonwealth Department of Community Services & Health
No 81	Commonwealth Department of Industrial Relations
No 127	Commonwealth Department of Social Security
No 102	Commonwealth Funds Management Ltd
No 195	Commonwealth Treasury
No 75	Cooley, L M

No 11	Correspondence only
No 245	Correspondence only
No 98	County NatWest
No 224	Craig, W
No 153	Crawford, G J
No 169	Crome, I
No 72	Crouch, W G
No 91	CSA Consulting Group
No 129	Davey & Associates
No 14	Davies, D
No 131	de Visser, L
No 280	Department of Social Security
No 248	Dewar, L
No 149	Docker, A R
No 19	Downs, B
No 46	du Cros, N
No 57	Duesburys
No 257	Dukas, E
No 200	Ellis, M
No 259	Emmenick, C
No 276	Equity Life Limited
No 142	Federated Ironworkers' Association of Australia
No 271	Financial Counselling Services (QLD) Inc
No 197	Financial Planning Association of Australia
No 2	Fisher F
No 47	Fisk, B
No 25	Foley, E
No 160	Foster, W
No 260	Friar, A
No 15	Garrett, P R
No 161	Gierczycki, L M
No 237	Gorringe, K
No 193	Grace E
No 255	Greco, A
No 249	Greco, L
No 187	Grey, P
No 133	Griffin, P
No 1	Gynn, W J
No 121	Hanson, Mr J H
No 192	Harrower E
No 165	Health Employees Superannuation Trust Australia Ltd (HEST)
No 157	Health Employees Superannuation Trust Australia
No 24	Hearn, G
No 262	Housing Industry Association Limited

No 32	Hughes, D
No 208	Human Rights and Equal Opportunity Commission
No 207	Humann, D
No 30	In camera
No 184	In camera
No 183	In camera
No 176	In camera
No 99	In camera
No 209	In camera
No 246	In camera
No 273	In camera
No 228	In camera
No 274	In camera
No 268	In camera
No 270	In camera
No 266	In camera
No 230	In camera
No 238	In camera
No 275	In camera
No 265	In camera
No 279	In camera
No 74	Independent Insurance & Superannuation Agencies
No 28	Independent Schools Superannuation Trust
No 164	Industry Research and Development Board
No 108	Institute of Actuaries of Australia, The
No 151	Insurance and Superannuation Commission
No 244	Intech Management Pty Limited, Mr Schaffer
No 10	InterData Pty Ltd
No 154	Investment Funds Association of Australia Limited
No 59	IOOF Australia
No 90	Jacques Martin
No 143	Jacques Martin - Reply to Tasmanian Taxpayers
No 282	Jazprizza & Co, E A
No 258	Jones, G
No 272	Kaye, Captain C
No 219	Kelberg, J
No 82	Klumpes, Dr P J M
No 171	Knight, Dr J
No 52	Knox, Professor D
No 226	Koeth, Dr
No 156	Langfield-Smith, I
No 111	Langley-Bates, D
No 78	Lee, W A
No 114	Life Insurance Federation of Australia Inc
No 4	Liquor Trades Union, The

No 51	Long, P D
No 22	Lucas, J M
No 92	Mansfield, G
No 206	Mathews, S R
No 267	Matusek, P
No 13	McJannet, D
No 66	Melbourne Metropolitan Board of Works (MMBW) Employees' Superannuation Fund
No 79	Mercer Campbell Cook & Knight Inc
No 62	Metal Manufacturers Limited
No 55	Metal Trades Industry Association of Australia
No 117	Metway Corporation
No 123	Moon, G
No 214	Moore, A
No 201	Moore, E J
No 58	Morgan Stockbroking Ltd
No 202	Morley, B
No 110	Motor Inn & Motel Association of Australia, The
No 113	Motor Trades Assocation of Australia (MTAA) Superannuation Fund
No 178	Mulhallen, J G & Sons (Vic) Pty Ltd
No 250	Mulray, K
No 45	Myuna Pty Ltd
No 8	N E Renton & Associates
No 144	National Association of Nursing Homes & Private Hospitals Inc
No 56	National Association of Nursing Homes & Private Hospitals Inc
No 104	National Association of Personnel Consultants Ltd
No 63	National Australia Bank
No 83	National Farmers Federation
No 100	National Mutual
No 158	National Mutual - Nexis Proprietary Limited
No 252	Negus, K
No 3	Newman, C A
No 42	Nipper, M R G and Weeks, P L
No 80	Noble Lowndes
No 60	Non-Government Schools Superannuation Fund
No 229	Norrish, Rex M & Associates
No 77	Northern Territory Superannuation Office
No 112	NSW Farmers' Association
No 118	NSW Minister for Industrial Relations
No 27	Owens, E S & Co
No 188	Pacific Industrial Investments
No 239	Peppin Financial Centre

No 163	Permanent Trustee Company Limited
No 5	Perry, K F
No 261	Pittaway, M
No 211	Pollard, D
No 218	Poole, R
No 43	Prudential Assurance Company Ltd
No 41	Prudential Life Underwriters Association (NSW)
No 128	Qld Director-General, Office of the Cabinet
No 278	Queensland Arts Council
No 162	Ramakrishnan, H
No 190	Reserve Bank of Australia
No 18	Restuccia, V
No 44	Retired Associate Members' Branch Public Service Association of NSW
No 109	Retirement Benefits Office
No 231	Richardson, G D & H D
No 141	Rothschild Australia Asset Management Limited
No 180	Rutter, A
No 185	SA Employers' Federation
No 122	SA Minister of Finance
No 16	Samson, S W
No 234	Sayers, K
No 196	SBC Dominguez Barry Ltd
No 17	Schwarz, D
No 68	Secondary Colleges Staff Association
No 177	Selstay Pty Ltd
No 9	Serendip Publications
No 167	Shell Australia Contributory Pension Fund
No 146	Shell Australia Contributory Pension Fund
No 204	Shell Australia Limited
No 33	Shell Superannuation Rights Committee
No 166	Shell Superannuation Rights Committee
No 236	Shilton, N
No 240	Skinner, A
No 182	Sly and Weigall
No 86	Smith, A W J
No 37	Smith, B
No 147	Smith, Dr G F
No 135	State Insurance Office of Victoria (SIO) Consumer Appeals Centre
No 251	Stevens, H
No 205	Tasmania Treasury
No 124	Taxation Institute of Australia, The
No 97	Taxpayers' Association of Tasmania, The

	The Institute of Chartered Accountants in Australia (joint submission)
No 221	Tickner, B C
No 203	Tindal, B
No 220	Toohey, J P
No 145	Trade Practices Commission
No 138	Trades and Labor Council of Western Australia
No 12	Trau, Dr J
No 53	Tribunal on Homosexuals and Discrimination
No 269	Trotter, Mrs K; The Gap P&C Association
No 48	Trustee Companies Association
No 87	Turner, M
No 69	Ulverstone Chamber of Commerce
No 168	Unity Action Group for Retired Persons
No 194	University of Melbourne, Dr Graham Smith
No 150	University of NSW Superannuation Economics Research Group
No 222	Ushay, F
No 241	Vere, P
No 140	Victorian Automobile Chamber of Commerce
No 225	Voeth, K
No 84	WA Government Employees Superannuation Board
No 115	WA Minister for Productivity and Labour Relations
No 6	Walsh, A
No 159	Weijers, A J
No 132	Westpac Banking Corporation
No 88	White, B
No 137	Whittimore-Hull, J
No 40	Williams, T
No 283	Williams, V D
No 281	Wilson, B
No 215	Wilson, R
No 71	Wilson, The Hon Ian, MP
No 64	Women's Action Alliance (Australia)
No 126	Women's Economic Think Tank
No 130	Women's Electoral Lobby Australia Inc
No 67	Yann, R N

APPENDIX F: GOVERNMENT AMENDMENTS AS CIRCULATED IN THE SENATE

1990-91-92

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

THE SENATE

TAXATION LAWS AMENDMENT (SUPERANNUATION) BILL 1992

(Amendment to be moved on behalf of the Government)

Clause 73, page 70, **omit the clause**, substitute the following clause:

Application

"73. The amendments made by this Division apply in relation to the provision of pensions after the commencement of this section, regardless of whether the members concerned retired before or after the commencement of this section.".

1990-91-92

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

THE SENATE

TAXATION LAWS AMENDMENT (SUPERANNUATION) BILL 1992

(Amendments to be moved on behalf of the Government)

(1) Clause 79, page 72, paragraph (b), line 29, omit "(2A),", substitute "(2A),(2B),".

(2) Clause 79, page 72, paragraph (c), omit the paragraph, substitute the following paragraph:

"(c) by inserting after subsection (2) the following subsections:

'(2A) If:

(a) the employer is contributing for the benefit of the employee to the fund in accordance with an industrial award, or a law of a kind referred to in paragraph (1)(ab), that was operative immediately before 21 August 1991; and

(b) section 13 would operate to determine a notional earnings base in relation to the employee if the employer had been so contributing immediately before 21 August 1991;

the notional earnings base in relation to the employee is the notional earnings base referred to in paragraph (b).

`(2B) If:

(a) the employer is contributing for the benefit of the employee to the fund in accordance with the agreement referred to in Order No. 292 of 1992 of the Coal Industry Tribunal of New South Wales and known as the New South Wales Coal Mining Industry Statutory **Superannuation** Fund (Salary Sacrifice) Agreement; and

(b) section 13 would operate to determine a notional earnings base in relation to the employee if the employer had been so contributing immediately before 21 August 1991;

the notional earnings base in relation to the employee is the notional earnings base referred to in paragraph (b).';

(3) Clause 87, page 76, paragraph (c), subparagraphs (a)(i) and (ii) of the definition of "starting day" in proposed subsection (5), lines 36 to 39, omit he proposed subparagraphs, substitute the following subparagraphs:

"(i) the day on which the contribution period commenced; or

(ii) if the contribution period commenced on 1 July 1992--the day on which the *Taxation Laws Amendment (**Superannuation**) Act 1992* received the Royal Assent; and".

(4) Clause 87, page 77, paragraph (c), subparagraphs (b)(i) and (ii) of the definition of "starting day" in proposed subsection (5), lines 1 to 6, omit the proposed subparagraphs, substitute the following subparagraphs:

'(i) the day on which the part of the contribution period commenced; or

(ii) if the contribution period commenced on 1 July 1992--the day on which the part of the contribution period commenced or the day on which the *Taxation Laws Amendment (**Superannuation**) Act 1992* received the Royal Assent, whichever is the later.'

APPENDIX G: LIST OF WITNESSES RE ON-GOING INQUIRY

WITNESS	Date of Appearance
Actuarial Consultant, Tribunal Working Group	21 February 1992, SYDNEY
Alexander Consulting Group Ltd	19 February 1992, SYDNEY
AM Corporation Limited	18 February 1992, SYDNEY
AMEV Life Assurance	10 April 1992, CANBERRA
Association of Superannuation Funds of Australia	21 February 1992, SYDNEY
Association of Superannuation Funds of Australia	18 February 1992, SYDNEY
Attorney-General's Department	24 February 1992, CANBERRA
Australian Society of Chartered Public Accountants	20 February 1992, SYDNEY
Australian International Pilots Association	19 February 1992, SYDNEY
Australian Pensioners Superannuants Federation	18 February 1992, SYDNEY
Australian Council of Social Service	6 March 1992, CANBERRA
Australian Small Business Association, NSW Division	19 February 1992, SYDNEY
Australian Finance Conference	20 February 1992, SYDNEY
Australian Securities Commission	6 March 1992, CANBERRA
Australian Lifewriters Association	10 April 1992, CANBERRA
Australian Federation of Business and Professional Women	25 March 1992, CANBERRA
Australian Federation of Consumer Organisations	10 April 1992, CANBERRA
Australian Banking Ombudsman	10 April 1992, CANBERRA
Australian Taxation Office	15 April 1992, CANBERRA
Australian Friendly Societies Association	25 March 1992, CANBERRA
Australian Council on Smoking and Health	10 March 1992, PERTH
Australian Association of Permanent Building Societies	6 March 1992, CANBERRA

Australian Workers Union	9 March 1992, ADELAIDE
Australian Retirement Fund Pty Ltd	11 February 1992, MELBOURNE
Bankers Trust Australia Ltd	19 February 1992, SYDNEY
Dr Owen Cartledge	6 March 1992, CANBERRA
Chamber of Commerce and Industry	10 March 1992, PERTH
Chifley Superannuation Services	18 February 1992, SYDNEY
Civil Service Association of WA Inc.	10 March 1992, PERTH
Clayton Utz Solicitors	18 February 1992, SYDNEY
Combined Pensioners and Superannuants of NSW Inc.	18 February 1992, SYDNEY
Superannuation Financial Services Commonwealth Bank of Australia	19 February 1992, SYDNEY
Commonwealth Funds Management Limited	6 March 1992, CANBERRA
Commonwealth Funds Management Limited	6 March 1992, CANBERRA
Mrs Lorna Cooley	13 February 1992, HOBART
County NatWest Australia Investment Management	10 February 1992, MELBOURNE
Mr Gary Crawford	10 March 1992, PERTH
Mr John Dermody	6 March 1992, CANBERRA
Federation of Industrial, Mechanical and Engineering Employees Comalco	13 February 1992, HOBART
Mr John Foley	1 April 1992, CANBERRA
Former Redundant Employees from West Australian Newspapers	10 March 1992, PERTH
Actuary, Godwins Australia Pty Ltd, and Consultant Metal Trades Industry Association of Australia	20 February 1992, SYDNEY
Government Employees Superannuation Board	10 March 1992, PERTH
Professor Robert Gregory	10 April 1992, CANBERRA
Mr Denis Hanley	10 April 1992, CANBERRA
Mr Graeme Hearn	10 March 1992, PERTH
Health, Housing and Community Services, Department of	10 April 1992, CANBERRA
HEST Australia Ltd	9 March 1992, ADELAIDE
Host-Plus	9 March 1992, ADELAIDE
Independent Schools Superannuation Trust	9 March 1992, ADELAIDE
Industrial Relations, Department of	25 March 1992, CANBERRA
Institute of Chartered Accountants in Australia	20 February 1992, SYDNEY
Institute of Actuaries of Australia	10 February 1992, MELBOURNE

Insurance and Superannuation Commission	30 March 1992, CANBERRA
Investment Funds Association of Australia Ltd	10 April 1992, CANBERRA
IOOF Australia	10 February 1992, MELBOURNE
Associate Professor David Knox	19 February 1992, SYDNEY
Mr Ian Langfield-Smith	10 February 1992, MELBOURNE
Mr Langley-Bates	12 March 1992, MELBOURNE
Mr William Lee	21 February 1992, BRISBANE
Life Insurance Federation of Australia	11 February 1992, MELBOURNE
Lifewriters Association	10 April 1992, CANBERRA
Liquor Trades Union	9 March 1992, ADELAIDE
Mr Julian Lucas	11 February 1992, MELBOURNE
Mr Garth Mansfield	6 March 1992, CANBERRA
Mercer Campbell Cook & Knight	10 February 1992, MELBOURNE
MMBW Employees Superannuation Fund	11 February 1992, MELBOURNE
Ms Gillian Moon	20 February 1992, SYDNEY
Motor Trades Association of Australia	10 April 1992, CANBERRA
Industry Superannuation Fund Pty Ltd	10 April 1992, CANBERRA
Motor Inn, Motel and Accommodation Association	20 February 1992, SYDNEY
Mr Clifford Newman	18 February 1992, SYDNEY
Myuna Pty Ltd	10 March 1992, PERTH
National Mutual Life Association of Australia	11 February 1992, MELBOURNE
National Mutual Life Association	1 April 1992, CANBERRA
National Superannuation Group, Arthur Andersen & Co.	21 February 1992, BRISBANE
National Association of Nursing Homes and Private Hospitals Inc.	19 February 1992, SYDNEY
National Farmers Federation	6 March 1992, CANBERRA
New South Wales Superannuation Office	19 February 1992, SYDNEY
Nexis Pty Ltd	13 February 1992, HOBART
Noble Lowndes Superannuation Consultants Ltd	11 February 1992, MELBOURNE
Occupational Health and Safety Training Unit Trades and Labor Council of Western Australia	10 March 1992, PERTH
Productivity and Labour Relations, Department of	10 March 1992, PERTH

Provident Fund, Comalco	13 February 1992, HOBART
Prudential Life Underwriters (NSW)	19 February 1992, SYDNEY
Prudential Assurance Co. Ltd	20 February 1992, SYDNEY
Public Service Association of New South Wales	20 February 1992, SYDNEY
Queensland Government Superannuation Office	21 February 1992, BRISBANE
Mr Nicholas Renton	10 February 1992, MELBOURNE
Reserve Bank of Australia	10 April 1992, CANBERRA
Retail, Commonwealth Bank of Australia	19 February 1992, SYDNEY
Retirement Benefits Office	6 March 1992, CANBERRA
Rothschild Australia Asset Management Ltd	10 February 1992, MELBOURNE
Mr Siegfried Samson	13 February 1992, HOBART
SBC Dominguez Barry Limited	19 February 1992, SYDNEY
SBC Dominguez Barry Ltd	10 April 1992, CANBERRA
School of Economics, University of NSW	20 February 1992, SYDNEY
Shell Australia Contributory Pension Fund	18 February 1992, SYDNEY
Shell Superannuation Rights Committee	18 February 1992, SYDNEY
Social Security, Department of	4 March 1992, CANBERRA
South Australian Superannuation Fund Investment Trust	9 March 1992, ADELAIDE
South Australian Treasury	9 March 1992, ADELAIDE
South Australian Employers Federation Inc.	9 March 1992, ADELAIDE
Superannuation Office, NT Government	10 March 1992, PERTH
Taxation Institute of Australia	20 February 1992, SYDNEY
Taxpayers Association of Tasmania	13 February 1992, HOBART
Trade Practices Commission, the Commissioner	4 March 1992, CANBERRA
Dr Jerzy Trau	18 February 1992, SYDNEY
Treasury, Department of the	15 April 1992, CANBERRA
Trustee Companies Association of Australia	11 February 1992, MELBOURNE
Mrs Margaret Turner	13 February 1992, HOBART
Victorian Automobile Chamber of Commerce	11 February 1992, MELBOURNE
Westpac Banking Corporation	18 February 1992, SYDNEY
Mrs Beverley White	13 February 1992, HOBART

Mr Trevor Williams	9 March 1992, ADELAIDE
Honourable Ian Wilson, MP	9 March 1992, ADELAIDE
Women's Action Alliance	10 February 1992, MELBOURNE
Women's Economic Think Tank	20 February 1992, SYDNEY
Women's Electoral Lobby, Australia	25 March 1992, CANBERRA

APPENDIX H: GLOSSARY

Allocated Pension	A pension where the member has his own account against which pension payments are debited and to which any investment earnings are credited. The pension will continue until the death of the pensioner, or until the account is exhausted. Upon death, any balance remaining in the account is paid to a designated beneficiary as a (taxable) lump sum payment, or is applied to secure further pension payments to a surviving spouse.
Annuity	A regular periodic payment to a person (cf pension). Where weekly, fortnightly or monthly payments out of a superannuation fund are involved, the expression 'pension' is more commonly used.
Approved Deposit fund (ADF)	A fund which has the purpose of holding lump sum superannuation benefits rolled over for the purpose of maintaining the concessional taxation treatment until the taxpayer attains preservation age.
Arms' Length	A term which refers to the relationship between the employer company and the members of a superannuation fund. If the members of the fund are employees of the sponsoring company, an arms' length fund is said to exist.
Commutation	Term used to describe the process whereby one type of superannuation benefit is commuted (changed) to another type, for example conversion from a pension to a lump sum.
Defined Benefits Fund	A superannuation fund that contracts to pay a member a fixed or defined amount of money that is linked to the salary level.
Deferred Annuity	An annuity under which the payments are

	delayed by a specified period or to the date of occurrence of a specified event.
Eligible Termination Payments (ETP)	Payments made to employees leaving employment. They include payments from a superannuation fund or other inducements to retire but exclude accrued annual and long service leave.
Life Office	A firm which sells life insurance and other insurance products, for example, life cover, super bonds, annuities and superannuation.
Life Policy	A contract of insurance agreed to when a person purchases life insurance.
Lump Sum	The amount which is paid to a retiree at the time of retirement (as opposed to a pension for life).
Master Trust	A trust arrangement which allows a single trustee appointed by the promoter of the fund to administer and manage the superannuation funds paid by a number of employers and employees.
Maximum Deductible Contribution Limit (MDCL)	A rule which places a cap on the level of superannuation contributions which employers or members can make for employees. When this limit is exceeded, the fund is deemed to be non-complying and loses concessional tax status.
Portability	Allowing a superannuation plan to be transferred from one fund (or one employer) to another.
Preservation	Maintenance of a member's entitlements in a superannuation until a specified minimum age (usually at least 55 years).
Prudential Controls	The measures instituted to supervise and control activities in the superannuation industry to ensure the security of contributor's funds.

Reasonable Benefits Limit (RBL)	The maximum limit on the amount a member can receive from superannuation, ADFs or DAFs, with preferential taxation treatment. The limit can be calculated from a member's highest average salary.
Repatriation of Surplus	The act of transferring surplus assets in a superannuation fund to the sponsoring employer.
Rollover Funds	The funds in which eligible termination payments are deposited when a person leaves or changes employment. These funds are preserved until retirement age is reached. Rollover funds receive concessional tax treatment in that the tax liability is deferred until retirement age.
Securities	Financial instruments which are evidence of debt or of property. Bonds, certificates of stock and shares are documents which indicate the existence of a security.
Superannuation Fund	A fund designed to produce retirement benefits for members. To attract tax concessions, it must have these characteristics: (a) be indefinitely continuing, and (b) be maintained solely for following purposes: provision of benefits for fund members, or for dependants of each member in the event of death, or any other purpose allowed by the Insurance and Superannuation Commission in writing.
Surplus	A position reached in a superannuation fund whereby the accrued earnings and contributions exceed the funds accumulated liabilities.
Trust	A fiduciary relationship in which one person (the trustee) holds the title to property for the benefit of another (the beneficiary).
Trust Deed	The legal document which appoints trustees and defines their power.

Trustee	A person, usually one of a body of persons, appointed to administer the affairs of a company, institution, etc, who holds the title to property for the benefit of another.
Unfunded Scheme	A superannuation scheme where the employer has not contributed to match liabilities, that is, benefits payable to members as they accrue. Instead, payments are made to members when they are due.
Undeducted Purchase Price	In relation to an annuity or superannuation pension, that portion of monies used to purchase the annuity or pension which has not been claimed as a deduction.
Vesting	Conferring on a superannuation fund member the ownership of all or part of the accrued benefit applicable to that member.

APPENDIX I: QUESTION BY SENATOR WATSON OF THE AUSTRALIAN TAXATION OFFICE RE : PAYE VARIATIONS

Estimates Committee B 20 October 1992

Senator WATSON -- Section 221D of the Act enables employees to have their rate of tax varied where they can demonstrate that their tax liability over a 12 month period would not be affected by lower PAYE deductions. One group in society has latched onto this, namely, life insurance and superannuation agents, and they have been advising their clients that, in order to obtain additional cash to put towards increased superannuation, they can apply for a variation authority.

I put it to you that this is causing a severe administrative burden on employers, particularly those who have computer payroll packages, because they are forced into a situation of having to manually calculate the tax deductions on behalf of those employees or their clients. We understand that these employers have been directed by the Tax Office to make deductions at the behest of the insurance agents et cetera at the lower rate on behalf of employees, which they are obliged to do, having received that notification. My understanding is that the Tax Office is aware of the administrative burdens that are being caused and is taking steps to reduce the burden. My question is: what steps have been taken? You can see the difficulty?

Department of Treasury
Agency : Australian Taxation Office

Senator Watson asked (Hansard page B 613):

(1) What the ATO was doing about the severe administrative burden on employers of employees who could obtain a section 221D notification allowing a reduction in tax instalment deductions for life insurance and superannuation.

(2) What was the ATO doing about life underwriters using section 221D to obtain additional superannuation business

Answer:

(1) The PAYE Business Team is currently mid-way through reviewing the whole section 221D process with the aim of simplification for the ATO, employees and their employers. The Team is producing and distributing a standard section 221D application form common to all ATO offices, and for use by tax agents and individuals. The Team is introducing the use of 'Reduce by $ .....' amount for variations instead of 'Reduce to .....' or percentage variation. However, the ability to use whichever variation method is most effective in the given circumstances will be retained.

The effect of this will be that the variation will be by a set amount and, as a consequence, assist in simplifying payroll calculations. The ATO has been mindful of the need to avoid adding to the collection burden already carried by employers and is seeking to reduce this burden wherever possible. Generally, variations will only be granted in those cases where there is a reasonable likelihood of a significant over-deduction of tax instalment deductions ie: where they would be likely to exceed the end of year liability by 10 per cent or $500, whichever is the lesser.

(2) Life insurance and superannuation agents have been advising clients that they could apply for a variation of tax instalment deductions under section 221D to obtain additional cash to put towards increased superannuation. Many of those applying for variations were just barely meeting the criteria for approval – that is, 10 per cent or more than $500 difference in tax liability. Approximately 50 per cent of the section 221D applications in the last year were reliant on superannuation contributions as deductible expense. Since the legislative changes this year to deductibility of superannuation contributions, the number of section 221D applications has dropped markedly.