
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;

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.

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.