

Bills Digest
No. 89 2000–01

Superannuation Legislation Amendment
(Post-retirement Commutations) Bill 2000

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I N F O R M A T I O N A N D R E S E A R C H S E R V I C E S

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Superannuation Legislation Amendment (Post-retirement
Commutations) Bill 2000

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23 February 2001

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Superannuation Legislation Amendment (Post-retirement Commutations) Bill 2000

Date Introduced: 7 December 2000

House: House of Representatives

Portfolio: Finance and Administration

Commencement: Royal Assent

Purpose

The purpose of the Bill is to allow beneficiaries under three Commonwealth superannuation schemes the option of commuting part of their pension, in order to pay off a surcharge assessment received after they have ceased to be members of the scheme.

Background

The Parliamentary Contributory Superannuation Scheme

The *Parliamentary Contributory Superannuation Act 1948* (PCS Act) provides a compulsory superannuation scheme for members of Parliament. It is administered, formally, by the Parliamentary Retiring Allowances Trust (the Trust) and on a day to day basis by the Department of Finance and Administration (DOFA).

The Parliamentary Contribution Superannuation Scheme (PCSS) requires Senators and Members to contribute a fixed percentage of their salary as parliamentarians and of any salary they receive as a Minister or office-holder in Parliament. The benefits payable under the scheme vary depending on factors such as years of service, the number of parliamentary terms served, invalidity etc. Longer-serving members qualify for payment of a pension, while those who don't qualify instead receive a lump sum consisting of their own contributions plus a supplement from the Commonwealth. The scheme offers a less restrictive approach than is ordinarily the case on the 'preservation' of benefits—that is rules preventing access to superannuation until retirement age which apply generally to the rest of the workforce—although those rules have tightened in relation to lump sum entitlements for parliamentarians since 1 July 1999. The scheme is widely regarded as generous to its beneficiaries.¹

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For those longer-serving members who are entitled to a pension, the PCSS provides the option of *commuting* up to 50% of their pension to a lump sum payment (subject to preservation rules for the component which has accrued since 1 July 1999). When a member exercises this *general* right to commute part of a pension to a lump sum, the remaining pension entitlement is reduced accordingly. The Bill proposes in addition a *specific* right to commute part of a pension, in order to meet a liability to pay the superannuation surcharge, where the surcharge assessment is received 'post-retirement' (that is, after the member has left the scheme).

The PCSS also provides benefits in certain circumstances to the surviving spouse(s) and children of a parliamentarian who dies either while serving in Parliament or after retirement when in receipt of a pension.

Because the PCSS is based on a fixed percentage of salary, it is known as a *defined benefits fund* (as opposed to an accumulation fund, under which the final entitlement depends on the success of the fund in investing employer and employee contributions). Like several other public sector schemes, the PCSS is known as an *unfunded* defined benefits scheme because it has no assets to meet benefit payments. Instead, it is financed by the Commonwealth out of the Consolidated Revenue Fund at the time benefits become payable.

The Commonwealth Superannuation Scheme

The *Superannuation Act 1976* established the Commonwealth Superannuation Scheme (CSS). It operated from 1976 as a compulsory superannuation scheme for most permanent Commonwealth public servants and was also open to contract and other employees. It was basically closed off to new members from 1 July 1990. As at 30 June 2000, it had almost 50 000 contributors, over 13 000 preserved benefit members and almost 110 000 pensioners. It is a defined benefits scheme which is predominantly unfunded ie the vast majority of liabilities will be met from consolidated revenue. The CSS Fund is administered by a Board of Trustees (the CSS Board).²

Benefits under the CSS are payable as a pension or a lump sum, although restrictions can apply to the latter option depending, for example, on a member's age at retirement.

The Public Sector Superannuation Scheme

From 1 July 1990 the *Superannuation Act 1990* created a new compulsory superannuation scheme for permanent public servants (optional for other employees) known as the Public Sector Superannuation Scheme (PSS). As at 30 June 2000 it had over 112 000 contributors, almost 60 000 preserved benefit members and nearly 6000 pensioners. It is a partly funded defined benefit scheme and is administered by a Board of Trustees (the PSS Board).

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Generally benefits are paid as a lump sum, although members may elect to take some or all of the lump sum as an indexed pension.³

The Superannuation Contributions Surcharge

The superannuation contributions surcharge is a tax on certain (basically employer) contributions to a superannuation account. It was introduced from 20 August 1996 as a result of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (the 1997 Act). It applies to individuals whose adjusted⁴ taxable income exceeds a threshold, which in 2000-2001 is set at \$81 493. The surcharge starts at one per cent and shades in at an additional one per cent for every \$1000 up to a maximum of 15%. The surcharge is in addition to the 15% tax generally payable on superannuation contributions.

While a member of an undefined benefit scheme, an individual will receive notice of a surcharge assessment each financial year that they exceed the threshold. The legal obligation to pay the surcharge, however, falls on the superannuation fund which will make a consequential deduction from the member's account after paying the Australian Tax Office (ATO). After leaving the scheme (eg due to retirement) an individual may receive a surcharge assessment, usually for the financial year in which they retired. In this instance, because they have left the scheme, the legal obligation to pay falls on them personally.⁵ According to the *Explanatory Memorandum*:

Changes were made in 1999 to the *Income Tax Assessment Act 1936* (Tax Act) and the regulations under the *Superannuation Industry (Supervision) Act 1993* to ensure that schemes would continue to comply with the general superannuation supervisory requirements where a pension is commuted to meet any post-retirement surcharge assessment.⁶

As the Commonwealth public sector schemes have a statutory basis, this Bill proposes to give beneficiaries of the PCSS, CSS and PSS the option of electing to commute a part of their pension as a lump sum specifically to pay off a surcharge assessment they receive *after leaving the scheme* (referred to here as 'retirement'). It is worth noting that unfunded or partly funded defined benefit schemes, such as these 3 Commonwealth statutory schemes, are treated differently from undefined benefit schemes for the purposes of the surcharge. The main problem is that the Commonwealth does not, year by year, make an actual employer contribution proportionate to the defined benefit. The calculation, therefore, of surchargeable contributions must be done on a notional basis taking into account actuarial advice. Instead of the trustees of the PCSS, CSS and PSS making annual payments of surcharge to the ATO, a 'phantom' debit account is set up for a member. Notional debits are entered in the account according to a statutory formula and when the member takes their benefit upon retirement the accrued surcharge liability is deducted by the trustees and sent to the ATO. The pension entitlement is adjusted accordingly.

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Main Provisions

Schedule 1—Amendments to the *Parliamentary Contributory Superannuation Act 1948*

At present, the Act provides two methods for parliamentarians to meet surcharge liabilities. When a serving parliamentarian attracts a surcharge liability in a particular financial year, the Department of Finance and Administration (DOFA) enters the amount in a surcharge debt account it keeps for the member (being a notional rather than actual sum of money). Interest is added each year at the 10 year Treasury bond rate. Upon ‘retirement’ the superannuation trust pays the debt amount to the ATO and reduces the member’s benefit accordingly. Alternatively, members can elect to pay off surcharge assessments as they go, with these amounts being credited to their surcharge debt account and the trust forwarding the payments to the ATO. The main point of **Schedule 1** to the Bill is to add a commutation option for payment of surcharge liability, where an assessment is received ‘post-retirement’.

The significant thing about a post-retirement assessment is the personal nature of the liability. Any surcharge assessment levied on a parliamentarian while a member of the scheme is the legal responsibility of the superannuation trust. But once he or she begins to be paid their benefit, any fresh surcharge assessment is a matter of personal financial liability: paragraph 10(4)(c) of the 1997 Act.

Items 1 and 2 contain terms whose definitions are found in the 1997 Act. The term in **item 3** is also found in that other Act but here in the Bill it has a more restricted meaning, confining itself only to those surchargeable contributions which are attributable to the operation of the Bill.

Item 4 draws attention to an unusual feature of the PCSS—that a parliamentarian may leave the Parliament (for example, because he or she lost their seat), begin to receive superannuation pension payments and then regain a seat in Parliament (at which payment of the pension ceases). The liability to pay a surcharge under the 1997 Act is linked to the point at which benefits become payable. **Item 4** makes clear that this point is defined as the *last* occasion upon which a benefit becomes payable (and surcharge liability is attracted). The term used is ‘the **most recent benefit start-up time**’. **Item 7** illustrates this amendment at work, acknowledging that the calculation of surcharge deductions from a member’s benefit will date from the most recent occasion on which a benefit became payable. **Items 9 and 10** adjust definitions in the PCS Act in the same vein. The modified definitions will allow surcharge deductions to be calculated accurately, taking into account any earlier surcharge payments made from the member’s account upon earlier ‘retirements’. **Item 11** replaces the definition of ‘**surcharge adjustment**’ with the same effect.

Items 5 and 6 are consequential on the insertion of subsection 18(8AC) by **item 12**.

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Item 8 is consequential on the commutation option being offered by the Bill, in **item 13**, for the payment of a surcharge debt.

Section 18 of the PCS Act details the benefits available to members of the scheme. **Item 12** inserts three new subsections which help calculate or describe the retirement benefit of a member who is subject to the surcharge. While existing subsection 18(8A) describes the formula for calculating the pension entitlement of a member where they have a surcharge debt upon 'retirement', **proposed subsection 18(8AA)** states the method for calculating one component of that formula—the surcharge adjustment or 'notional adjustment debit'. That method basically involves dividing the surcharge liability determined by the Trust, by a factor which is intended to spread the burden of the surcharge evenly across the life of the pension.

Proposed subsection 18(8AB) describes, for the purposes of this Act, as a 'notional adjustment debit', the surcharge adjustment made to a member's account under subsection 18(8A) in a particular situation. The situation is where the calculations were made before the commencement of this Bill, and at commencement the member is receiving a pension according to that calculation. This amendment is linked to **item 11**, ensuring that any fresh surcharge adjustment takes account of any earlier 'retirements' from Parliament (and consequent pension adjustments).

Proposed subsection 18(8AC) is also consequential on the Bill giving members the option of post-retirement commutation of a pension to meet a post-retirement surcharge assessment (see **item 13**). It says that if a member elects to commute part of their pension to pay off the assessment, the reduced pension payable is calculated according to the formula set out in the proposed subsection.

Item 13 is the centrepiece of Schedule 1 being the actual provision which grants members the option to commute a part of their pension entitlement to a lump sum benefit, in order to pay off a surcharge liability imposed on them after 'retirement'. As noted above, a post-retirement assessment is currently the personal responsibility of the member.

A member will generally have 3 months from a post-retirement assessment to notify they have elected to commute part of their pension to a lump sum in order to meet the surcharge liability in full or in part. The sum nominated will be known as the **surcharge commutation amount**. Upon receipt of the notice DOFA must forward that amount to the ATO and ask that it be set off against the member's surcharge debt. **Proposed subsection 18A(6)** contains a formula for calculating the notional adjustment debit, that is the reduction in pension arising from the decision to commute under this new section of the PCS Act.

The formula in this last proposed subsection in turn depends on the calculation of a 'conversion factor', a figure which reflects the requirement to spread the surcharge liability across the reasonable life of a pension. The conversion factor is to be determined in accordance with advice from the Australian Government Actuary and be published in the

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Gazette (**proposed section 22B** in **item 25**). The first such determination can be backdated to commence from the date of Royal Assent to this Bill: **item 31**.

Section 18B of the PCS Act deals with the existing general right of members to commute up to 50% of their pension entitlement as a lump sum. **Item 14** adds three new subsections to section 18B to cater for the new possibility that a member will opt to both generally commute part of their pension *and* to commute specifically for the purposes of meeting a post-retirement surcharge assessment. By adjusting the necessary calculations, the amendments are intended to preserve the general right to commute up to 50% of the retirement benefit to a lump sum.

Under the PCSS, if a Senator or Member dies while a member of Parliament his or her spouse is entitled to a pension. If a *former* Senator or Member dies and at that point was entitled to a pension, a pension is also payable to their spouse provided the marital or de facto relationship meets certain legal criteria. A surcharge assessment issued after a parliamentarian's death will be a matter of personal financial liability for the spouse who has become entitled to a pension. **Proposed section 19AAA**, in **item 16**, will give such a spouse the option, within 3 months of the assessment, to commute part of the pension to a lump sum in order to meet the surcharge liability. The procedures for notifying DOFA and for the Department sending the required sum on to the ATO are essentially the same as those set out for members in proposed section 18A (see above). The method of recalculating the spouse's pension entitlement is left to the Trust, in consultation with the Australian Government Actuary, and must take into account the spouse's age and any other relevant factors (**proposed subsections 19AAA(6)-(7)**).

Item 15 is consequential on item 16.

Under the PCSS, where:

- a Member or Senator dies while in Parliament, or
- he or she dies after leaving Parliament and had met the statutory service requirements for a superannuation pension

and either:

- the Member or Senator is not survived by a spouse (entitled to a pension) who is the natural or adoptive parent of the child, or
- he or she was so survived, but the spouse in receipt of a pension has now died

a pension is payable to a dependent child under 16 or full-time student under 25, subject to certain other statutory requirements being satisfied.

Such a child in receipt of a pension will also be given by the Bill the option of electing to commute a lump sum to meet a personal liability for a surcharge assessment on the parent member's superannuation account. In this case the relevant provisions are found in

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proposed section 19ABA in item 18. They are in identical terms to the spouse pension provisions in proposed section 19AAA. A child is defined by section 19AA of the PCS Act to include a child of either the member or his or her spouse, and includes adopted and ex-nuptial children.

Item 17 is consequential on item 18. **Items 22 and 23**, dealing with the distribution of benefit amongst multiple children and/or spouses, is consequential on items 16 and 18.

Section 20 of the PCS Act deals with the situation where a former member becomes entitled to a superannuation benefit but subsequently is re-elected to Parliament. Subsection 20(3A) says that where a member earlier chose to commute part of their pension as a lump sum, then when they become again entitled to a pension an adjustment must be made to take account of their earlier commutation. **Item 20** ensures that that approach is confined to an election under the *general* commutation provisions in section 18B and does not cover a commutation under proposed section 18A intended to discharge a post-retirement surcharge liability. Proposed subsection 18(8AC) will cater for this latter situation and the consequent recalculations which are required.

Section 20 also states that upon re-election to Parliament, the earlier pension is cancelled and as a general rule all subsequent rights and liabilities are determined as if the member had never received the earlier pension. **Proposed subsection 20(3D) in item 21** ensures that this general rule does not prevent the accurate calculation of all surcharge debits from all periods of parliamentary service and consequent adjustments to pension entitlements.

Item 19 is consequential on item 21.

Section 21B of the PCS Act provides for a 50% reduction in pension over a certain amount, where an ex-parliamentarian takes up a post which answers the description of 'an office of profit' under the Commonwealth or a State, and their remuneration exceeds a statutory threshold. Where a member holds such an office and is also liable to a pension reduction because either:

- they commuted some of their pension as a lump sum, or
- they commuted some of their pension as a lump sum and then were subsequently re-elected to Parliament

subsection 21B(4) provides that the reduction is to be a maximum of 50% of the benefit payable and that this 50% is calculated without reference to the commutation. **Item 24** extends the same principle to situations where the office-holder is subject to

- a pension reduction because of the operation of section 21B, and
- a pension reduction because they have elected to commute an amount as a lump sum to pay a post-retirement surcharge assessment, under proposed section 18A.

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In other words, the 50% reduction attributable to taking up an office of profit is calculated without taking into account the reduction attributable to the section 18A election.

Before deciding whether to make a post-retirement commutation to pay a surcharge assessment, a retired member (or where eligible for a pension, their surviving spouse or dependent child) may seek advice from the Trust. **Proposed section 24E** gives the Trust power to give the person 'such advice as it thinks appropriate'.

As the PCSS is an unfunded defined benefits scheme, the Trust does not ordinarily pay financial contributions nor surcharge bills year by year. Instead, when a lump sum or pension begins to be paid, the Trust must forward within a month an amount equal to the full surcharge debt on the member's account: subsection 16(6) of the 1997 Act. Currently, these amounts are paid out of an annual appropriation. **Item 27** will ensure that after 1 July 2001 they will be paid from a special appropriation. A special appropriation is a standing authority to appropriate money from consolidated revenue for a specified purpose, and does not require annual authorisation from Parliament. As a result of this amendment, that cost of the PCSS becomes less transparent.

The provisions for surcharge-related post-retirement commutations by members, spouses and children in the Bill apply whether the assessment was issued before or after Royal Assent is given to the Bill: **item 29**. In the case of spouses and children, the provisions apply whether the member's death occurred before or after Royal Assent to the Bill: **item 30**.

The amendments to subsection 18(8A) (in **items 7-11**) will not apply to a member who is entitled, at the time of Royal Assent, to a reduced pension unless that person subsequently either makes a surcharge commutation election or is re-elected to parliament and then retires: **item 28**.

Schedule 2—Amendments to the *Superannuation Act 1976* (the CSS)

Proposed Part IXA (inserted by **item 4**) will permit for CSS scheme members the same option as provided in Schedule 1 for parliamentarians: an election to commute part of a pension to a lump sum in order to pay off a post-retirement assessment of surcharge liability. The pension will be reduced accordingly to take account of the amount commuted as a lump sum.

The same procedure applies as that set out in Schedule 1 and described above: a CSS pension recipient who is sent a post-retirement surcharge assessment has 3 months to notify the CSS Board that he/she has elected to commute a particular amount as a lump sum so that it can be forwarded by the Board to the ATO to pay off the surcharge liability. The pension will be reduced accordingly, in line with a formula contained in **proposed subsection 146C(7)**. A conversion factor must be calculated, taking account of the person's age at the time they make the election, as well as any other relevant factors. The conversion factor will provide for the surcharge liability to be spread across the expected

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life of the pension: **proposed section 146D**.⁷ The *Explanatory Memorandum* draws attention to the fact that some pensions payable under the CSS scheme are subject to indexation while some are not, so different conversion factors will need to be determined, on the basis of actuarial advice. Determinations of the relevant conversion factor must be published in the *Gazette*: **proposed subsection 146D(3)**.

Indexation also explains the presence of **proposed subsection 146C(9)**. If a member elects to commute for surcharge purposes between the start of the financial year and the making of the first fortnightly pension payment, the Act will deem the election to have been made on the day *after* the first fortnightly pension payment. This will ensure, as the *Explanatory Memorandum* points out, 'that any indexation is applied to the rate of pension before reduction'.

The Bill also permits surviving eligible spouses (**proposed sections 146E-146F**) and surviving eligible children (**proposed sections 146G-146H**) to take up the same option of commutation when confronted by a post-retirement surcharge assessment. Again the same procedures apply: 3 months to notify an election, payment forwarded to the ATO by the CSS Board and a consequent pension reduction based on a conversion factor which takes actuarial advice as well as relevant personal and other factors into account.

Section 157 of the *Superannuation Act 1976* deals generally with elections made under the Act. It includes a provision allowing a person who has made an election to change their mind and, within 3 months, ask the Board in its discretion to cancel the election. The legal effect is as if the election had not been made: subsection 157(3). **Item 5** adds **proposed subsection 157(4)** which similarly allows a person who makes a commutation election under proposed Part IXA to ask for the election to be cancelled. It empowers the Board, in its discretion, to cancel the election but this can only occur if no payment has yet been made in accordance with the election. The legal effect is as if the election had not been made.

An election can be made under proposed Part IXA whether the assessment was made before or after Royal Assent to the Bill (**item 7**) and, in the case of elections by surviving spouses or children, whether the employee member died before or after Royal Assent (**item 8**).

Item 6 permits Regulations made within 12 months of Royal Assent to the Bill, arising from changes made by the Bill, to commence earlier than the date on which they are made although not earlier than the date on which the Bill receives Royal Assent.

Like item 31 in Schedule 1, **item 9** in Schedule 2 permits the first conversion factor determined under proposed Part IXA to be backdated to take effect from Royal Assent to the Bill.

Items 1-3 are similar to item 22 in Schedule 1. They deal with the discretion the CSS Board has to distribute benefits between surviving spouses and/or eligible children where the member has died. The proposed amendments ensure that in assessing the need of a

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child or spouse any election they make to commute part of a pension to pay off a post-retirement surcharge debt will be disregarded.

Schedule 3—Amendments to the *Superannuation Act 1990* (the PSS)

Item 1 is consequential on item 2. It ensures that the legal obligation imposed by the *Superannuation Act 1990* on the PSS Board and in turn the Commonwealth, to pay beneficiaries the benefit due under the PSS rules, excludes that part of the benefit which is a commuted lump sum to be wholly applied to a post-retirement surcharge assessment.

Item 2 contemplates changes to the Rules governing the PSS which would permit commutation of a lump sum to pay off a post-retirement surcharge assessment. It says that where such an election has been validly made under the Rules, the nominated sum must be forwarded to the ATO in payment of the surcharge assessment.

Endnotes

- 1 See, for example, the range of comments made about the scheme in Bills Digest No. 105 of 1995-1996, dealing with the Parliamentary Contributory Superannuation Amendment Bill 1996, which can be found at <http://www.aph.gov.au/library/pubs/bd/1995-96/96bd105.htm> (8 February 2001). See also, for example, the speech made to the House of Representatives by the Member for Calare Mr Andren MP on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000 in *Debates*, 4 October 2000 at p. 20 723.
- 2 More information about the CSS can be obtained at the Comsuper website: <http://www.comsuper.gov.au/css/index.htm> (7 February 2001).
- 3 More information about the PSS can be obtained at the Comsuper website: <http://www.comsuper.gov.au/pss/index.htm> (7 February 2001).
- 4 The adjusted taxable income includes the surchargeable contributions made to a superannuation fund and reportable fringe benefits.
- 5 Such an obligation may also arise if an amended assessment increases the adjusted income of the contributor.
- 6 *Explanatory Memorandum*, p. 2. It appears that the amendments were made by item 1 of Schedule 4 to the *Superannuation Contributions and Termination Payments Legislation Amendment Act 1999* and Schedule 1 to the *Superannuation Industry (Supervision) Amendment Regulations 1998* (No. 8).
- 7 It may be noted that while in the case of the PCSS the Trustee must act in accordance with the advice of the Australian Government Actuary, the Board may consult any actuary.

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