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No. 166 2002–03

Superannuation (Surcharge Rate Reduction) Amendment Bill 2003

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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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No. 166 2002–03

Superannuation (Surcharge Rate Reduction) Amendment
Bill 2003

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Contents

Purpose	1
Background to reducing the superannuation surcharge rates	1
Surcharge on superannuation contributions	2
2001 Election: Coalition Promises on Superannuation	2
2002-03 Budget announcement	2
Revitalising Superannuation.	3
Main Provisions	3
Schedule 1 – Amendments related to reduction of the superannuation surcharge	3
Part 1—Amendments related to the reduction of the superannuation surcharge rate	3
Part 2—Amendments related to the reduction of the superannuation surcharge cap	4
Part 3—Application provisions	5
Concluding Comments.	5
Endnotes.	6

Superannuation (Surcharge Rate Reduction) Amendment Bill 2003

Date Introduced: 29 May 2003

House: House of Representatives

Portfolio: Treasury

Commencement: 1 July 2002 except for item 30 which has a commencement date of 28 December 2002.¹

Purpose

The purpose of this Bill is to:

- reduce the superannuation surcharge rates by one-tenth of their current level over 3 years.

Background to reducing the superannuation surcharge rates

General information on reducing the superannuation surcharge rates was provided in the Bills Digest for the original Bill for this measure, [Taxation Laws Amendment \(Superannuation\) Bill \(No. 2\) 2002](#) (TLA(S) Bill No. 2 2002)² and in [Superannuation Legislation Amendment Bill 2002](#) (SLA Bill 2002).³

During debate on the TLA(S) Bill No. 2 2002 on 27 June 2002, the Government withdrew the amendments that reduced the superannuation surcharge rates.⁴ These amendments were reintroduced in Schedule 2 of the SLA Bill 2002. The SLA Bill 2002 was introduced with the Superannuation (Government Co-contribution for Low Income Earners) Bill 2002. These two bills were last debated in the Senate on 18 November 2002 in cognate debate.

To attempt to meet its 2001 Election commitment to reduce the superannuation surcharge rate and introduce the Government co-contribution for low income earners the Government has split the SLA Bill 2002 into this Bill and the Superannuation (Government Co-contribution for Low Income Earners) (Consequential Amendments) Bill 2003. This will allow this Bill to be debated separately from the Government co-contribution for low income earner bills.

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Surcharge on superannuation contributions

All employer contributions, certain 'golden handshakes' and tax deductible personal contributions made to superannuation funds for high-income earners are subject to a surcharge of up to 15 per cent. For the 2002-03 income year, the surcharge is phased in over the income levels of \$90 527 to \$109 924 with the surcharge increasing by one per cent for each additional \$1295 of income from \$90 527.

2001 Election: Coalition Promises on Superannuation

During the 2001 election campaign, the Government released *A Better Superannuation System*⁵ containing a number of proposed reforms to superannuation. This document contained 13 election promises. One of these promises was to reduce the superannuation and termination payments surcharge rates by ten per cent of their current level over each of the next three years (a maximum of 1.5 percentage points each year) with a date of effect of 1 July 2002.

2002-03 Budget announcement

The 2002-03 Budget provided further details about the implementation of these proposals. This section provides the Budget announcements on this measure.

A Better Superannuation System — reducing the Superannuation Surcharge rate

Revenue (\$m)

	2002-03	2003-04	2004-05	2005-06
Australian Taxation Office	-	-50.0	-120.0	-200.0

Explanation

From 1 July 2002, the superannuation and termination payments surcharge rates will be reduced by one tenth of their current levels for each of the next three income years. As a consequence, the maximum surcharge rates will be reduced to 13½ per cent in 2002-03, 12 per cent in 2003-04 and 10½ per cent in 2004-05 and succeeding years.

Further, in keeping with its election commitment, the Government will review the surcharge arrangements after three years to determine whether any further changes are required.⁶

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The Explanatory Memorandum for this Bill updates the figures included in the 2002-03 Budget Papers. The financial impact is now expected to be a cost to revenue of \$65 million in 2003-04, \$170 million in 2004-05 and \$290 million in 2005-06.⁷

Revitalising Superannuation

On 25 May 2003 the Minister for Revenue and the Assistant Treasurer, Senator, the Honourable Helen Coonan, announced that the Federal Government would:

increase the momentum for superannuation reform with renewed efforts to implement its election promises.⁸

Part of the proposal to revitalise superannuation was the reintroduction into the House of Representatives of the superannuation surcharge rate reduction legislation by splitting it from the Government co-contribution for low income earners.

Main Provisions

Schedule 1 – Amendments related to reduction of the superannuation surcharge

Part 1—Amendments related to the reduction of the superannuation surcharge rate

Item 1 adds a new **subsection 5(1AA)** into the *Superannuation Contributions Tax Imposition Act 1997* (SCT Act) that changes the definitions in a formula used to calculate the superannuation surcharge. This simplifies the calculation of the surcharge over the years in which the surcharge rate is reduced each year. The new terms in the formula do not affect the indexation of the thresholds, only the maximum rate of surcharge levied over the next three financial years.

Item 3 inserts a new **subsection 5(1) (formula)** into the SCT Act to substitute a new formula for calculating the surcharge to incorporate the new definitions in **item 1**.

Item 9 adds a new **subsection 5(1A)** into the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997* (SCTMCPSF Act) that changes the definitions in a formula used to calculate the superannuation surcharge. This simplifies the calculation of the surcharge over the years in which the surcharge rate is reduced each year. The new terms in the formula do not affect the indexation of the thresholds, only the maximum rate of surcharge levied over the next three financial years.

Item 11 inserts a new **subsection 5(1) (formula)** into the SCTMCPSF Act to substitute a new formula for calculating the surcharge to incorporate the new definitions in **item 9**.

Item 17 adds a new **subsection 5(1AA)** into the *Termination Payments Tax Imposition Act 1997* (TPTI Act) that changes the definitions in a formula used to calculate the

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superannuation surcharge. This simplifies the calculation of the surcharge over the years in which the surcharge rate is reduced each year. The new terms in the formula do not affect the indexation of the thresholds, only the maximum rate of surcharge levied over the next three financial years.

Item 19 inserts a **new subsection 5(1) (formula)** into the TPTI Act to substitute a new formula for calculating the surcharge to incorporate the new definitions in **item 17**.

Part 2—Amendments related to the reduction of the superannuation surcharge cap

Constitutionally protected superannuation schemes⁹ have complicated methods of calculating superannuation surcharge, primarily due to the design of such schemes. For members of these schemes, superannuation surcharge liability accumulates in a 'surcharge debt account.' The member's liability is the lesser of the amount in the 'surcharge debt account' and 15 per cent of the employer contribution (reflecting the current maximum surcharge rate). Trustees of certain constitutionally protected superannuation funds can reduce the benefits payable to members of such funds by no more than 15 per cent of the employer financed component that accrued after the commencement of the surcharge to discharge a surcharge liability.

The items in this **Part 2 of Schedule 1** enable trustees to reduce this employer component of a benefit by the following amounts:

- 13.5% for the amount that accrued in the 2002-03 financial year
- 12% for the amount that accrued in the 2003-04 financial year, and
- 10.5% for the amount that accrued in the 2004-05 financial year.

The new reduction amounts are implemented by:

- **Item 24**, which replaces **subsection 6C(3)** of the *Defence Force Retirement and Death Benefits Act 1973*
- **Item 25**, which replaces **subsection 4E(3)** of the *Parliamentary Contributory Superannuation Act 1948*
- **Item 26**, which replaces **subsection 80A(3)** of the *Superannuation Act 1976*
- **Items 27 and 28**, which replace **subsections 4(1) and 4(2)** of the *Superannuation Contributions Tax (Application to the Commonwealth—Reduction of Benefits) Act 1997*, and
- **Items 29, 30 and 31**, which replace **paragraphs 15(6)(b) and 15(6AA)(d) and 15(6A)(b)** of the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997*.

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Part 3—Application provisions

Item 32 states that amendments made in **Part 1** apply to surcharge in respect of the 2002-03 and subsequent financial years.

Item 33 states that amendments made by **items 24 to 29** apply in relation to benefits that become payable on or after 1 July 2002.

Item 34 states that the amendment made by **item 30** continues to apply in relation to benefits that become payable before that item commences as if the amendment made by that item had not been made.

Item 35 states that the amendment made by **item 31** applies in relation to superannuation funds that cease to be constitutionally protected funds on or after 1 July 2002.

Concluding Comments

The amendments in this Bill reduce the superannuation surcharge rates by one-tenth of their current level over 3 years. These amendments are the subject of some controversy. The Government is implementing its election promises to reduce the superannuation surcharge. Apart from *2002-03 Budget Papers*, the Government has not produced any economic analysis of the benefits of this proposal. The Government could correctly argue that such arguments have been made elsewhere.¹⁰

Notwithstanding this omission, the inescapable conclusion is that, based on the estimates in the Explanatory Memorandum, this Bill will narrow the tax base and reduce the tax burden of high income earners by \$525 million by the end of the 2005-06 year. The superannuation contributions and termination payments surcharge are important sources of revenue for the Government. In 2001-02 surcharge collections alone amounted to \$824 million.¹¹ This Bill will reduce these collections significantly. The surcharges were introduced as 'equity measures' to make the level of superannuation taxation concessions available to high income earners more comparable to those available to middle and lower income earners.

However, the surcharge has never really met this objective with around 900,000 superannuation contributions and termination payments assessments issued in 1998-99¹² compared to around 450,000 taxpayers declaring a taxable income of \$70,000 or more in 1998-99.¹³ Two groups adversely affected by the surcharges are individuals in an employment catch-up phase¹⁴ or individuals who have received redundancy payouts.¹⁵ The eroding of the equity argument was enhanced on 5 February 2003 when the High Court ruled that the method used to impose the superannuation surcharge on Supreme Court Judges and Masters of the State Supreme Courts by making them personally liable for the surcharge debt when they retired from the bench was a discriminatory tax.¹⁶

While these amendments will assist in a small way the individuals in the catch-up phase and those receiving redundancy payments, the amendments in this Bill also undermine the

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equity argument by increasing the level of tax concession available to high income earners. The Government has yet to justify the vertical inequity of this measure (i.e., why high income earners should be treated to this tax cut and not lower income earners).

The Leader of the Opposition, the Hon. Simon Crean, MP, argued that this proposal benefits the top 3 per cent of income earners. His alternative proposal is outlined below.

Our alternative propositions for the use of the money are these: we can redirect the money earmarked for the few into cutting the superannuation tax for all Australians from the present 15 per cent to 13 per cent; or we can cut the tax to 11 and a half per cent for people over 40 years of age—the age when most people start getting serious about planning for their retirement. The last option would mean a cut of more than 25 per cent in superannuation contributions tax. It would add many thousands of dollars to everyone's retirement income whilst still being economically responsible. It would be a powerful incentive for Australians to invest in their own future, helping us to cope with our future needs. It is a fairer alternative.¹⁷

This proposal was refined during the Leader of the Opposition's 2003–04 Budget Reply speech where he announced that the Opposition would lower the superannuation contributions tax from 15 per cent to 13 per cent.¹⁸ This proposal adds another layer of grandfathering to an already complex area, i.e. the taxation of benefits and eligible termination payments and it does not address the problem of how to fix the administratively complex surcharge system.

It is arguable that reducing the surcharge rates is a step in the right direction. Much has been written about its complexity, poor design, and effect on the incentive for employees to save for their retirement. At the very least, the measures in the Bill are a small concession to those who would prefer to see the surcharge abolished altogether.

If the Parliament passes this Bill, the surcharge legislation will remain on the statute books. Many of the witnesses to the 23rd report of the former Senate Select Committee on Superannuation provisions will still be dealing with inefficiencies associated with the complex administration, clumsy assessment procedures and on-going administration costs that are borne not just by high income earners, but all superannuation fund members.¹⁹

Endnotes

- 1 Item 30 has a commencement day of immediately after the commencement of item 37 of Schedule 1 of the Family Law Legislation Amendment (Superannuation) (Consequential Provisions) Act 2001 (the FLLA(S)(CP) Act 2001). Item 37 of the FLLA(S)(CP) Act 2001 commenced on 28 December 2002.
- 2 <http://www.aph.gov.au/library/pubs/bd/2001-02/02bd161.pdf> .
- 3 <http://www.aph.gov.au/library/pubs/bd/2002-03/03bd016.pdf>

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- 4 See Senator the Hon. Helen Coonan, Senate, *Debates*, 27 June 2002, p. 2963.
- 5 'A Better Superannuation System', *Press Release*, The Hon. John Howard, Prime Minister, Liberal Party of Australia, 5 November 2001.
- 6 The Hon. Peter Costello, MP, Treasurer, *Budget Paper No. 2: Budget Measures 2002-03*, p. 14.
- 7 Superannuation (Surcharge Rate Reduction) Amendment Bill 2003, *Explanatory Memorandum*, p. 3.
- 8 'Revitalising Superannuation' *Press Release*, Senator the Hon Helen Coonan, Minister for Revenue and the Assistant Treasurer, 25 May 2003.
- 9 The *Income Tax Assessment Act 1936* section 267(1) defines these as "a fund that is declared by the regulations to be a constitutionally protected fund." These are State superannuation funds that cannot be taxed under the Commonwealth's taxing power (see *South Australia v The Commonwealth* 92 ATC 4066). The funds are listed in Income Tax Regulation 177, schedule 14.
- 10 For example, the 23rd report of the former Senate Select Committee on Superannuation, *Superannuation Surcharge Legislation*.
- 11 Commissioner of Taxation, *Annual Report 2001-02*, p. 38.
- 12 Australian Taxation Office, *Tax Statistics 1999-2000*, p. 81.
- 13 *ibid.*, statistical tables, individuals table no. 8
- 14 An employment earnings catch-up phase is where an individual returns to the workforce earning a high wage after spending time out of work to raise children, to take up further study or some other activity that causes them to be out of the workforce for a substantial period of time.
- 15 Senate Select Committee on Superannuation, *Superannuation and standards of living in retirement - Report on the adequacy of the tax arrangements for superannuation and related policy*, Canberra, December 2002, p. 98.
- 16 *Austin v Commonwealth* 2003 ATC 4042.
- 17 The Hon. Simon Crean, MP, House of Representatives, *Debates*, 16 May 2002, Second Reading Speech, Appropriation Bill (No. 1) 2002-03, p. 2391.
- 18 The Hon. Simon Crean, MP, House of Representatives, *Debates*, 15 May 2003, Second Reading Speech, Appropriation Bill (No. 1) 2003-04, p. 14497.
- 19 See the 23rd report of the former Senate Select Committee on Superannuation, *Superannuation Surcharge Legislation*, especially Chapter 4: The Proposed Collection Mechanism.

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