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Superannuation Budget Measures Bill 2004

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Superannuation Budget Measures Bill 2004

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Economics, Commerce and Industrial Relations Section
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Superannuation Budget Measures Bill 2004

Date Introduced: 13 May 2004

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent

Purpose

The purpose of the Superannuation Budget Measures Bill 2004 (the Budget Measures Bill) is to implement the changes to the government co-contribution for low income earners and the superannuation contributions surcharge announced by the Treasurer in the 2004-05 Budget.

Background

Government low income earners co-contribution

The *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (the Co-contribution Act) commenced on 12 November 2003 with application for the 2003-04 year of income. It provides for contributions to be made by the government towards the superannuation of low income earners.

To be eligible for a government co-contribution an individual must have made personal contributions to a complying superannuation fund, have employer–supported superannuation[1] and have total income of less than $40 000 for the year of income. Where an individual is eligible for the government co-contribution the government will match dollar for dollar an individual's personal contributions up to the individual's maximum co-contribution amount. For individuals whose total income is $27 500 or less the maximum co-contribution amount payable is $1000. For individuals whose total income is between $27 500 and $40 000 the maximum co-contribution amount decreases at a rate of eight cents for every dollar earned above $27 500.

An individual does not have to apply for the government co-contribution. Provided the individual lodges a tax return for the relevant year of income, the Australian Taxation Office will, using information collected from superannuation surcharge statements provided by superannuation providers, determine if an individual is eligible for a government co-contribution payment and calculate the amount that is to be paid into their superannuation fund.

As the government co-contribution first applies in the 2003-04 year of income and relies on the individual lodging their tax return and superannuation funds lodging superannuation surcharge member contribution statements, no individual has actually received a government co-contribution payment. Nevertheless, the Commonwealth Government has decided to increase from the 2004-05 year of income the co-contribution amount and increase the income amount at which an individual is no longer eligible for the government co-contribution.

More background information and history of the government co-contribution can be found in the Bills Digests for the Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 (the S(GCLIE) Bill 2002) and the Superannuation (Government Co-contribution for Low Income Earners) Bill 2003 (the S(GCLIE) Bill 2003).

Superannuation contributions surcharge

The superannuation contributions surcharge was announced in the 1996-97 Budget and commenced from 20 August 1996. Prior to 1 July 2003 all employer contributions, certain 'golden handshakes' and tax deductible personal contributions made to superannuation funds for taxpayers with an adjusted taxable income[2] greater than the lower income amount were subject to a surcharge of up to 15 per cent.

The maximum surcharge rate was reduced to 14.5 per cent for the 2003–04 year of income by the *Superannuation (Surcharge Rate Reduction) Amendment Act 2003*. The maximum surcharge is currently scheduled to reduce to 13.5 per cent in the 2004–2005 year of income and 12.5 per cent in the 2005–2006 year of income.

For the 2003-04 income year, the surcharge is phased in over the income levels of $94 691 to $114 981 with the surcharge increasing by one per cent for each additional $1399 of income from $94 691.

The Budget announcements propose to speed up the rate at which the maximum surcharge rate is reduced.

More background information and history of the superannuation contribution surcharge can be found in the Bills Digest for the Taxation Laws Amendment (Superannuation) Bill (No. 2) 2002 (TLA(S) Bill No. 2 2002), Superannuation Legislation Amendment Bill 2002 (SLA Bill 2002) and the Superannuation (Surcharge Rate Reduction) Amendment Bill 2003 (S(SRR)A Bill 2003).

Extract - 2004-05 Budget announcement

In the 2004-05 Budget the Commonwealth Government announced changes to the government co-contribution system and an increase in the rate at which the maximum surcharge rate is reduced. Below are extracts from Budget Measures 2004-05, *Budget Paper No. 2* that relate to both these measures.

Incentives for saving for retirement — enhancement of Government superannuation co-contribution scheme

Expense ($m)

	2004-05	2005-06	2006-07	2007-08
Australian Taxation Office	-	595.0	730.0	790.0

The Government will enhance the superannuation co-contribution scheme by increasing the maximum co-contribution, giving $1.50 for every $1 of personal contribution, and by raising the income thresholds so that more employees will qualify under the scheme. These changes will apply for personal contributions made from 1 July 2004.

The maximum Government contribution will be increased under the new arrangements from $1,000 to $1,500. The Government will pay $1.50 for every $1 of contribution up to the co-contribution maximum.

The income level up to which the maximum co-contribution applies will be increased from $27,500 to $28,000. For incomes above $28,000, the maximum co-contribution will reduce by 5 cents for each dollar of income, and phase out completely at an income of $58,000. The co-contribution currently phases out at an income of $40,000.

This measure will increase the incentive for people to save for their retirement through the superannuation system.[3]

Incentives for saving for retirement — surcharge rate reduction

Revenue ($m)

	2004-05	2005-06	2006-07	2007-08
Australian Taxation Office	-	-55.0	-170.0	-385.0

The Government will reduce the maximum surcharge rate to 12.5 per cent for 2004-05, 10.0 per cent for 2005-06 and 7.5 per cent for 2006-07 and subsequent years.

This accelerates the current schedule to reduce the maximum surcharge rates to 13.5 per cent for 2004-05 and to 12.5 per cent for 2005-06 and subsequent years.

This measure will further improve the incentives for higher income individuals to make superannuation contributions.[4]

Pros and cons

Government low income earners co-contribution

The government co-contribution legislation has been in place for less than 12 months, therefore, the arguments for and against the government co-contribution system have not changed significantly since the publication of the Bills Digest for the S(GCLIE) Bill 2003. However, some of the points discussed in the Bills Digest for the S(GCLIE) Bill 2003 relating to the reporting system will not be affected by the amendments in the Budget Measures Bill. The possible advantages and disadvantages discussed below are an updated discussion of the possible advantages and disadvantages that appeared in the S(GCLIE) Bill 2003 Bills Digest.

Possible advantages

- The amendments to the government co-contribution in the Budget Measures Bill improve the vertical equity in the superannuation system. It widens the coverage of the government co-contribution system so that persons earning up to $58 000 will benefit whereas, currently, only those earning up to $40 000 benefit.

- The Budget Measures Bill will improve the retirement income of low and middle income earners. Compulsory superannuation (in particular the Superannuation Guarantee system) was designed to improve the retirement income of people beyond what would be received on the age pension alone. The Budget Measures Bill widens the eligibility criteria so that the government co-contribution targets those earning less than $58 000. It helps increase their retirement benefit and, therefore, their potential income in retirement by:

  – increasing the matching rate from dollar-for-dollar to $1.50 for each dollar contributed

  – increasing the lower income threshold from $27 500 to $28 000, and

  – decreasing the phase down rate from eight cents for every dollar above the lower income threshold to five cents for every dollar above the lower income threshold.

- The Budget Measures Bill does not add to the administrative arrangements already in place under the government co-contribution system or impose any additional costs on superannuation funds.

- The Budget Measures Bill does not add any additional costs or burdens on low or middle income earners as it will continue to use existing reporting systems to determine who is eligible for a government co-contribution.

Possible disadvantages

- The Budget Measures Bill has a significant negative impact on the tax base. The government co-contribution as introduced in the S(GCLIE) Bill 2003 abolished a relatively inexpensive rebate (costing $10 million per year) and replaced it with a government superannuation co-contribution scheme. In the Explanatory Memorandum for the S(GCLIE) Bill 2003 the government co-contribution was initially expected to cost $115 million in the 2003–04 year. Following the deal with the Australian Democrats the measure was expected to have a cost of $95 million is 2004-05, $120 million in 2005-06 and $110 million in 2006-07.[5] The announced 2004-05 Budget measures are expected to cost $2.1 billion in the forward estimate years ($595 million in 2005-06, $730 million in 2006-07 and $790 million in 2007-08).[6]

- The Budget Measures Bill does not enhance horizontal equity. Different taxpayers receive different relative advantages by saving through superannuation. These amendments to the government co-contribution measure will not help those employees, who currently cannot afford to make personal contributions, to find the extra money to benefit from the government co-contribution systems and these amendments.

- The *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* requires that the superannuation surcharge reporting system be used for the collection of information for assessing entitlement to government co-contribution. The superannuation surcharge has been criticised for its complex administration, clumsy assessment procedures and on-going administration costs that are borne not just by high income earners, but all superannuation fund members.[7] The Budget Measures Bill does not make any changes to the reporting provisions.

Superannuation contributions surcharge

The introduction of the superannuation contributions surcharge was announced in the 1996-97 Budget and from its introduction has been strongly criticised by many people and organisations involved in the superannuation industry due to its complex administration, clumsy assessment procedures and on-going administration costs. The Budget Measures Bill does not address these issues. The following arguments represent possible advantages and disadvantages from the amendments made to the superannuation contributions surcharge by this Bill.

Possible advantages

- Reducing the superannuation contributions surcharge will result in higher retirement income benefits. By reducing the superannuation contributions surcharge, the employer contributions for those superannuation members whose adjusted taxable income is higher enough that they are subject to the full superannuation contributions surcharge will be taxed less during the accumulation phase. Therefore, through the advantages of compounding, those members subject to the superannuation contributions surcharge will have larger retirement benefits and will have less reliance on the Commonwealth Government for welfare benefits in their retirement.

- Reducing the superannuation contributions surcharge will provide a greater incentive for higher income earners to have contributions made on their behalf by their employer. While this may involve salary sacrifice arrangements the extra superannuation accumulated would result in high income earners being less likely to require support from the Commonwealth Government in their retirement.

Possible disadvantages

- The reduction of the superannuation contributions surcharge proposed in the Budget Measures Bill has a significant negative impact on the tax base. In the Explanatory Memorandum for the S(SRR)A Bill 2003 the government's first round of rate reductions of the superannuation contributions surcharge was initially expected to cost $65 million in 2003–04, $170 million in 2004-05 and $290 million in 2005-06. Following the deal with the Australian Democrats which reduced the rate reductions the expected cost was $145 million is 2004-05, $205 million in 2005-06 and $175 million in 2006-07.[8] The announced 2004-05 Budget measures are expected to cost $610 million in the forward estimate years ($55 million in 2005-06, $170 million in 2006-07 and $385 million in 2007-08).[9]

- The provisions in the Budget Measures Bill relating to the reduction of the superannuation contributions surcharge rate only affects high income earners. It does not provide a reduction in the tax rate imposed on low and middle income earners who have employer contributions made on their behalf.

- The measures relating to the reduction of the maximum rate of the superannuation contributions surcharge in the Budget Measures Bill does not address the problems associated with the complex administration, clumsy assessment procedures and on-going administration costs. By reducing the rate of the superannuation contributions surcharge the on-going administration cost as a proportion of the revenue collected will increase.

ALP/Australian Democrat/Greens policy position/commitments

The Australian Labor Party (ALP) has announced that it will not support the Budget Measures Bill. The ALP believes that the reduction to the superannuation contributions surcharge is a tax cut for the wealthy and should be redirected to lower-income earners.[10] The ALP has previously announced that should it win government at the next federal election it will reduce the contributions tax from 15 per cent to 13 per cent.[11]

The Australian Democrats have not indicated whether they will support the Budget Measures Bill. However, they have indicated that they are not yet convinced that the 2004-05 Budget proposals are well targeted[12] and are somewhat sceptical the budget superannuation measures did enough for low income earners.[13]

Main Provisions

Schedule 1 – Extension of the Government's superannuation co-contribution

Item 1 amends subsection 9(1) of the Co-contribution Act to increase the co-contribution rate from 100 per cent of personal contributions a member makes in the 2003-04 year of income up to 150 per cent from the 2004-05 year of income onward up to their maximum amount.

Item 2 amends subsection 10(1) of the Co-contribution Act so that it only applies for the 2003-04 year of income.

Item 3 inserts **proposed subsection 10(1A)** into the Co-contributions Act. **Proposed subsection 10(1A)** sets the maximum government co-contribution for the 2004-05 year of income and later years at $1500 for total incomes at or below the lower income threshold (**proposed subsection 10A(2)** will set the lower income threshold at $28 000 for the 2004-05 year of income). For persons with total incomes between the lower income threshold and the higher income threshold (**proposed subsection 10A(3)** will set the higher income threshold at $58 000 for the 2004-05 year of income), the $1500 maximum is reduced by 5 cents for each dollar by which the person's total income exceeds the lower income threshold. **Item 4** amends subsection 10(2) of the Co-contributions Act so that provisions listed in subsection 10(2) are subject to both subsection 10(1) and **proposed subsection 10(1A)**.

Item 5 amends section 10A of the Co-contributions Act so that:

- the lower income threshold (subsection 10A(2)) is $28 000 for the 2004-05 to 2006-07 years of income and indexed inline with full time adult average weekly ordinary time earnings from the 2007-08 year of income onwards, and

- the higher income threshold (subsection 10A(3)) is $58 000 for the 2004-05 to 2006-07 years of income and $30 000 above the indexed lower income threshold from 2007-08 onwards.

Item 6 provides that the amendments made by **Schedule 1** of the Budget Measures Bill apply to the 2004-05 year of income and later years of income.

Schedule 2 – Superannuation Surcharge

Part 1 – Amendments related to the reduction of the surcharge rate

Items 1 to **3** substitute a new definition of maximum surcharge percentage into:

- subsection 5(1AA) of the *Superannuation Contributions Tax Imposition Act 1997*
- subsection 5(1A) of the Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997, and
- subsection 5(1AA) of the *Termination Payments Tax Imposition Act 1997*.

The new definition of maximum surcharge percentage inserted by **items 1** to **3** proposes to reduce the maximum surcharge percentage to 12.5 per cent in the 2004-05 year of income, 10 per cent in the 2005-06 year of income and 7.5 per cent for the 2006-07 year of income and later years of income.

Part 2 – Amendments related to reduction of the surcharge cap

The items in **Part 2** of **Schedule 2** amend the surcharge caps prescribed in the legislation governing certain Commonwealth operated superannuation schemes. The surcharge caps place a limit on reduction of the employer component of a benefit accrued in a particular year of income for superannuation contribution surcharge purposes. **Items 4** to **10** will result in:

- the surcharge cap being amended to 12.5 per cent for the amount that accrues in the 2004-05 financial year
- the surcharge cap being amended to 10 per cent for the amount that accrues in the 2005-06 financial year, and
- a new surcharge cap of 7.5 per cent for amounts that accrue after 30 June 2006.

The new surcharge caps are implemented by:

- **item 4**, which replaces paragraphs 6C(3)(c) and (d) of the *Defence Force Retirement and Death Benefits Act 1973* and inserts **proposed paragraph 6C(3)(e)**

- **item 5**, which replaces paragraphs 4E(3)(c) and (d) of the *Parliamentary Contributory Superannuation Act 1948* and inserts **proposed paragraph 4E(3)(e)**
- **item 6**, which replaces paragraph 80A(3)(c) and (d) of the *Superannuation Act 1976* and inserts **proposed paragraph 80A(3)(e)**
- **item 7** which replaces paragraphs 4(2A)(c) and (d) of the *Superannuation Contributions Tax (Application to the Commonwealth–Reduction of Benefits) Act 1997* and inserts **proposed paragraph 4(2A)(e)**, and
- **items 8, 9** and **10** replace subparagraphs 15(6)(b)(iii) and (iv), 15(6AA)(d)(iii) and (iv) and 15(6A)(b)(iii) and (iv) of the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997* and inserts **proposed subparagraphs 15(6)(b)(v), 15(6AA)(d)(v)** and **15(6A)(b)(v)**.

Part 3 – Application

Item 11 states that:

- amendments made in **Part 1** of **Schedule 2** apply to the surcharge in respect of the 2004-05 and subsequent financial years
- amendments made by **items 4** to **9** apply in relation to benefits that become payable on or after 1 July 2004, and
- the amendment made by **item 10** applies in relation to superannuation funds that cease to be constitutionally protected funds on or after 1 July 2004.

Concluding Comments

The amendments in the Budget Measures Bill achieve the government's objectives of widening the eligibility for the government co-contribution and reducing the superannuation contributions surcharge rate as announced in the 2004-05 Budget. These amendments are the subject of some controversy.

Low and middle income earners (those whose taxable income plus reportable fringe benefits are less than $58 000) who can afford to make personal superannuation contributions will benefit from the changes to the government's co-contribution measure. Increasing the government co-contribution rate ensures that recipients of the government-co-contributions will have a higher retirement benefit than they would have if the current arrangement remains unchanged. Meanwhile high income earners, i.e. those subject to the superannuation contributions surcharge, will benefit from the reduction in the superannuation contributions surcharge rate.

The Investment and Financial Services Association Ltd estimates that around 40% of those people earning between $30 000 and $50 000 will take up the government's co-contribution.[14] However, this still leaves a significant number of people who, along with the people who do not qualify for the government co-contribution or are not liable for the superannuation contributions surcharge, will not receive a benefit from the 2004-05 Budget announcements.

Also the Budget Measures Bill does not address the problems associated with collection mechanism for the superannuation surcharge. The collection mechanism, which also provides information for the government co-contribution, derided for its complex administration, clumsy assessment procedures and on-going administration costs borne by all superannuation fund members.

The Bills Digest for the S(SRR)A Bill 2003 highlighted in it conclusion that the superannuation contributions and termination payments 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. They have never really met this objective. Two groups that continue to be adversely affected by the surcharges, even with the current legislated rate of reduction are individuals in an employment catch-up phase[15] or individuals who have received redundancy payouts.[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 the Budget Measures Bill undermine the equity argument by increasing the level of tax concession available to high income earners. The Commonwealth 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).

Nevertheless, the inescapable conclusion is that, based on the estimates in the 2004-05 Budget Papers, this Bill will have a significant cost to the budget of $2.7 billion over the forward estimate years. This loss of revenue is approximately 8.85 per cent of the revenue that is estimated to be collected if this Bill is not passed.

This Bill continues the tinkering and fiddling at the edges of the superannuation system by both sides of the political spectrum. It adds more complexity to an already mind-boggling system that needs serious review. Even the ALP's proposal to lower the superannuation contributions tax from 15 per cent to 13 per cent does not address the complexity or fairness issue.

Real reform is needed to the superannuation system so that those who are able to finance their own retirement can do so without wanting to resort to schemes to obtain access to welfare benefits and those who cannot sufficiently finance their own retirement can receive a benefit better than the age pension. Neither the proposals in this Bill nor the ALP's alternatives achieve this goal.

Endnotes

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1 Superannuation Laws Amendments (2004 Measures No. 1) Bill 2004 proposes to amend this requirement for the 2003-04 year of income and onwards so that people who do not receive employer supported superannuation (i.e. fall outside the superannuation guarantee system as they are paid less than $450 in a month) can be eligible for the Government co-contribution if they make personal contributions.

2 Adjusted taxable income includes the person's assessable income, eligible termination payments, surchargeable contributions and reportable fringe benefits.

3 Budget Measures 2004-05, *Budget Paper No. 2*, pp. 12-13.

4 ibid., p. 13.

5 *Mid-Year Economic and Fiscal Outlook 2003-04*, pp. 127-128.

6 *Explanatory Memorandum*, p. 3.

7 See the 23rd report of the former Senate Select Committee on Superannuation, *Superannuation Surcharge Legislation*, especially Chapter 4: The Proposed Collection Mechanism.

8 *Mid-Year Economic and Fiscal Outlook 2003-04*, p. 69.

9 *Explanatory Memorandum*, p. 4.

10 Mark Davis, 'Labor no to super tax cut', *Australian Financial Review*, 25 May 2004, p. 4.

11 Australian Labor Party, *Superannuation: Setting a Goal*, Australian Labor Party, Canberra, 15 March 2004, p. 10, (http://parlinfoweb.parl.net/parlinfo/Repository1/Library/partypol/ZRXB61.pdf) accessed on 7 June 2004.

12 Senator John Cherry, *Super Changes Need Review for 'Savings Effect'*, Press Release Number: 04/394, Australian Democrats, Canberra, 14 May 2004.

13 Mark Davis, op. cit.

14 Investment and Financial Services Association, *Super Co-contributions - Modelling signals positive take-up rates*, media release, Investment and Financial Services Association Ltd, Sydney, 25 May 2004.

15 An employment earnings catch-up phase is were 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.

16 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.