



## Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005

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## Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005

**Date Introduced:** 26 May 2005

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** Royal Assent, but with effect from 1 July 2005.

### Purpose

The Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005 (the Bill) prevents the superannuation surcharge, payable in individual's surchargeable superannuation contributions and relevant termination payments, from applying on or after 1 July 2005. It achieves this by amending the:

- *Superannuation Contributions Tax (Assessment and Collection) Act 1997*
- *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997*, and
- *Termination Payments Tax (Assessment and Collection) Act 1997*.

In addition, this Bill makes consequential amendments to:

- *Defence Force Retirement and Death Benefits Act 1973*
- *Parliamentary Contributory Superannuation Act 1948*
- *Superannuation Act 1976*
- *Superannuation Contributions Tax (Application to the Commonwealth—Reduction of Benefits) Act 1997*
- *Superannuation Contributions Tax (Assessment and Collection) Act 1997*
- *Superannuation Contributions Tax Imposition Act 1997*
- *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997*
- *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997*
- *Termination Payments Tax (Assessment and Collection) Act 1997*
- *Termination Payments Tax Imposition Act 1997*

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The Superannuation surcharge is not abolished, rather it is discontinued from 1 July 2005. It continues to apply to superannuation contributions (and eligible termination payments) made in respect of the financial years 1996–97 through to 2004–05.<sup>1</sup>

## Background

The Superannuation Surcharge was announced on 20 August 1996 as part of the first Howard Government's budget. While the superannuation surcharge was introduced as a revenue measurer, in his second reading speech, the then Parliamentary Secretary (Cabinet) to the Prime Minister noted that:

The superannuation system has been inequitably biased in favour of high income earners. Those high income earners have been benefiting from the concessional taxation treatment of superannuation to a much greater extent than low income earners. The introduction of the superannuation contributions surcharge for high income earners is this government's response to ensure that the superannuation system is more equitable for all Australians, while also ensuring that superannuation remains an attractive savings option.<sup>2</sup>

In contrast, the Treasurer, in his second reading speech to this Bill, noted that:

The superannuation surcharge was introduced in 1996 at a time when the budget was deeply in deficit as a result of Labor's economic mismanagement. It was introduced in 1996 in part to drive the budget back into balance. The government laid down a policy in 1996 to drive the budget back into balance from a \$10.3 billion deficit which the Labor Party had left in place.<sup>3</sup>

That is, the reason for the introduction of the superannuation surcharge was purely fiscal and its restriction to the years 1996–97 to 2004–05 is due only to the improvement of the Commonwealth's budgetary position.

The income of a superannuation fund, including contributions made on behalf of a member, is subject to concessional tax treatment, if the fund satisfies certain conditions. The principal condition is that the fund satisfies the *Superannuation Industry (Supervision) Act 1993* and its regulations, which relate to matters such as vesting, the provision of information to members and financial management requirements. The concessional tax treatment means that a superannuation fund's income was generally taxed at the rate of 15 per cent rather than at the normal company or personal income tax rates.

The introduction of the superannuation surcharge meant that the concessional tax treatment would be altered and that a 'surcharge' would apply to contributions that were subject to a tax deduction (this includes employer contributions and contributions made by members where there is no employer contribution and a deduction has been claimed).

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The surcharge had effect to apply as the member's total income for surcharge purposes exceeded \$70 000 per annum.<sup>4</sup> The surcharge was imposed at the rate of 1 per cent for each \$1 000 of assessable income and superannuation contributions up to a maximum of 15 per cent where assessable income for surcharge purposes reached \$85 000 per annum, or above. These income thresholds have been indexed since that time and now stand at \$99 710 and \$121 075 respectively. As already noted, income for surcharge purposes included superannuation contributions, but also includes salary and wages, fringe benefits and superannuation lump sums paid to individuals.<sup>5</sup>

The surcharge is levied on:

- superannuation contributions for which a tax deduction has been claimed.<sup>6</sup> Generally these are employer contributions made under the provisions of the Superannuation Guarantee regime, but also include contributions principally made mainly by self employed workers who claim a tax deduction in respect of those contributions, and
- if the receipt of a superannuation lump sum (i.e. an eligible termination payment) increased the taxpayer's assessable income for surcharge purposes over the income thresholds—the superannuation lump sum received.

The surcharge applies to both accumulated benefits funds, i.e. the 'usual' type of superannuation fund where the members' ultimate benefit will depend on the investment performance of the fund, and defined benefits funds, which are funds where the member's benefits are defined, usually on such matters as the number of years of contributions and final salary.<sup>7</sup>

The maximum surcharge rate was 15 per cent. The *Superannuation (Surcharge Rate Reduction) Amendment Act 2003* and the *Superannuation Budget Measures Act 2004* between them reduced the maximum surcharge rate to 14.5 per cent for 2003–04, 12.5 per cent for 2004–05 and 10 per cent for 2005–06 and later financial years. The Government has announced that it intended to reduce the maximum surcharge rate to 7.5 per cent in 2006–07 and for later financial years.<sup>8</sup>

The superannuation surcharge has been an extremely unpopular impost for a number of reasons:

- it is complex and costly to administer and collect<sup>9</sup>
- its collection costs are carried by all fund members, most of whom do not have surcharge deducted from contributions made on their behalf<sup>10</sup>
- it applies to low income earners, if the value of their superannuation lump sum payment on retirement meant that their annual income for surcharge purposes, in the income year in which they received the lump sum payment, was above the surcharge thresholds<sup>11</sup>

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- it is especially difficult to determine the amount of surcharge paid by defined benefit fund members, because the value of their deductible contribution (i.e. their employer's notional contribution) is difficult to calculate<sup>12</sup>
- whilst the surcharge applying to accumulation fund members was paid in the year after the liability occurred, defined benefit fund members paid any surcharge liability out of the benefits paid (either pension or lump sum) when they finally retire<sup>13</sup>
- the surcharge particularly affects those who have not had the opportunity to accumulate significant superannuation benefits until late in their working lives and started earning a high income from that point on. This mainly affected women who returned to the workforce following time out of the paid work force (for example, due to family responsibilities etc).<sup>14</sup>

Lateral Economics have estimated that about 640 000 Australians are affected by the application of superannuation surcharge, many of whom spent the majority of their working lives in the decades before the implementation of compulsory superannuation payments.<sup>15</sup> The Association of Superannuation Funds of Australia has calculated that the discontinuation of the superannuation surcharge will benefit over 1 million Australians.<sup>16</sup>

### **Basis of policy commitment**

This measure was announced in the 2005–06 Budget and was also outlined in the Treasurer's Press Release No. 41 of 10 May 2005, *Abolishing the superannuation surcharge*.<sup>17</sup>

### **Position of significant interest groups/press commentary**

The superannuation industry has warmly welcomed the proposed abolition of the superannuation surcharge.<sup>18</sup> Press commentary has largely endorsed the abolition of the superannuation surcharge.<sup>19</sup>

Other press comments note that the abolition of the surcharge makes the tax system less progressive, by partly flattening the overall tax structure.<sup>20</sup>

### **Pros and cons**

There are a number of advantages flowing from the discontinuation of the superannuation surcharge. Amongst these may be:

- the rate of national savings will be increased, both by the amount of tax foregone and by the additional contributions to superannuation funds that the abolition of the surcharge will encourage
- levels of individual superannuation savings will also increase

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- much (but by no means all) of the administrative complexity associated with the surcharge will disappear with its abolition. This will decrease the administrative costs of running many funds. It is less clear whether this will result in a lowering of overall fees and charges
- to the extent that the above advantages occur - superannuation funds will increase in size at a faster rate, thereby increasing the cost advantages of larger funds (i.e. the larger the fund the less a percentage of assets under management are taken up by the fixed costs of running that fund)
- over the longer term, increased superannuation benefits are expected to lead to less reliance on the Age Pension in retirement, and
- over the longer term, the diversion of additional funds to superannuation decreases consumption and therefore can be seen as a factor in restraining inflation.

However, the discontinuation of the superannuation surcharge is not without its disadvantages, including that:

- the government will not collect as much revenue, (it is estimated that forgone revenue will be over \$2.5 billion in the four years to 2008–09)
- the discontinuation of the superannuation surcharge makes the overall tax system less progressive, and
- the injection of additional funds into the superannuation system will increase the amount of funds available to invest and thereby add to asset price inflation.

#### **ALP/Australian Democrat/Greens policy position/commitments**

The ALP has signalled that it would oppose the recently announced tax cuts. These tax cuts include the abolition of the superannuation surcharge from 2005–06 onwards. Presumably this means that the ALP will oppose this particular Bill in the House and the Senate.<sup>21</sup>

The Democrats have expressed concern that Parliamentarians will be significant beneficiaries of the discontinuation of surcharge from 1 July 2005.<sup>22</sup> Further, while they hold the balance of power, they have stated that they will oppose the Government's announced tax cuts, which presumably, this means that they will oppose this Bill in the Senate.<sup>23</sup>

#### **Any consequences of failure to pass**

The superannuation surcharge will continue to apply from 1 July 2005, albeit at a maximum rate of 10%. For that financial year and following years.

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## Main Provisions

**Part 1 of Schedule 1** amends the *Superannuation Contribution Tax (Assessment and Collection) Act 1997*, *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997* and the *Termination Payments (Assessment and Collection) Act 1997* to effectively limit the payment of the superannuation surcharge to superannuation contributions and eligible termination payments made in respect of the financial years 1996–97 to 2004–05.

**Items 4, 5 6 and 7 in Part 2 of Schedule 1** limit the application of the surcharge regime to various Commonwealth Superannuation Funds to the period commencing 1 July 1996 and ending 30 June 2005.

**Items 8 to 48 in Part 2 of Schedule 1** either:

- limit the application of the superannuation surcharge provisions to the financial years 1996–97 to 2004–05
- remove any obligation the Commissioner for Taxation has to publish various surcharge related income thresholds in respect of the 2005–06 and later financial years, or
- remove any obligation superannuation providers have to provide certain information to the Commissioner for Taxation for surcharge purposes.

These amendments are all consequent on the amendments made in **Part 1 of Schedule 1** of the Bill.

## Concluding Comments

The amending legislation does not simply repeal the entire suit of superannuation surcharge legislation. Retaining the Acts that impose the surcharge (as amended by this Bill) allows:

- the Commissioner for Taxation to collect any outstanding surcharge amounts in relation to the years 1996–97 to 2004–05 inclusive. The Australian National Audit Office has estimated that between \$360m and \$750m in surcharge remains uncollected due to problems with the computerised surcharge administration system<sup>24</sup>
- the collection of surcharge liabilities in respect of the 2004–05 year. These collections take place from October 2005
- surcharge amounts to be collected, in respect of the years 1996–97 to 2004–05, from defined benefit fund members, when they eventually take their benefit, and
- superannuation providers continuing to report information necessary for the operation of the superannuation co-contributions scheme.

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More importantly, maintaining the legislation maintains equity in the superannuation system. Simply abolishing superannuation surcharge from 1 July 2005 would result in defined benefit fund members, to whom the surcharge would have applied, to not pay this tax. This outcome would be unfair as accumulation fund members have paid this tax in respect of contributions made on their behalf (or if self employed tax deductible contributions made) between 1996–97 and 2004–05.

The surcharge will not end in a quick or painless way.

## Endnotes

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- 1 An eligible termination payment is a payment made as a consequence of the termination of employment. The bulk of eligible termination payments are made up of superannuation lump sums.
- 2 The Hon. Chris Miles MP, Parliamentary Secretary (Cabinet) to the Prime Minister, ‘Second Reading Speech: Superannuation Contributions Surcharge (Assessment and Collection) Bill 1997’, House of Representatives, *Debates*, 13 February 1997, p. 887.
- 3 The Hon. Peter Costello MP, Treasurer ‘Second Reading Speech: Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005’, House of Representatives, *Debates*, 26 May 2005, p. 3.
- 4 Total income for surcharge purposes is made up of tax assessable income, superannuation contributions, fringe benefits (if any) and eligible termination payments (if any).
- 5 Definition of income for surcharge purposes contained in Sections 7A & 7B *Superannuation Contributions Tax (Assessment and Collection) Act 1997*.
- 6 If a contribution to a superannuation fund is tax deductible that means that the amount contributed is not included in either the business assessable income for tax purposes, or, in the case of the self employed, their personal assessable income for tax purposes.
- 7 Chris Field, ‘Superannuation Contribution Surcharge (Assessment and Collection) Act 1997, *Bills Digest*, No. 124, Parliamentary Library, Canberra, 1996-97.
- 8 Budget Paper No. 2, 2005–06, p. 33.
- 9 Australian National Audit Office, Performance Audit, *The Australian Taxation Office’s Administration of the Superannuation Contributions Surcharge*, Audit Report, No 39, 2004-05, 13 April 2005, pp. 14–20.
- 10 Annette Sampson, ‘Dumped surcharge was anything but fair’, *Sydney Morning Herald*, 11 May 2005, p. 6.
- 11 Annette Sampson, *ibid*.
- 12 Annette Sampson, *ibid*.

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- 13 Annette Sampson, *ibid.* Worse still, the surcharge liability paid by defined benefit fund members is calculated by the initial liability plus the interest on that liability. The interest rate may exceed the fund earnings rate in some years, thereby increasing the liability's effect on the accumulation of a superannuation benefit.
- 14 Diana Olsberg, 'Woman, Superannuation and Retirement: Grim Prospects Despite Policy Changes', *Just Policy*, No. 35, March 2005, p. 3; Investment and Financial Services Association (ISFA), *Great budget for retirement savings*, Media Release, 10 May 2005 at [http://www.ifsa.com.au/IFSAWeb/Attach.nsf/Attachments/Media+Releases~2005\\_0510\\_IFSA+Response+to+2005+Budget%2Epdf/\\$File/2005\\_0510\\_IFSA+Response+to+2005+Budget.pdf](http://www.ifsa.com.au/IFSAWeb/Attach.nsf/Attachments/Media+Releases~2005_0510_IFSA+Response+to+2005+Budget%2Epdf/$File/2005_0510_IFSA+Response+to+2005+Budget.pdf) accessed 27 May 2005. For a general discussion of all these problems see Chris Field, *op-cit.*
- 15 ISFA, *ibid.*
- 16 Association of Superannuation Funds of Australia (ASFA), *Surcharge – A Quick Painless Death Please*, Press Release, 26 May 2005.
- 17 The Hon. Peter Costello MP, Treasurer, Explanatory Memorandum to Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005, p. 3.
- 18 ISFA, *Great budget for retirement savings*, Press Release, 10 May 2005 and *Surcharge down & out, funds rise – a super week*, Press Release, 27 May 2005 and ASFA, *Budget – Pretty Super*, Press Release, 10 May 2005 and *Surcharge – A Quick Painless Death Please*, Press Release, 26 May 2005.
- 19 For example, Elizabeth Colman and Dennis Shanahan, 'High flyers not Costello's only fans', *Australian*, 19 May 2005, p. 2. Chris Wright, 'Unloved super levy gets the chop', *Australian Financial Review*, 11 May 2005, p. 22.
- 20 Alan Kohler, 'Super retirement awaits, so long as you're a fund manager or politician', *the AGE*, 18 May 2005, p. 14.
- 21 The Hon. Kim Beazley, Leader of the Opposition, 'Second Reading Speech (Address in Reply): Appropriation Bill (No. 1) 2005–2006', House of Representatives, *Debates*, 12 May 2005, p. 81.
- 22 Senator John Cherry, Press Release, *Politicians big winners out of tax, superannuation changes*, No. 05/244, 12 May 2005 at: [http://www.democrats.org.au/news/index.htm?press\\_id=4573&display=1](http://www.democrats.org.au/news/index.htm?press_id=4573&display=1) accessed 29 May 2005.
- 23 Senator Lyn Allison, Leader of the Democrats, 'Budget Statement and Documents, Address in Reply' Senate, *Debates*, 12 May 2005, p. 76.
- 24 Australian National Audit Office, Performance Audit, *The Australian Taxation Office's Administration of the Superannuation Contributions Surcharge*, Audit Report, No. 39, 2004–05, 13 April 2005, p. 17.

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