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No. 9 2001–02

Superannuation Ready Reckoner: Taxation and  
Preservation Rules for 2001–2002

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Superannuation Ready Reckoner: Taxation and  
Preservation Rules for 2001–2002

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## Introduction

Superannuation is a tax-effective investment vehicle, but is known for its complexity and frequent change. The complexity covers most areas of the superannuation system including prudential legislation, taxation legislation and disclosure regulation. Frequent legislative changes contribute to the system's complexity. In addition, the superannuation system constantly changes as many of the financial thresholds are indexed. Consequently, numerous thresholds change at the beginning of each new financial year. Hence, the need to know the new superannuation taxation thresholds for each new financial year.

This paper, updated for the 2001–2002 financial year, is designed to provide readers with a 'ready reckoner'—a simple, easy to use summary of superannuation taxation and preservation rules, and covers the following topics:

- the taxation of superannuation contributions and benefits
- the rebates that apply to certain superannuation contributions and benefits
- the level of superannuation contributions that employers must make
- the preservation rules that came into operation on 1 July 1999
- the application of the Goods and Services Tax (GST) to superannuation,
- proposed changes to the taxation of superannuation.

Superannuation law is extremely complex and individual circumstances can drastically alter its general application. It is therefore stressed that this paper is not intended to be used for determining the tax liability attached to superannuation in any particular case, especially in view of the many specific considerations that need to be addressed in a summary document of this kind.<sup>1</sup>

It is anticipated that this paper will continue to be updated annually at the beginning of every financial year.

All figures in **bold** type are indexed thresholds, and are only current for the 2001–2002 financial year.<sup>2</sup>

Numerous laws and regulations regulate superannuation, each administered by a particular government agency. Superannuation laws and regulations can be separated into three separate categories: prudential regulation, disclosure regulation and taxation.

Prudential legislation and regulations, administered by the Australian Prudential Regulation Authority (APRA), are directed at safeguarding the assets of superannuation fund members and investors. Disclosure legislation and regulations, administered by the Australian Securities and Investments Commission (ASIC), are directed at ensuring superannuation fund members and investors are provided with relevant information by fund trustees to enable them to make a fully informed investment decision. Taxation legislation and regulations, administered by the Australian Taxation Office (ATO), are directed at superannuation funds and their members to collect revenue for the Commonwealth.

The main focus of this paper is the taxation legislation and regulations that affect superannuation funds and their members.

## **Taxation of Superannuation Contributions**

This section shows how superannuation contributions are taxed, the maximum amount of tax-deductible contributions that an employer can make and the tax rebates that apply to certain superannuation contributions. A superannuation contribution is a payment to a superannuation fund, which is generally concessional tax. A tax rebate is a reduction in tax liability that has the same value to all taxpayers independent of the taxpayer's marginal tax rate.

### **Age Based Deduction Limits**

Contributions made to a complying superannuation fund<sup>3</sup> or Retirement Savings Account<sup>4</sup> (RSA) are fully tax deductible to employers up to the age based deduction limits. 'Self-employed persons' (whose income from an employer is less than 10 per cent of their total income) get a full tax deduction on the first \$3000 of contributions plus 75 per cent of the remaining contribution up to the age based deduction limits. The deduction limits are:

<b>Age of employee (years)</b>	<b>Deduction limit</b>
under 35	<b>\$11 912</b>
35 to 49	<b>\$33 087</b>
50 and over	<b>\$82 054</b>

### **Taxation of Contributions**

Employer and tax deductible personal contributions are included in a complying superannuation fund's and RSA's income and are taxed at a rate of 15 per cent.



## Surcharge on 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. The surcharge is currently phased in over the income levels of **\$85 242** to **\$103 507** with the surcharge increasing by one per cent for each additional **\$1219** of income from **\$85 242**. The surcharge may also be payable if a member doesn't quote their Tax File Number to their superannuation fund. For an account which existed prior to 7 May 1997 and received less than the surchargeable contributions threshold of **\$3248**, the surcharge will not be levied merely due to the non-quotation of a Tax File Number in relation to that account for that year.

## Low Income Superannuation Rebate

An employee who receives any form of employer superannuation support (but is not a 'self employed person') is entitled to a tax rebate of up to \$100 for personal contributions made to a complying superannuation fund, provided the employee's assessable (i.e. gross) income is less than \$31 000. The tax rebate is calculated as ten per cent of the lesser of:

- \$1000 reduced by 25 cents for each dollar of the taxpayer's assessable income over \$27 000, or
- the contribution actually made.

## Low Income Spouse Rebate

A contributing spouse is entitled to receive an 18 per cent rebate for contributions up to \$3000 per annum to the superannuation fund or RSA of a spouse who has an assessable income of \$10 800 or less per annum. The maximum rebate phases out on a dollar-for-dollar basis, and is not available when the low-income spouse's assessable income is \$13 800 or more per annum.

## Regulation of Superannuation Contributions

The level of superannuation support an employer is required to provide to employees is prescribed under Federal and State industrial awards and the Commonwealth's Superannuation Guarantee (SG) scheme.

Under award superannuation, the parties (generally unions and employers) are bound by an industrial agreement (or award) to make superannuation contributions to a superannuation fund nominated in the agreement. The level of support is normally not greater than three per cent of ordinary time earnings (although this varies between awards).

The SG scheme requires all employers to provide a minimum level of superannuation support in each financial year for employees (with limited exceptions). The SG scheme operates in conjunction with award superannuation so that contributions made by an employer in conjunction with an industrial award may be counted towards the employer's superannuation guarantee obligations.

## Superannuation Guarantee

The table below shows the minimum level of employer support.

Year	Per cent of ordinary time earnings
2001–02	8
2002–03 and subsequently	9

## Maximum Contribution Base

Employers that do not make SG contributions are liable for the SG charge (SGC). The SGC is made up of the employer's SG shortfall (the amount the employee should have received in SG contributions), an interest (or penalty) component and an administration component (to recover costs incurred by the ATO). When calculating an individual employee's SG shortfall, the amount of an employee's salary or wages used to calculate their 'ordinary times earnings' in a contribution period is limited to the maximum contribution base, which is **\$27 510** for each quarterly period, or **\$110 040** per annum.

## Taxation of Superannuation Fund Earnings

The investment earnings of a complying superannuation fund or RSA are taxed at a rate of 15 per cent. This rate can be reduced through the use of imputation credits. Non-complying funds are taxed at a rate of 47 per cent on their entire assets. Superannuation funds can be non-complying either through choice or through failing to meet the necessary standards and condition required under prudential legislation to qualify for tax concessions.

## Taxation of Superannuation Benefits

This section describes the taxation arrangements that apply to superannuation benefits. A superannuation benefit is the amount of money in the superannuation fund or RSA to which the fund member or RSA holder is entitled. Most benefits are payable on termination of employment and will often be subject to preservation (see 'preservation' below).

The taxation of superannuation benefits is complex due to changes made on 1 July 1983 and 1 July 1988. The complexity arises from avoiding retrospectivity by applying new

taxation treatment to only those portions of benefits attributed to service after 1 July 1983 and 1 July 1988.<sup>5</sup>

## Eligible Termination Payments

Eligible Termination Payments (ETPs) are lump sums usually paid on retirement or resignation from a job and include 'golden handshakes', payments from superannuation funds, approved deposit funds (ADFs), and RSAs. ETPs are taxed differently from other income.

ETPs are comprised of several components (although not all ETPs have every component). Each component of an ETP is taxed in a different manner and may be subject to various rebates.

The various components of an ETP and their respective taxation treatment is provided in the following table:

ETP Component	Maximum Tax Rate (add Medicare levy)
<p><b>Post-June 1983 component</b>—refers to superannuation benefits accrued with respect to employment or fund membership after 30 June 1983. This component is the amount of the ETP reduced by the total amount of all the other ETP components. These benefits are taxed according to whether the fund earnings were taxable and the age of the benefit recipient, as follows.</p> <p><b>Person less than age 55:</b></p> <ul style="list-style-type: none"> <li>• <b>Taxed element:</b> a post-June 1983 component is a taxed element if the fund is subject to 15% tax on investment earnings of the fund (i.e. most superannuation funds). 20%</li> <li>• <b>Untaxed element:</b> a post-June 1983 component is an untaxed element if the fund is not subject to 15% tax on investment earnings (e.g. some government superannuation funds and golden handshakes for employees). 30%</li> </ul> <p><b>Person 55 years or over:</b></p> <ul style="list-style-type: none"> <li>• <b>Taxed element:</b> <ul style="list-style-type: none"> <li>– from \$0 to <b>\$105 843</b> 0%</li> <li>– balance 15%</li> </ul> </li> <li>• <b>Untaxed element:</b> <ul style="list-style-type: none"> <li>– from \$0 to <b>\$105 843</b> 15%</li> <li>– balance 30%</li> </ul> </li> </ul>	
<p><b>Pre-July 1983 component</b>—the amount of an ETP that relates to superannuation benefits accrued with respect to employment before 1 July 1983.</p>	5% of amount is taxed at marginal tax rates
<p><b>Undeducted contributions</b>—member contributions (since 1 July 1983) not subject to a tax deduction (not included for RBL purposes—see below).</p>	Exempt

ETP Component	Maximum Tax Rate (add Medicare levy)
<b>CGT exempt component</b> —an exemption from CGT (on a total maximum capital gain of \$500 000) can be claimed on the sale of a small business where the proceeds are used for retirement.	Exempt
<b>Concessional component</b> —until 1 July 1994, this included any approved early retirement scheme payment, bona fide redundancy payment or invalidity payment. From 1 July 1994, ETPs no longer have a concessional component, except where an ETP with a concessional component was rolled over (transferred to) a complying superannuation fund before 1 July 1994 and subsequently paid out by the fund.	5% of amount is taxed at marginal tax rates
<b>Post-June 1994 invalidity payments</b> —the recipient's disability must be verified.	Exempt
<b>Non-qualifying component</b> —that part of an ETP that represents investment income accruing between the time of purchasing an annuity (other than by a rollover) and the time of payment.	Full amount taxed at marginal tax rates
<b>Excessive component</b> —the amount of an ETP in excess of a person's RBL.	47%

### Reasonable Benefit Limits

The amount of concessional taxed superannuation benefits a person is allowed to receive over his or her lifetime is limited by reasonable benefit limits (RBLs). The table below shows the lump sum and pension RBLs. The pension RBL is available provided that at least 50 per cent of the total benefit received by a person is taken in the form of a pension or annuity that satisfies the pension and annuity standards.

Reasonable Benefit Limits	\$
Lump sum	529 373
Pension	1 058 742

### Bona fide Redundancy Payments

From 1 July 1994 a limit of **\$5295** plus **\$2648** for each year of completed service has been placed on redundancy and early retirement payments. Amounts within the limit are exempt from tax.

### Death Benefits

All death benefits made on or after 1 July 1994 are subject to pension RBLs. Death benefit payments made directly to the dependants of a deceased member are exempt from tax up to the deceased person's pension RBL. Any amount above that is treated as an excessive

component. When paid to a person other than a dependant, death benefit payments become ETPs. The post June 1983 death benefit ETP is taxed at 15 per cent if paid from a taxed source and 30 per cent if paid from an untaxed source.

## Pension and Annuity Rebate

Where a person receives an ETP and uses it to purchase an annuity or pension from a taxed superannuation fund and the person is 55 or more years of age, the person is entitled to a tax rebate, at 15 per cent, on the assessable part of the annuity or pension payment that is not in excess of the person's RBL.

## Income Tax Rates

Individual income tax rates are relevant to calculating an individual's superannuation entitlement. For example, a fund member that has an ETP that contains a non-qualifying component has taxation levied on that component at the member's marginal income tax rate. In addition, if a fund member has an ETP that contains a concessional component, five per cent of that component is taxed at the member's marginal income tax rate. The marginal income tax rates are in the following table:

<b>Taxable income (\$)</b>	<b>Marginal income tax rate (%)</b>
up to 6000	0
6001–20 000	17
20 001–50 000	30
50 001–60 000	42
excess over 60 000	47

The marginal income tax rates above apply to Australian residents and do not include the Medicare levy, which is generally 1.5 per cent. A low-income rebate, worth a maximum of \$150, can affect the tax paid for lower income earners.

These marginal income tax rates come into affect from 1 July 2000.

## GST and Superannuation

This section summarises how the GST is applied to superannuation funds.<sup>6</sup>

The GST is a broad-based value-added tax of 10 per cent on most goods and services supplied in Australia. It is fully effective from 1 July 2000. (Some contracts entered into before that date are affected by the GST.) The GST is payable on transactions where goods and/or services are supplied for consideration (payment). No business is GST free; only certain transactions may be classified as such.

In all countries that have a GST-type tax, financial services are given special treatment. This is because of the difficulty in valuing the service provided when there are sums of capital and interest and other earnings in most financial transactions. It is just too hard and uncertain to unscramble the egg when a fee for service and an interest charge may both be involved in a transaction. Accordingly, financial services are 'input taxed'.

Superannuation funds are financial supplies,<sup>7</sup> meaning the provision, acquisition, or disposal of an interest in or under a superannuation fund, scheme, ADF or RSA or in or under an annuity or allocated pension, is a financial supply. Accordingly, no GST is payable by superannuation funds in respect of contributed capital and related fees paid by members or employer sponsors as the consideration for the rights or interests of the members in the fund or scheme.

Most of the services provided by superannuation funds are free of GST; that is, they are 'input taxed financial supplies'. This means that superannuation funds pay GST on many of their purchases (e.g. computers), do not levy GST on the supplies they make to their ultimate customers (i.e. on benefits paid to fund members), and are input-taxed (i.e. they are not able to obtain input credit for the GST levied on the goods or services they purchased).

Nonetheless, in some circumstances superannuation funds are eligible for reduced input tax credits. For example, superannuation funds are eligible for reduced refunds of the GST they paid for administration and legal services. In addition, superannuation funds also have to levy GST on their non-'input tax financial supplies'. For example, superannuation funds are required to levy GST on the supply of premises to commercial property tenants. If a superannuation fund's turnover (which excludes input taxed supplies) exceeds \$50 000 per year, it must register with the ATO for GST purposes. The Government is also encouraging people who manage their own superannuation funds to apply for an Australian Business Number (ABN) to assist with the administration of their fund. Possession of an ABN does not necessarily mean that a superannuation fund is registered for the GST.<sup>8</sup>

## **Preservation Rules**

Preservation refers to the prudential regulatory requirement<sup>9</sup> that certain superannuation benefits be maintained either in a superannuation or rollover fund or RSA until permanent retirement or after the member reaches preservation age.

### **New Preservation Rules from 1 July 1999**

New preservation rules, administered by APRA, took effect from 1 July 1999. Under the new regulations, all superannuation contributions (including member contributions) and superannuation fund investment earnings, from that date forward, will be preserved till the

member's preservation age. Pre-1 July 1999 non-preserved components of a member's superannuation entitlement generally retain their non-preserved status.

## New Preservation Age from 1 July 1999

Preservation age is the age at which a fund member can gain access to benefits that have accumulated in a superannuation fund or RSA, provided the member has permanently retired from the workforce.

The Government announced in the 1997 Budget that the preservation age would be increased from 55 to 60 years on a phased—in basis. By 2025, the preservation age will be 60 years for anyone born after June 1964, with the age 60 years preservation age being reduced by one year for each year that the person's birthday is before 1 July 1964. This means that persons born before 1 July 1960 will continue to have a preservation age of 55. The following table summarises the phase—in schedule:

<b>For a person born</b>	<b>Preservation age (years)</b>
Before 1 July 1960	55
1 July 1960–30 June 1961	56
1 July 1961–30 June 1962	57
1 July 1962–30 June 1963	58
1 July 1963–30 June 1964	59
1 July 1964–30 June 1965	60

Under the new preservation rules, a person will continue to be allowed to have early access to preserved benefits where the benefits are taken in the form of a non-commutable lifetime pension or lifetime annuity on termination of gainful employment, subject to the governing rules of the fund or RSA. Preserved superannuation benefits can be accessed on compassionate grounds and severe financial hardship.

## Proposed Changes

During the 2001 election campaign, the Government released a number of proposed reforms to superannuation.<sup>10</sup> The majority of these proposals will change the tax treatment of superannuation, which when implemented, will affect the accuracy of this publication in future years. Future versions of this publication are likely to contain major revisions. Readers are therefore recommended to ensure that they have obtained the most up to date version of this publication.

The date of effect of the Government's proposals is only indicative at this stage. The proposed reforms that affect the taxation of superannuation (and preservation) and the Government's proposed date of effect are in the following table.

<b>Proposed reform</b>	<b>Proposed date of effect</b>
Allowing couples to split their superannuation contributions	1 July 2003
Allowing superannuation contributions up to \$1000 per annum to be made on behalf of children who do not otherwise have superannuation	1 July 2002
Increase the current deduction limit for the self employed	1 July 2002
Reducing 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)	1 July 2002
A Government co-contribution of up two \$1000 per annum (in place of the current \$100 rebate) for superannuation contributions made by low income earners	1 July 2002
Reducing the tax rate on the excessive component of an ETP	Not announced
Allowing the First Child Tax Refund to be contributed by the parent to their superannuation fund	Not announced
Permitting non-residents to access their superannuation benefits after they have permanently departed from Australia, subject to withholding of tax concessions provided to the benefits	1 January 2002

## Endnotes

1. This paper has been prepared as a briefing and reference tool only and is not intended for use in a providing financial advice. The author disclaims any liability in relation to any financial decision taken which may be influenced by the content of this paper.
2. Indexed thresholds were obtained from the following sources:
  - Commissioner of Taxation, *Superannuation Guarantee Determination*, SGD 2001/1
  - Commissioner of Taxation, *Superannuation Contributions Determination*, SCD 2001/4, and
  - Commissioner of Taxation, *Taxation Determination*, TD 2001/15.
3. A complying superannuation fund qualifies for concessional tax rates. It is regulated under the *Superannuation Industry (Supervision) Act 1993*.
4. RSAs are simple low-cost, low-risk superannuation products offered by life insurance companies, banks, building societies and credit unions. They are regulated under the *Retirement Savings Account Act 1997* and have the same tax treatment as superannuation.
5. For more information on the evolution of the taxation of superannuation, refer to Michael Reid, 'Supercalifragilisticexpianation—A Plain English Guide to Australian



Superannuation Arrangements', *Background Paper No. 23 1994*, Department of the Parliamentary Library.

6. For more details see the Association of Superannuation Funds of Australia and the GST Start-Up Office, *The Goods and Services Tax and the Superannuation Industry, January 1999*, website at: <http://www.superannuation.asn.au>.
7. This is set out in Regulation 40–13 of *A New Tax System (Goods and Services Tax) Regulations 1999*.
8. See The New Tax System Advisory Board media release, *Self Managed Super Funds Should Apply for an ABN Now*, 28 May 2000.
9. These prudential regulatory requirements are set out in the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Industry (Supervision) Regulations*.
10. Liberal Party of Australia, *A Better Superannuation System*, November 2001.