

November 2006

Senator Andrew Murray: Australian Democrats

## **Discussion Paper Arising from the 'Costello 2006 Budget Superannuation Proposals'**

### **EXECUTIVE SUMMARY**

In May 2006 Treasurer Peter Costello released 'A Plan to Simplify and Streamline Superannuation' as part of the Government's policy response towards both superannuation and Australia's ageing demographic. It is a broad-ranging policy response to Australia's exceedingly complex superannuation system.

The proposals contain potential changes to many aspects of the superannuation system, including:

- the taxation of superannuation benefits (discussed at sections 2 and 3, below);
- the abolition of reasonable benefit limits (discussed at section 4.1, below);
- modification of payment rules (discussed at section 4.2, below);
- modification of contribution rules (discussed at section 4.3, below);
- halving of the assets test taper rate (discussed at section 4.4, below);
- simplifying the process for transferring amounts between superannuation funds (discussed at section 4.4, below); and
- increasing the integration of self-employed persons into the system (discussed at section 4.4, below).

The Costello Proposals represent significant changes to Australia's superannuation regime. They have drawn considerable response from both industry bodies and members of the public, both of whom have been invited to make submissions to the Treasury. We await the final outcome therefore.

As well as outlining some of the contents of the Treasurer's proposals, this paper also attempts to identify and discuss some of the issues and concerns that arise in response to the Treasurer's plans, some of which are discussed below, at section 5.

There are a number of general comments which can be made about the proposals put forward by the Treasurer, including:

- the May 2006 Costello proposals (revised in September 2006) are not yet in draft legislation, and the exact form is still unknown;
- taxpayers over 60 years of age will benefit most, and wealthier retirees will benefit more than the less wealthy;
- the removal of the reasonable benefits limits seems to be aimed primarily at the better-off and wealthy, as most people do not currently breach the current reasonable benefit limits;
- the superannuation system is badly in need of structural reform, and this includes simplification;
- the proposals do seem to be a part of the current Government's desire to increase participation in the workforce;
- the changes will genuinely improve simplicity significantly, making superannuation easier to understand and cheaper to administer and use;
- industry and public support for the proposals seems to be widespread; and
- there is currently no comprehensive Treasury modelling of the impacts that the changes may have on the tax base or fiscal implications, though the Institute of Actuaries of Australia has released its own paper, finding these effects to be quite small.

# AUSTRALIA'S SUPERANNUATION SYSTEM

## 1. Introduction

Australia's retirement income policy comprises a three-tiered approach, consisting of a general age pension which is available to everyone but is means tested and funded out of general taxation receipts; a minimum level of compulsory superannuation contributions made by employers (the Super Guarantee) on behalf of employees; and a system of voluntary private superannuation, supported by government incentives to save through concessional tax treatments.

It is generally agreed that the regulatory and taxation framework surrounding the superannuation system is extremely complex. By the Government's own admission "...superannuation benefits tax is by far the most complicated...At present it is difficult for anyone to understand how their superannuation benefits will be taxed."<sup>1</sup>

When compared against the standard policy criterion of efficiency, equity and simplicity there is undoubtedly room for improvement.

In the face of Australia's ageing demographic and the associated fiscal pressures that will accompany it, the superannuation system and retirement incomes of individuals will become increasingly important. Thus it is increasingly important that Australia has in place a retirement income (superannuation) system that can both be well understood and well utilised by the 'ordinary' members of the public.

In May 2006, the Treasurer, Peter Costello announced a number of changes which seem to encapsulate much needed reforms in the superannuation system (the 'Costello Proposals'), in that they definitely make it simpler.

The reforms also seem to be part of the Government's primary policy response to our ageing demographic. According to the Institute of Actuaries of Australia, increasing

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<sup>1</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 2

participation rates is a key focus of the government in allowing them to increase future revenues, and to reduce the demands of an ageing population.<sup>2</sup>

The problems associated with an ageing population are set to become very real and of increasing importance over the next four decades as Australia experiences a massive increase in its population over the age of 65, from approximately one in eight at the moment, to one in four by the year 2044-45.

As Australia experiences this shift in its demographic, substantial increased pressures will be placed on government finances (especially in those areas which are age-dependent, such as health care and pensions), and by the year 2044-45 a 'fiscal gap' between revenue and expenditure of approximately five percent of GDP is expected to have opened up (this fiscal gap, will however, first become apparent in 2020 if nothing is done).<sup>3</sup>

It should be noted that a new Intergenerational Report is due for release in 2007, and it will be interesting to see a revision of forecasts and predictions, as well as the impacts of government policy actions to date.

The Costello proposals relate not only to taxation of superannuation benefits, but also extend to other areas of the superannuation system such as payments and contributions, and transferring superannuation between funds.

It should also be noted that the discussion contained below relates to changes in connection with taxed super funds.

'Untaxed' super funds (which is a misnomer because taxation can apply in different ways) are also the subject of some elements of the Costello Proposals, but as they represent a small fraction of super members (mainly public servants) discussion of these changes has been left to an appendix, Appendix A)

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<sup>2</sup> Institute of Actuaries of Australia, *Tax-free superannuation benefits: a future revenue problem?* 2006, 5

<sup>3</sup> The Treasury, *Intergenerational Report 2002-03*, 2002, 6

## **2. Current Superannuation Taxation Arrangements**

Currently, there are divisions between the way in which lump-sum and superannuation benefits are taxed, as well as different taxes on earnings, contributions and benefits.

### **2.1 Lump Sums**

Lump sum payments of superannuation benefits are classified as Eligible Termination Payments, and are taxed in a highly complex manner. There are various components of a lump sum, each of which are subject to specific tax treatment. These components include: Concessional component; Post-June 1994 invalidity component; CGT exempt component; Non-qualifying component; Undeducted contributions component; Excessive component; Pre-July 1983 component; and Post-June 1983 component.<sup>4</sup>

Because each of these components are subject to a unique taxation arrangement, retirees choosing to take some (or all of) their superannuation in the form of a lump sum are currently faced with a very difficult task when working out how much they will finally receive when they claim their benefits.

This level of complexity is not only unwelcome, and may not lead to optimal decision-making, but could in theory create an additional cost by virtue of the fact that retirees may need to seek professional financial advice on such matters.

### **2.2 Pension Payments**

As an alternative to taking their superannuation as a lump sum payment, retirees can choose to receive their superannuation in the form of a pension stream, and thus receive benefits on a time-continual basis, until their super runs out.

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<sup>4</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 83-84

Such payments are included in the person's yearly income, and are considered assessable income for tax purposes. They are taxed at marginal rates, subject to extra concessions and allowances available to older Australians.<sup>5</sup>

### **2.3 Reporting**

Individuals also have reporting requirements placed on them and must report details of eligible termination payments and pensions in their tax returns, which will then impact upon their income tax liability.<sup>6</sup>

## **3. Costello's Proposed Changes to Superannuation Taxation Arrangements**

The Treasurer announced a number of proposals relating to simplifying superannuation arrangements earlier this year when he released the 2006-07 budget. Although none of them are in draft legislation yet, it has been suggested by Peter Dutton (the Assistant Treasurer) that the Government is hoping to have draft legislation out before Christmas.<sup>7</sup>

As mentioned previously, the proposals relate to more than just taxation of superannuation. Some of the other proposals are discussed below under "Other Proposals".

### **3.1 Lump Sums**

The Costello Proposals draw a distinction between people over the age of 60 and people under the age of 60 for the purposes of the tax treatment of superannuation. People 60 or over will be able to take their superannuation as lump sums and pay no income tax (as against the paying of tax on up to eight different components – see 2.1 above).<sup>8</sup>

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<sup>5</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 11

<sup>6</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 12

<sup>7</sup> Swift, P "Push for savings incentives" *The Australian Financial Review*, 09/08/2006, 53

<sup>8</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 12

For people under 60 benefits will still be taxed (this is part of the Government's efforts to keep people in the workforce for longer and to increase retirement incomes).

However, instead of the tax being calculated on the basis of eight components, it will be based upon just two components, consisting of: an exempt component (which will be tax free) and a taxed component (tax free up to the 'low rate threshold' and then 15% above the threshold). There is a further distinction for persons aged 55 or under: this tax rate will be 20%.<sup>9</sup> (This arrangement will be unchanged from the current system).

### **3.2 Pensions**

For individuals over the age of 60 all pension payments will be tax free. For those under 60 "pensions payments for individuals would generally continue to be taxed under current arrangements" (until they turn 60).<sup>10</sup>

### **3.3 Reporting**

The Costello Proposals also contain changes to the reporting requirements. Those individuals under the age of 60 will still be required to report details of eligible termination payments and pensions in their tax returns.<sup>11</sup>

For people over the age of 60, lump sum benefits and pensions would not need to be reported in their tax return, (this would in turn lower their taxable income and possibly the tax paid on other income).<sup>12</sup>

## **4. Other Proposals**

In addition to removal and modification of certain taxation arrangements currently in place, the Costello Proposals contain a number of other modification to the current superannuation system.

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<sup>9</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 13 - 14

<sup>10</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 15

<sup>11</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 15

<sup>12</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 13

#### **4.1 Abolition of the Reasonable Benefit Limits**

Currently, the RBL system caps the amount of superannuation (and similar benefits) that can be received by an individual on a concessionally taxed basis. For pensions the limit is approximately \$1 298 000; for lump sums it is approximately \$649 000. Payments received above the RBL are taxed at 38% (or 47% if from an untaxed source).

Under the Costello Proposals the RBL system would be abolished.

#### **4.2 Modification of Payment Rules**

Under the current system there exist arrangements in relation to both the voluntary and compulsory withdrawal of a person's superannuation fund.

A member may voluntarily withdraw their benefits once they have retired (after their preservation age – the age at which a person can access their superannuation) or reached the age of 65. Once a person reaches the age of 65 and the person has worked less than 240 hours in the most recent financial year, then superannuation funds are forced to pay out the benefits accrued by that member. Once a person reaches the age of 75, the fund normally must pay out the benefits irrespective of whether or not the member is still working.<sup>13</sup>

Under the proposed new system, members would still have the choice of when to take their benefits (either when they retire after their preservation age or when they reach 65). However, the compulsory withdrawal/payment would be abolished and there would be no forced payment of superannuation benefits after age 65. Super funds would no longer have to administer work tests (to see whether or not members over the age of 65 are still working). Super funds would also no longer have to pay out

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<sup>13</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 19 - 20

benefits to those over 75. People would be able to keep their benefits in their superannuation fund indefinitely.<sup>14</sup>

### **4.3 Modification of Contribution Rules**

Currently, contributions made by employers to an employee's superannuation are subject to a 15% contributions tax. In addition, there are also age-based limits above which contributions are still taxed at 15% and the employer is denied a 30% deduction on those contributions. As they currently stand, the age-based limits are: \$14 603 for people under 35, \$40 560 for people aged 35 – 49 and \$100 587 for people aged 50 – 69.<sup>15</sup>

Under the new system the age-based deduction limits will be removed. Instead a concessional limit of \$50 000 on tax deductible contributions will be introduced. Any contributions above this will be taxed at the individual's top marginal income tax rate. A general limit of \$150 000 per year on contributions made from after tax money, subject to some transitional provisions, was also contained within the proposals.

### **4.4 Other Measures**

In addition to those measures outlined above the Costello Proposals also involve:

- Halving the pension assets test taper rate so that pension recipients lose \$1.50 per fortnight (rather than \$3.00) for every \$1 000 of assets above the relevant threshold. Currently, a homeowner who is single loses all pension entitlements once they have assets (including superannuation assets) above \$325 000. Under the new system, the corresponding figure would be \$494 000.<sup>16</sup>
- Where a tax file number has not been provided to a taxed fund, the top marginal tax rate would apply where taxable contributions to that fund member exceed \$1 000.<sup>17</sup>

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<sup>14</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 20

<sup>15</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 25 - 26

<sup>16</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 37 - 38

<sup>17</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 43

- In a bid to increase the ease with which amounts can be transferred between super funds, a standardised form would be introduced, and the maximum time period allowed for the transfer will be reduced from 90 days to 30 days.<sup>18</sup>
- The situation of self-employed persons will also be changed. Under the proposed changes, a self-employed person will be able to claim a full deduction for personal contributions and have access to the Government co-contribution scheme, if they met the relevant criteria. Currently, self-employed persons do not have access to the Government co-contribution scheme, and personal deductions are not fully deductible.<sup>19</sup>

## 5. General Comments

The superannuation system as it currently stands is extremely complex and difficult to understand, and the time is probably right to deliver some much needed reform and change to the system. However, it is important to remember that the Costello Proposals are not yet legislation and thus their exact form is not yet known.

It is also important to be wary of any partisan political agenda which may distort otherwise worthy policy intentions. It is important to keep in mind the growing importance in numbers of votes of the over-60 cohort.

The many-taxation aspect of superannuation does seem like a prime ground for reform, though, as Ross Gittins recently highlighted, the key issue is probably not so much the number of times it is taxed, but rather the amount that it is taxed.<sup>20</sup> However, every time you tax something there is another cost incurred, both financially and in terms of time and expertise needed to make sure that everything is in correct order and complies with the relevant requirements.

There seems to be a degree of ‘age-taxing’ going on: why should older people pay more (or less!) tax by virtue of their age? If they are wealthier then that is one thing, but just to determine taxation rates based on age seems a somewhat inequitable

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<sup>18</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 51

<sup>19</sup> The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 33

<sup>20</sup> Gittins, R ‘Demolishing a few of the super myths’ *Sydney Morning Herald* 14/06/2006

notion. However there is a participation incentive built in. The reduction in tax rates for those above 60 seems to have been formulated in a bid to make it more attractive for people to stay in the workforce until they are over 60, relative to retiring before they are 60 (and thus lifting participation rates in the workforce).

The removal of the age-based limits seems to be a positive idea from the point of view of reducing the administrative burden on, and cost to, employers. Instead of having to keep track of three categories of employees and how much each employee within that band has contributed, the employer would be able to just keep track of how much it has contributed for each employee. It also seems to be a step in the direction of fairness from the point of view that everyone is treated the same, regardless of their age.

The proposals seem to be geared towards benefiting those people investing in their superannuation at the end of their working life. What about the lack of government policies designed to target younger people and their superannuation investment decisions? More specifically it seems to be dealing with concerns about the levels of retirement savings held by only the 'Baby Boomer' generation (those born between 1946 and 1961). Does this mean we can infer that there is less of a problem with the savings rates of other generations?

The abolition of Reasonable Benefit Limits (RBLs): RBLs cap the amount of benefits that a person can receive on a concessional-tax basis. Current limits are ~ \$649 000 (for lump sum) and ~ \$1 298 000 (for pension). Above this, benefits are taxed at the highest marginal rate (45% plus the Medicare Levy of 1.5%). The concern lies with who will benefit the most from such an amendment. Which people are most likely to fall above the RBL? If it appears that the average amount in superannuation is above the RBL, then why not revise the limit upwards and still tax those wealthy super-holders? (as opposed to getting rid of the RBL altogether). As it stands, it is only wealthier retirees that stand to gain from the removal of RBLs - about two percent of the Australian population stand to benefit from this particular proposal.

Making the superannuation system simpler is a must: most people do not understand the current superannuation arrangements. Yet, throughout their working lives (and

into retirement) nearly everyone has unavoidable contact with superannuation. The more people know and understand their financial affairs the better it is, and the more likely they are to use the superannuation system effectively. Simplicity and being readily understandable are key criteria of any tax system, and is an area in which the current superannuation taxation arrangements fall well short. For a retiree to take full advantage of the system requires that they be able to afford expert financial advice, meaning that within the complexity lies an inherent element of inequity and cost. Hopefully, by making the system genuinely simpler, more people are able to properly manage their affairs, regardless of their ability to pay for financial advice.

Also, complexity has the potential to be a great mask for disguising detrimental things. With a simple and transparent system which all the participants understand and use, there is, in theory, less scope for people to be misled and deceived. That said, with something as complex and varied as superannuation, new policy can be introduced into the system under the guise of simplification, yet may not necessarily prove for the benefit of the people overall. For example, hidden amongst Mr Costello's simpler super plan is the fact that people who do not provide their tax file number to their superannuation fund may attract greater tax rates (up to 45%) and not be able to make their own undeducted contributions. At present up to 38% of each funds members have not provided their tax file numbers to their super fund.

Industry support for the plans seems to be very widespread, as evidenced by the large number of submissions received by the Government in response to the Costello proposals which were of a supportive and positive nature. However, there has been concern expressed about the costs involved in implementing the reforms if and when they come into effect. The Association of Superannuation Funds of Australia say they would face up to \$40m in costs just in relation to informing and explaining changes to super members.<sup>21</sup>

Some suggest that another set of changes to the superannuation system may scare some people off, but this seems a questionable proposition. Surely those people who

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<sup>21</sup> Wright, S "Super industry warns of major costs with changes" *Australian Associated Press* 09/08/2006, story no. 3724) (A number of the submissions have been made public and are on the Simpler Super website, [www.simplersuper.treasury.gov.au](http://www.simplersuper.treasury.gov.au))

are interested in making additional payments in their superannuation are driven more by other factors (such as availability of financial resources, or a simpler user-friendly system) than whether or not the system is changing. Nonetheless, it is possible that it may impact upon some portion of the relevant cohort.

What about those people currently in the process of working out their retirement options and what they will be doing with their superannuation? Are these people exempt from the changes? For those people who plan on consolidating their asset base and transferring some of the proceeds into their superannuation, this process can take some time. Will all such people be able to carry out their current plans so that they can have a sufficient retirement income?

In changes announced on Tuesday 5<sup>th</sup> of September, 2006, the Treasurer announced some changes to the proposals that he released at Budget time earlier this year. Of particular relevance was the announcement that people will be allowed to make up to \$1m of post-tax contributions up until 30 June 2007, allowing those people who were planning to do so under the existing rules to still do so.<sup>22</sup>

It has been suggested that the removal of the tax on end-benefits will lead to a narrowing of the tax base. How will the government address the shortfall in revenue as a result of removing the tax on superannuation benefits? Will the forecast increase in super funds lead to a sufficient increase in tax receipts on contributions and earnings such that the loss is negligible? Or will it be funded out of current government surpluses? Are the revenues so large that the removal of the tax on benefits needs to be worried about? As yet it is difficult to answer these questions as there is no Treasury modelling available.

However, in their recently released paper “Tax-free superannuation benefits: a future revenue problem?” the Institute of Actuaries of Australia found that the current revenues raised from taxes on (end) benefits of superannuation only amount to some \$500m, or 0.05% of GDP. By 2040 it is forecast that this amount will have grown to approximately 0.33% of GDP. Taxes on contributions on the other hand, currently

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<sup>22</sup> The Treasurer, *Simplified Superannuation – Final Decisions*, Press Release no. 093 available at [www.treasurer.gov.au/tsr/default.asp](http://www.treasurer.gov.au/tsr/default.asp)

amount to nearly \$5b, or 0.5% of GDP.<sup>23</sup> Such a small gap (\$500m) in the government's fiscal position can easily be covered at the moment via the budget surpluses. Into the future, there is perhaps the possibility of increased income tax receipts (due to people staying in the workforce longer) being able to fund the gap.

## **6. Where do Costello's proposed changes sit within the Democrat's traditional superannuation policy stance?**

The answer to this question is in two-parts: first, the Democrat's traditional stance on superannuation policy needs to be outlined. Once this has been done then it is possible to discuss where Costello's proposed changes sit within the Democrat's superannuation policy stance.

### **6.1 Democrat's stance on superannuation policy**

The Democrats support the 3-tier system that Australia currently has in place but believe that simplifying the superannuation system is essential. They support restructuring superannuation tax concessions so that lower income earners receive a greater benefit than they do currently. This would also rectify a degree of inequality in the system, which can currently be used by higher income earners as a way of minimising their tax liability. Outlined below (at Appendix B) is a proposal for consideration which could potentially increase the equality of the superannuation taxation arrangements (by removing a regressive element from the current system) in relation to the taxation of superannuation contributions.

The Democrats also believe that self-funded retirees should be encouraged and supported in their decisions to be self-funded in retirement, and also support the increased participation of older people in the workforce.

As per stated Democrats superannuation principles, the Democrat's believe that "...the laws and regulations that apply to superannuation should be simplified..." and

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<sup>23</sup> (Institute of Actuaries of Australia, *Tax-free superannuation benefits: a future revenue problem?*, 2006, 1)

“will support measures to improve the portability of superannuation.”<sup>24</sup> Both of these principles are, at least partially, encapsulated in the Costello Proposals.

## **6.2 Where do Costello’s proposed changes sit within this framework?**

Given that the Democrats support the simplification of Australia’s superannuation system, then that particular element of the Costello Proposals should sit quite well with the Democrats.

At this stage the Costello Proposals are not so much about re-structuring the superannuation tax concessions overall, as removing the taxation of superannuation benefits and encouraging people to stay on in the workforce past the age of 60 (and thus attempt to remedy some of the possible implications of an ageing population). Given that the Democrats support increased participation rates for older Australians, this particular element of the Costello Proposals seems to sit comfortably with Democrats policy.

It is questionable whether or not the Costello Proposals improve the equality of the superannuation system, especially as some of the proposals (eg. the abolition of RBLs) seem to favour a small (and wealthier) segment of the population.

To date there does not seem to have been any in-depth Treasury costing done of Costello’s superannuation proposals. It is essential that these be conducted and some attention be given to their findings before any final view be taken.

There is also the issue of public awareness. If the Government is not already contemplating it, a public education and awareness campaign should be initiated. This does not necessarily have to only be on the superannuation proposals; it could be on superannuation more generally.

As a major part of the Costello proposals is that people will stay in the workforce longer and participation rates will increase, the Democrats should request that some

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<sup>24</sup> Official Democrat Policy on Superannuation, available at [http://www.democrats.org.au/policies/policy\\_dis.htm?id=45&policy=Superannuation](http://www.democrats.org.au/policies/policy_dis.htm?id=45&policy=Superannuation)

studies and investigation take place to see that there is actually a serious likelihood of Costello's proposal actually impacting favourably upon participation rates.

Finally, the question of modifying the 9% superannuation guarantee charge has not been raised by the Costello proposals. Some people (for example, former prime-minister Paul Keating) argue that it is essential that the compulsory contribution made to superannuation accounts be increased. Without an increase, it is argued, people will be retiring on incomes substantially less than average weekly earnings levels.<sup>25</sup> However, others argue that increased employer contributions are not an option, and that any further increase in compulsory contributions should fall on employees not employers.<sup>26</sup>

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<sup>25</sup> (Keating, P 'Why 9 per cent is just not enough' *The Age*, 27/02/2004)

<sup>26</sup> (Hendy, P 'Increased Employer Superannuation Contributions will cost jobs' *Australian Chamber of Commerce and Industry*, Media Release 13/10/2006)

## **APPENDIX A**

### **PROPOSALS IN RELATION TO UNTAXED SUPERANNUATION FUNDS**

#### **1. Introduction**

Untaxed funds do not attract contributions or earnings taxes, but do attract benefits tax.

Currently there are some superannuation schemes run by both the Federal, and State and Territory governments, under which no employer contributions are made until a benefit becomes payable, and no contributions or earnings tax is paid. These funds generally only apply to public servants, and are estimated to include only about ten percent of all super fund members. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 45)

#### **2. Current Arrangements**

Due to the fact that no contributions or earnings tax is paid under these un-taxed schemes, they currently attract a higher level of benefits tax. This is designed to maintain equity with other superannuation funds and their obligation to pay taxes at three different phases. This distinction would continue. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 46). As with other funds, a distinction is drawn between lump sums and pensions.

##### **2.1 Lump Sums**

As with normally taxed superannuation schemes, lump sum payment of superannuation benefits are also divided into various components, all of which are subject to a particular tax regime.

The difference in treatment lies in the way in which the post-1983 component is taxed. In an untaxed scheme, this component is taxed at 15% up to the low rate threshold (~ \$129 750) with any amount over this being taxed at 30% up to the RBL.

For an individual under 55 the entire component is taxed at 30% up to the RBL. Amounts above the RBL are taxed at 47%.

## **2.2 Pensions**

As with normally taxed schemes, those belonging to untaxed schemes can also choose to take their superannuation as a pension stream. Pension payments received by a person are included in the person's assessable income and taxed at marginal rates. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 46).

## **2.3 Reporting**

Currently, members of untaxed superannuation schemes must also report details of eligible termination payments and pensions in their tax returns, and all benefits must be reported to the Australian Tax Office by the scheme for RBL purposes.

These rules do not differ from those applying to members of taxed schemes.

## **3. Proposed Changes to Untaxed Schemes**

Similarly to the Costello proposals discussed above (at Section 3 in the main text), a distinction is drawn between people over the age of 60, and those under the age of 60.

### **3.1 Lump Sums**

For those members over the age of 60 who take their benefit as lump sum, the post-June 1983 element would be taxed at 15% up to the RBL and then the top marginal tax rate. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 47).

For those aged 55 to 59, a tax rate of 15% would apply for payments up to the low-rate eligible termination payment threshold (~ \$129 750); a 30% tax up to the \$700

000 threshold; and the top marginal rate above that amount. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 48).

For those under 55, a rate of 30% would apply up to \$700 000, and the top marginal rate above this amount. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 48).

On Tuesday 05/09/2006, the Treasurer announced that this limit would in fact be increased to \$1m. (The Treasurer, *Simplified Superannuation – Final Decisions*, Press Release no. 093).

### **3.2 Pensions**

It is proposed that taxation arrangements on pensions will continue, but they will now be eligible for a ten percent taxation offset. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 47).

For those under the age of 60 pensions payments will continue to be included in assessable income and taxed at marginal rates. They would not be eligible for the proposed 10% pension offset (ie a reduction in the tax due on a person's taxable income). (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 48).

### **3.3 Reporting Requirements**

Reporting requirements for RBL purposes would cease for the schemes. However, the reporting obligations placed on individuals would still continue. (The Treasury, *A Plan to Simplify and Streamline Superannuation Detailed Outline*, 2006, 48)

## APPENDIX B

### DEMOCRATS CONTRIBUTIONS TAX PROPOSAL FOR CONSIDERATION

Currently, superannuation is taxed at three different points: contributions, earnings, and benefits. Contributions are taxed at the flat rate of fifteen per cent. As the Australian Council of Social Service note in their submission to the Treasury on the proposals to simplify superannuation “the effect of taxing employer contributions at a flat rate of 15% instead of the marginal tax rates...is regressive.”<sup>27</sup>

The Democrats wished to see how the system could be made less regressive. One suggestion by the Democrats for consideration is that this flat tax rate is removed, and contributions be taxed progressively.

The Democrats proposal is that:

- those on the 15% tax rate would pay no super contribution tax;
- those on 30% would pay 15%;
- those on 40% would pay 25%; and
- those on 45% would pay 30%.

The Democrats asked the Parliamentary Library for outline costings. These show the cost to revenue being:

- \$60m in 2006-07;
- -\$790m in 2007-08;
- -\$830m in 2008-09; and
- -\$870m in 2009-10.

(Note: a negative sign means an addition to revenue.)

Primary inspection of the figures shows quite a large windfall to government revenue, especially from 2007-08 onwards. However, the Parliamentary Library advise that some caution should be attached to their estimation. The massive change in the

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<sup>27</sup> ACOSS, 2006

revenue from 2006-07 to 2007-08 is partially due to the data they used: because they used averages across a range, when everyone moves up a tax bracket you get large steps in revenue. However, the positive trend is sound.

In doing their calculations for the Democrats the Parliamentary Library noted “in making the calculations ATO 2003-04 Taxation Statistics were used with the following data/assumptions:

- Only salary and wages (in assessable income) data and, therefore, those individual taxpayers with salary and wages were used - it is not possible to separate out those public sector (and other) employees on defined benefits schemes for whom employer contributions may not be made annually, so there will be some overestimation. However, this will be offset (to an extent) by the factor in the next dot point;
- Contributions were calculated at the legislated minimum of 9% - the taxation data implies that the average contribution rate is higher than 9%, but any underestimation here will be offset (to an extent) by the overestimation outlined in the first dot point;
- Salary and wages were increased by the growth in the ABS' wage price index to estimate amounts for 2006-07;
- Individual salary and wage earners were increased by the growth in employment to estimate numbers for 2006-07; and,
- Income limits were ignored and superannuation contributions were calculated on the entire salary and wages amounts.”

The Library also made the following points:

- The above estimate assumes that income from all employer and employee contributions will continue to be taxed at 15% as at present.
- The implementation of this policy will add to the costs of administering super funds as trustees of super funds will need to keep track of the taxable income of each member to know at what rate contributions in respect of each member will be payable by the trustees.

- The alternative is to impose a withholding tax on employer contributions made by employers to super funds, but this will merely shift the burden to employers and will be particularly burdensome to the small and medium sized employers.
- In the case of members of defined benefit schemes where annual contributions may not be made or made only in part, the question of tax on contributions relating to the taxable income of each member for each year of employment may present additional administrative problems either for the trustees or the employers.

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