Chapter 2

Key provisions and overview

2.1 This chapter explains the main provisions of the bills and how the new tax arrangements would work in practice. The following aspects of the bill are considered in approximately the same order they appear in Explanatory Memorandum:

- Streamlined contribution arrangements
- Taxation of superannuation benefits
- Tax File Numbers
- Employment termination payments
- Self-employed provisions
- Age pension arrangements
- Regulation of self-managed superannuation funds
- Portability
- Unclaimed superannuation

Streamlined contribution arrangements

2.2 The bill seeks to implement a range of measures to simplify and streamline the existing contribution arrangements, for example the removal of age-based limits on concessional contributions and the deductibility of employer contributions.

2.3 As is the case under the current taxation system, the tax treatment of superannuation contributions would vary depending upon whether they were made from a pre-tax or post-tax income. Below is an overview of the proposed streamlined contribution arrangements. The topic is divided into concessional (pre-tax) and non-concessional (post-tax) contributions.

Concessional contribution

2.4 Concessional contributions essentially refer to superannuation contributions that are made from pre-tax income. Examples of concessional contributions include employer superannuation guarantee contributions, additional employer contributions, salary sacrifice contributions and contributions made by the self-employed for which they claim a tax deduction.

2.5 If the bill passes, a new annual cap for concessional contributions would be set at $50 000 per person (irrespective of age) from 1 July 2007. This single cap will replace the multiple thresholds that make up the current age-based limits.[1] The concessional contributions cap is set at around the average of the current age-based limits. The new cap will apply irrespective of the number of employers contributing on behalf of the person. The cap will be indexed annually in $5000 increments.[2]

2.6 Such contributions will be taxed at the concessional rate of 15 per cent (equivalent to the existing rate). Earnings from concessional contributions will continue to be taxed at the notional concessional rate of 15 per cent.

2.7 Excess concessional contributions (that is, contributions made from pre-tax income in excess of the annual $50 000 cap) will be effectively taxed at the top marginal tax rate plus the Medicare levy (a total of 46.5 per cent). This is essentially the same arrangement for contributions that exceed the age-based limits under the current system.

2.8 Tax liabilities for excess concessional contributions will be levied on fund members. The individual can elect for their superannuation fund to release some of the monies held in their account to pay the tax liability.[3]

2.9 Excess concessional contributions will be counted towards the non-concessional cap (discussed below) to ensure that people cannot circumvent the non-concessional cap by making excessive concessional contributions.

2.10 A five year transitional cap of $100 000 per annum will apply to anyone aged 50 and over at the end of a financial year, in the period 2007–08 to 2011–12. The transitional cap has been set at a similar level to the current system's age-based limit for individuals aged 50 and over. This arrangement will enable those planning to retire soon to make larger contributions at concessional rates. Unlike the concessional contribution cap, the transitional cap will not be indexed.[4]

2.11 Several items will be expressly excluded from an individual's concessional contributions including transfers of investment earnings on foreign superannuation benefits while an individual was an Australian resident.[5]

2.12 The deduction rules that currently apply to employers and the self-employed arrangements will be simplified as all contributions to superannuation funds on behalf of employees under the age of 75 will be fully deductible.

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1 The annual age-based limits for 2006–07 are $15 260 for people under 35 years; $42 385 for people aged 35–49 years; and $105 113 for people 50 years and over.

2 Explanatory Memorandum, p. 21.

3 Explanatory Memorandum, p. 38.

4 Explanatory Memorandum, p. 23.

5 Other categories of excluded contributions are outlined in the Explanatory Memorandum at page 22.

Non-concessional contribution

2.13 Currently there are no limits on the amount of post-tax contributions that can be made each year. The removal of the benefits tax (for people aged 60 and over) and the abolition of reasonable benefits limits will increase the concessions provided to superannuation and therefore increase its appeal as an investment option. The changes will make superannuation an attractive vehicle in which to retain assets to avoid paying tax. There will also be an incentive for high-wealth individuals to transfer large amounts of assets currently held outside superannuation to the favourably taxed superannuation system.

2.14 To ensure the concessions are targeted appropriately, a cap of $150 000 per person per annum on non-concessional superannuation contributions will apply from 1 July 2007. The non-concessional cap will remain at three times the level of the concessional contributions cap and will increase as the concessional cap moves with indexation.[6]

2.15 To provide greater flexibility to larger contributors, people under the age 65 will be able to bring forward two years worth of future entitlements, giving a cap of $450 000 over three years.[7]

2.16 No tax will be payable on non-concessional contributions that fall below these caps. Earnings from non-concessional contributions will continue to be taxed at the notional concessional rate of 15 per cent.

2.17 A transitional cap of $1 million on non-concessional contributions will apply between 10 May 2006 and 30 June 2007. These arrangements will allow people who were planning larger contributions under the existing rules to continue with their plans.[8]

2.18 The proposed level of the non-concessional contributions cap appears generous and according to the Treasury 'is expected to impact on very few people'.[9]

2.19 Excess non-concessional contributions will be taxed at the top marginal tax rate plus the Medicare levy (a total of 46.5 per cent). To ensure that people cannot circumvent the non-concessional cap by making excessive concessional contributions, excess concessional contributions will count towards the non-concessional cap.

2.20 The bill proposes two exemptions from the non-concessional cap:

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6 Explanatory Memorandum, p. 25.

7 Explanatory Memorandum, p. 26.

8 Explanatory Memorandum, p. 32. To be eligible for the transitional cap those aged 65–74 must satisfy the 'work test' set out in the *Superannuation Industry (Supervision) Regulations 1994*.

9 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 30.

- the proceeds from the disposal of assets that qualify for the small business capital gains tax exemptions up to a lifetime limit of $1 million (indexed); and
- the proceeds from a settlement for an injury resulting in permanent disablement.[10]

2.21 The tax liability arising from excess non-concessional contributions must be paid from a member's superannuation account.[11]

Taxation of superannuation benefits

2.22 The proposed changes seek to provide greater incentives to invest in superannuation by simplifying the arrangements for the taxation of benefits and reducing the amount of tax levied from benefits paid. The Explanatory Memorandum to the bills states:

> The complexity of these [current] arrangements affects the ability of individuals to make decisions relating to their retirement and adds to the administration costs for superannuation funds.[12]

2.23 As a general rule the taxation of superannuation benefits depends on the age of the member.

Taxed funds

2.24 The most significant change is the removal of tax on superannuation benefits paid to people aged 60 and over when paid from a 'taxed' superannuation fund (where the benefits have already been subject to tax on contributions and earnings). These funds contain around 90 per cent of Australian employees and are typically private sector accumulation funds. The removal of tax on benefits for this age category applies to both lump sum payments and superannuation income stream payments.

2.25 Presently, the taxation arrangements for those aged 60 and over and receiving lump sum superannuation benefits are more complex:

> Superannuation lump sum benefits paid from a taxed source comprise up to eight different components that are each subject to different taxation arrangements.[13]

2.26 Marginal tax rates with a 15 per cent tax offset are presently applied to superannuation income stream payments from a taxed source.

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10 Explanatory Memorandum, p. 29.

11 Explanatory Memorandum, p. 39.

12 Explanatory Memorandum, p. 44.

13 Explanatory Memorandum, p. 51.

2.27 Removing taxes on benefits for the 60 and over category is designed to provide a substantial incentive for people to remain in the workforce until then, rather than opting out at the preservation age.[14] Consequently, for those aged between the preservation age and 59, superannuation benefits will remain subject to tax. However, the varying tax treatment of different benefit components will be simplified and in some cases reduced, leaving an exempt component and a taxable component.[15] The exempt component will be tax free.

2.28 For lump sum payments to those aged 55 to 59, the taxed component will be tax free up to the low rate threshold, beginning at $140 000 on 1 July 2007 and indexed in $5000 amounts. Beyond this amount, lump sum benefits will be taxed at 15 per cent. Pension payments to this category of recipient will be taxed under the current arrangements, at marginal tax rates with a 15 per cent offset, though subject to the simplification of benefit components also applying to lump sum payments.[16]

2.29 Lump sum superannuation benefit payments to those aged under 55 will be taxed at 20 per cent, with no tax free threshold. Superannuation income streams for this category will simply be taxed at marginal rates with no tax offset.

Untaxed funds

2.30 Benefits that have an untaxed element (typically payments from an untaxed fund) will still be subject to tax.[17] 'Untaxed' funds are generally a component of public sector defined benefit funds. The amount of tax applied to untaxed earnings is explained at page 47 of the Explanatory Memorandum.

2.31 Although this category of benefits will continue to be taxed, the arrangements proposed are more generous than those currently in place for those who receive a lump sum in excess of the current low rate threshold.[18] In addition, untaxed benefits received as an income stream by those 60 and over will be entitled to a 10 per cent tax offset not currently applied.[19]

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14 From 2015 until 2024 the preservation age will be incrementally increased from 55–60.

15 These are outlined in further detail at Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, p. 14.

16 Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, pp 13–15. See also Explanatory Memorandum, p. 46.

17 Explanatory Memorandum, pp 45 and 47. See also Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, pp 24–25.

18 Explanatory Memorandum, p. 51. Lump sums above this threshold ($135 590 in 2006–07) are taxed at 30 per cent and at marginal rates above the RBL.

19 Explanatory Memorandum, p. 51.

Reasonable benefit limits

2.32 Reasonable benefit limits (RBLs), which presently restrict the benefit amount that is subject to concessional tax treatment, will be abolished if these measures are enacted.[20]

Tax File Numbers

2.33 Currently, there is no requirement for a person to quote their tax file number (TFN) before making a contribution to a superannuation fund. Under the new system, it is proposed that in cases where a TFN has not been quoted to a taxed fund, the top marginal tax rate of 46.5 per cent (31.5 per cent on top of the 15 per cent of tax on contributions) will apply where taxable contributions to that fund for a member exceed $1000 per annum.[21] The additional tax will be refunded if TFNs are quoted within the subsequent three year period.[22] Interest on the additional no-TFN tax may also be payable by the ATO where an employer fails to inform the superannuation provider of the individual’s TFN before the end of the financial year.[23]

2.34 The provision of TFNs is important for the effective administration of the new superannuation system, particularly enforcing the new superannuation contribution caps. The Treasurer's second reading speech on the bills stressed the importance of TFNs to the operation of the new system:

> In order to ensure the integrity of the generous taxation concessions given to superannuation, it is necessary to ensure that tax file numbers are quoted for as many superannuation accounts as possible. Increased TFN quotation will also, over time, lead to better matching of people with their lost superannuation benefits.[24]

2.35 According to the Treasury, new arrangements will be put in place to minimise the number of accounts subject to the additional tax:

> ...the legislation will be amended so that where an employee quotes a TFN for employment purposes it is automatically taken to be quoted for superannuation purposes. Generally, the employer must pass this onto a superannuation fund within 14 days of the TFN being quoted. Enforcement

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20 In 2006–07 the lump sum RBL was $678 149 and pension RBL $1 356 291. Further information is available at www.ato.gov.au/super.

21 The no-TFN tax is specified under new section 29 on the *Income Tax Rates Act 1986*. The $1000 threshold is provided for under new section 295-610 of the *Income Tax Assessment Act 1997*. According to new paragraph 295-610(2)(a) the $1000 threshold will not apply for accounts opened on or after 1 July 2007.

22 New section 295-675.

23 New section 8ZD of the *Taxation (Interest on Overpayments and Early Payments) Act 1983*.

24 The Hon. Peter Costello MP, Second Reading Speech, *Tax laws Amendment (Simplified Superannuation) Bill 2006*, 7 December 2006.

> of this requirement will move from the Australian Prudential Regulation Authority to the ATO.
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> Where possible, the ATO will use its systems to match TFNs to members where non-quotation has occurred and contact members to organise for a TFN to be provided to their superannuation fund. The ATO will also undertake an education campaign to encourage members to provide their TFN to the fund.[25]

Employment termination payments

2.36 As a consequence of the proposed abolition of RBLs and changes to taxes on benefits, the concessional tax treatment for employment termination payments is also subject to amendment. Currently, such payments are counted with superannuation benefits when assessing concessional treatment within RBLs. In the absence of RBLs under the new arrangements, the following concessional caps are proposed:

> Employer ETPs will be comprised of two components — exempt and taxable. The exempt component will be any post-June 1994 invalidity amount and the pre-July 1983 amount. This will be exempt from tax. The taxable component will be the post-June 1983 amount. This will be taxed at 15 per cent for amounts up to $140,000 (indexed) for recipients aged 55 and over and at 30 per cent for those aged under 55. Amounts in excess of $140,000 will be taxed at the top marginal tax rate (plus Medicare levy). These arrangements will apply per termination and any payment must be made within one year of termination.[26]

2.37 The current tax treatment of genuine redundancy payments, early retirement scheme payments or unused leave will remain unchanged.[27]

2.38 Given the aforementioned changes to taxes on benefits, employment termination payments will not be permitted to be rolled over into superannuation. However, transitional arrangements will apply to payments specified in employment contracts in existence as at 9 May 2006.[28]

Self-employed provisions

2.39 Two measures designed to provide greater incentives for the self-employed to contribute to superannuation have been proposed.

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25 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, pp 22–23.

26 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, p. 21.

27 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, p. 22. Superannuation benefits are not included in employment terminiation payments.

28 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, p. 21.

Contributions tax deductibility

2.40 These measures will allow the self-employed to claim a full deduction for superannuation contributions until the age of 75. Consequently, contributions made by the self-employed will be treated in the same way as those made for the benefit of employees.

2.41 Presently, only the first $5000 per year is fully deductible. Beyond that amount, contributions are 75 per cent tax deductible up to age-based limits.[29]

Accessing the co-contributions scheme

2.42 Should the bills be passed, access to the co-contribution scheme would be extended to the self-employed. Presently, they are not eligible unless 10 per cent or more of their income is earned as an employee.[30] According to Treasury:

> The Government co-contribution scheme will be extended to the self-employed, effective from 1 July 2007 provided they satisfy the existing eligibility criteria for the co-contribution.
>
> To provide for the self-employed, income will be determined by adding the assessable income of an individual (including any reportable fringe benefits, if applicable) and then reducing that amount by their expenses incurred in carrying on a business.[31]

Age pension arrangements

2.43 The design of the age pension system has important implications for incentives to work and save for retirement. The eligibility for the age pension is determined primarily by two factors – the income test and assets test. The age pension is generally paid on the lower amount resulting from these two tests.

2.44 The income test is relatively generous. A single person can earn up to $36 000 per annum and still be eligible for a part-rate pension.

2.45 Under the current assets test, a person loses $3 per fortnight for every $1000 of assets above the relevant threshold.[32] The Treasury noted that the 'high [assets test] withdrawal rate creates a disincentive to save and build retirement savings.'[33]

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29 Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, p. 33.

30 Explanatory Memorandum, p. 176.

31 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, p. 18.

32 Current threshold rates are $161 500 for single homeowners; $229 000 for couple homeowners; $278 500 for single non-homeowners and $346 000 for couple non-homeowners.

33 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 37.

2.46 The bill will halve the pension assets test taper rate so that Age Pension, Service Pension and other pension recipients will only lose $1.50 a fortnight for every $1000 of assets above the relevant threshold, effective from 20 September 2007. This change will increase the entitlement of those already receiving a part pension and also increase the number of people eligible for the part pension and the associated concessions.

2.47 When he introduced the bill, the Treasurer explained the beneficial financial impact of the reduced pension assets test taper rate:

> Pensioners currently have to achieve an after-tax return of 7.8 per cent on their additional savings; otherwise they lose more age pension than they generate in income on their savings. The halving of the taper rate will reduce the break-even rate of return to 3.9 per cent.[34]

2.48 The reduced assets test taper rate will apply to the following payments:

- Age and service pensions;
- Disability support pension;
- Carer payment;
- Wife pension;
- Widow B pension; and
- Bereavement allowance.

2.49 To properly target the proposed change to the assets test taper rate a consequential change to the current 50 per cent assets test exemption for 'complying' income streams is also required. The Treasury noted that '[r]etaining the assets test exemption alongside the reduced assets test withdrawal rate would create scope for wealthier individuals to access the age pension.'[35] The bill will remove the 'complying income streams' exemption for future income streams purchased on or after 20 September 2007. The assets test treatment of income stream products purchased before 20 September 2007 will not change.

Regulation of self-managed superannuation funds

2.50 The bill will amend the *Superannuation Industry (Supervision) Act 1993* and other Acts to enhance the regulation of self-managed superannuation funds (SMSFs) and to ensure that self-managed superannuation funds comply with their legislative obligations. These proposed changes were not included in the original policy

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34 The Hon. Peter Costello MP, Treasurer, Second Reading Speech, Tax Laws Amendment (Simplified Superannuation) Bill 2006, *House of Representatives Hansard*, 7 December 2006, p. 1.

35 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 39.

announcement of May 2006, but instead in the *Outcomes of Consultations* document in September 2006.

2.51 The key changes to the sector include:

- streamlined reporting arrangements, by moving to a single annual requirement;
- the introduction of administrative penalties for late returns and false or misleading statements, which currently do not apply to SMSFs;
- enhanced regulation through increased ATO compliance activity;
- clarification of trustee requirements so that directors of corporate trustees cannot receive remuneration for trustee duties or be appointed as the legal representative of a disqualified person;
- clarification of auditor requirements so that auditors report on specified matters to the Regulator; and
- an increase in the supervisory levy from $45 to $150 per annum.[36]

Portability

2.52 The bill introduces measures to simplify the transfer of superannuation benefits between funds and improve arrangements in respect of lost and unclaimed superannuation. Two new initiatives will make it easier for individuals to transfer superannuation benefits between funds and take more control of their superannuation, and reduce processing delays.

2.53 First, all funds will be required to use a new standardised form for portability to facilitate the transfer of benefits between funds. This will include standard proof of identity requirements to ensure uniformity between funds. Second, the maximum time period in which this transfer must occur will be reduced from 90 days to 30 days. The 30 day period will commence after a person has provided all necessary information. Trustees will also be required to follow up incomplete requests for transfers promptly.[37]

Unclaimed superannuation

2.54 The government has provided a significant increase in resources for the ATO to further improve the operation and effectiveness of the current lost member arrangements. A number of measures will be phased in to improve the operation of the Lost Member Register and reduce the number of people listed on it, including:

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36 Explanatory Memorandum, pp 157–171.

37 Treasury, *A plan to simplify and streamline superannuation*: *Outcomes of consultation*, September 2006, p. 27.

- rationalising existing processes to identify actual lost members including redefining lost members to exclude inactive accounts and more comprehensive reporting from funds;
- allowing accounts of less than $200 to be paid tax free;
- an extensive letter campaign to lost members commencing in 2007 with lost account reviews to be conducted over a four year period through a combination of phone calls and letters;
- establishing a web-based tool through which members can locate their lost accounts using their TFN;
- by 2009–10, enabling members to electronically request consolidation of their accounts through the ATO website.[38]

38 Simplified Superannuation – Frequently Asked Questions, *Portability and Lost Member Register*, http://simplersuper.treasury.gov.au/faq/html/portability.asp.