The Senate

Economics
Legislation Committee

Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009 [Provisions]

June 2009

ISBN 978-1-74229-121-5

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Economics Legislation Committee

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Chapter 1

Background and description of the bill

Conduct of the inquiry

1.1 The Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009 was introduced into the House of Representatives on 27 May 2009. This committee considers it pursuant to an order of the Senate 14 May 2009 which referred certain budget-related bills to committees (subject to any contrary recommendation by the Senate Selection of Bills Committee).

1.2 The Committee advertised the inquiry in *The Australian* and on its website, and wrote to a number of peak organisations inviting submissions. The Committee received 115 submissions (see Appendix 1). The Committee held a hearing on 10 June (see Appendix 2). The Committee thanks submitters and witnesses for their contribution.

The bill

1.3 The bill comprises three unrelated schedules, discussed in the following three chapters.

1.4 Schedule 1 amends section 23AG of the *Income Tax Assessment Act 1936* to change the taxation of income earned by Australian resident taxpayers in foreign service.

1.5 Schedule 2 amends superannuation law relating to the matching rate and maximum government co-contribution for eligible personal superannuation contributions made over the next five income years.

1.6 Schedule 3 reduces the caps on concessional superannuation contributions.

1.7 The Government expects these changes to generate savings of almost $5 billion over the forward estimates period (Table 1).

Table 1: Budget savings from bill

	2009-10	2010-11	2011-12	2012-13	total
schedule 1	0	$215m	$225m	$235m	$675m
schedule 2	$385m	$395m	$410m	$205m	$1,395m
schedule 3	$625m	$640m	$720m	$825m	$2,810m

Source: derived from *Explanatory Memorandum*.

Chapter 2

Schedule 1: taxation of foreign income

Description of the measure

2.1 Schedule 1 of the bill amends section 23AG of the *Income Tax Assessment Act 1936*. Section 23AG currently provides that where an Australian resident has been engaged in foreign service for a continuous period of not less than 91 days, any foreign earnings from the foreign service are exempt from income tax.[1] The exemption was introduced in 1986 in conjunction with the former foreign tax credit system.[2]

2.2 Proposed subsection 23AG(1AA) removes the general exemption, but maintains it for certain aid or charitable workers or government employees, or for an activity prescribed in the regulations.

2.3 The current exemption applies to persons who are Australian residents for tax purposes. The bill will not change this, and thus will not affect citizens who are not residents for tax purposes.

2.4 The change will apply to foreign earnings derived on or after 1 July 2009 from foreign service performed on or after 1 July 2009. Foreign tax paid will be claimable as a non-refundable foreign income tax offset (FITO).[3]

2.5 If an individual is no longer exempt as a result of proposed subsection 23AG(1AA), the employer will be obliged to comply with the pay-as-you-go (PAYG) withholding rules in Division 12 of the *Income Tax Administration Act 1953*. The employer will also have to comply with *Fringe Benefits Tax Assessment Act 1986* in relation to any fringe benefits provided.[4]

2.6 The Government argued that '[the current] section 23AG provides a mechanism to relieve double taxation, but does not contain a requirement that foreign tax has been paid for the exemption to apply. This can produce non-neutral tax outcome between Australian resident individuals working in different countries with different tax rates, and between individuals working overseas and individuals working

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1 There are some exceptions in s23AG(2).

2 Treasury, *Submission 21*, p.1.

3 Explanatory Memorandum, p.11.

4 Explanatory Memorandum, p.7.

in Australia… The change will remove non-neutral tax outcomes that can currently arise and will minimise opportunities for tax avoidance.'[5]

2.7 Treasury estimates that -

- 15,000 to 20,000 individuals could lose their current exemption;
- Of these, around 3,300 taxpayers earning over $100,000 are currently paying very little tax on more than a third of their income on average because of the general exemption;
- A further 8,000 individuals currently pay no or very little tax at all in Australia because of the exemption, despite having average incomes of around $85,000;
- After FITOs are claimed for foreign tax paid, the average impact for affected workers will be an increase in tax of $11,000 per year.[6]

2.8 Treasury exposed a draft of this schedule for comment between 12 and 18 May 2009. In response to submissions -

- a new paragraph 26(1AA)(c) was inserted to ensure that employees of recognised organisations that undertake aid or charitable activities, that do not form part of Australian 'official development assistance', are eligible for exemption;
- a regulation making power was inserted to allow the continuing exemption to be extended in future as appropriate;
- the application provisions were amended to ensure that income received after 1 July 2009 in respect of services before 1 July 2009 is exempt.[7]

Issues raised in submissions

2.9 Submissions argued against the change for various reasons summarised below.

Effects on competitiveness of Australian firms

2.10 Submissions argued that the change will reduce the competitiveness of Australian firms working offshore, as it will increase their costs. This refers both to the administrative costs of compliance and to the cost of topping up salaries to leave the employee no worse off (assuming they do this).

2.11 For example, the Association of Consulting Engineers Australia claimed:

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5 Treasury, *Submission 21*, p.1.

6 Treasury, *Submission 21*, p.3.

7 Treasury, *Submission 21*, p.4.

> The current exemption from income tax makes Australian consulting engineering firms competitive when bidding for international work. Removing the exemption will substantially increase the cost of working abroad, making it less attractive for engineering businesses to export their services.[8]

2.12 In their submission, they gave the example of a firm with revenue of $99 million and pretax profit of $10 million, which estimates that the measure will increase its costs, or its employees' costs, by $5 million.[9] Pricewaterhouse Coopers gave an example in which the cost of an employee in China was estimated to increase from $332,000 to $565,000.[10]

2.13 Submissions argued that implementing this bill will reduce Australia's income from exporting services; encourage firms to employ foreign nationals in preference to Australian residents; and encourage workers to become non-resident to avoid tax, or to return to Australia. [11] A number of submissions argued that the returning expatriates would add to unemployment in Australia.[12]

2.14 Many submissions from individuals argued that the changes will lead them to either become non-resident or return to Australia.[13]

2.15 Treasury commented generally on these arguments:

- some organisations have been using the exemption as a wage subsidy by paying employees less than they would otherwise receive;
- this results in inequity between employers with Australian resident workers offshore and those who employ Australians to work in Australia. [14]

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8 Mrs Nicola Grayson, Association of Consulting Engineers Australia, *Proof Committee Hansard*, 10 June 2009, p 11.

9 Association of Consulting Engineers Australia, *Submission 18*, p.7 and additional information 15 June 2009, p.6.

10 Pricewaterhouse Coopers, additional information 10 June 2009.

11 Most submissions from the peak organisations and accounting firms made these points - for example, Institute of Chartered Accountants in Australia, *Submission 13*, p.2; Deloitte, *Submission 16*, p.2; Pricewaterhouse Coopers, *Submission 17*, p.1-2; ACEA, *Submission 18*, p.7; Taxation Institute of Australia, *Submission 19, p.5;* KPMG, *Submission 20*, p.5; Minerals Council of Australia, *Submission 24*, pp 2-3.

12 Examples include Mr Mike Durack, *Submission 2*, Mr Peter Lewis, *Submission 3* and Mr George Nims, *Submission 9*.

13 Examples of such submissions are Mr Brett Harms, *Submission 12*, Mr Ray O'Brien, *Submission 27* and Mr Jack Smith, *Submission 111*.

14 Treasury, *Submission 21*, p.6.

Short notice of the change

2.16 Some submitters were concerned by the short notice of the change. For example:

> At any given time a large number of Australian residents will be working offshore…changes to section 23AG from 1 July 2009 will directly impact their remuneration arrangements without any regard for, or recourse to, the terms of the agreement under which they moved offshore.[15]

2.17 The Institute of Chartered Accountants suggested that only new employment agreements made after 1 July 2009 should be caught.[16] Pricewaterhouse Coopers (PWC) noted a problem for companies carrying out long fixed price contracts that do not allow a change in contract price because of tax changes in Australia. PWC suggested that if the government insists on the change, it should at least be deferred for 12 months to allow companies time to adjust. KPMG suggested that projects already in train before the measure was announced should be protected from the change by giving them approved status under section 23AF.[17]

2.18 Treasury argued that inserting a grandfathering provision to protect existing contracts could create inequity and opportunities for tax avoidance. It would create inequity between parties to long term contracts (who would benefit more) and parties to short term contracts.[18]

Issues to do with PAYG withholding

2.19 Employees who are no longer exempt will be subject to PAYG withholding rules. Several concerns were raised about this:

- Employers may have to withhold PAYG tax twice - once for Australia and once for the other country. This could create cashflow problems for employees in the period before the foreign income tax offset could be claimed. If an employer advances salary to cover the employee's cash flow problem this in itself would be a taxable fringe benefit.
- There will be particular cashflow problems where the tax year in the country of work is different from Australia's.
- Seeking a PAYG variation to avoid this problem is impractical for many employers and employees given the difficulty of estimating the likely foreign

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15 Institute of Chartered Accountants in Australia, *Submission 13*, p.3.

16 ICA, *Submission 13*, p.3.

17 Pricewaterhouse Coopers, *Submission 17*, p.2,4. KPMG, *Submission 20*, p.6. Section 23AF gives the same exemption as the current section 23AG to projects approved by the Minister for Trade as being in the national interest.

18 Treasury, *Submission 21*, p.6.

income tax offset. It would be liable to penalty payments if a variation based on estimating the year end liability is mistaken.

- Foreign employers might have to withhold tax for the Australian Tax Office, which would arguably be impractical.[19]
- The administrative difficulties will create a culture of non-compliance (for example, among backpackers working casually or short term), which is undesirable.[20]

2.20 The Taxation Institute elaborated on the 'backpacker problem':

> …I go and stay in a hotel, work, and get paid my £250 each week. However, after three or four months overseas I return to Australia. In that circumstance I will have to disclose my £250 which tax has been withheld. I will also have a problem that my tax year in Australia is different to the tax year in the UK…Since I have paid no tax in Australia on that income, that income will be fully taxed at whatever my marginal rate is. The tax that I have had withheld in the UK is not available as an offset because the offset rules require that tax to actually have been paid…I have to wait through until at least April before the UK tax year ends…I then have a problem because the UK does not require lodgement of tax returns. I have to …pay a UK tax person to lodge my return for £3,000 or £4,000 …which in turn I submit to the government and seek an amendment of my tax return to provide that credit so that reduces the tax that I have already paid. This is just a very simple scenario.[21]

2.21 Pricewaterhouse Coopers and KPMG suggested that these problems could be alleviated by exempting employers from the PAYG rules in respect of their offshore employees - employees would simply pay their tax liability (net of foreign income tax credits) in arrears. PWC suggested that alternatively taxpayers could be allowed to self assess PAYG variations.[22]

2.22 Treasury responded or commented:

- The Commissioner for Taxation may approve a PAYG variation on application. The ATO would use that provision to avoid the scenario of double withholding - Australian PAYG withholding amounts could be varied to match the likely end of year liability net of foreign income tax offsets. In

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19 For example, ICA, *Submission 13*, p.4; Deloitte, *Submission 16*, p.2-3; Pricewaterhouse Coopers, *Submission* 17, p.3; ACEA, *Submission 18*, p.8; Taxation Institute of Australia, *Submission 19*, p.2-3; KPMG, *Submission 20*, p.3.

20 Dr Michael Dirkis, Taxation Institute of Australia, *Proof Committee Hansard* 10 June 2009, p.5.

21 Dr Michael Dirkis, Taxation Institute of Australia, *Proof Committee Hansard*, 10 June 2009, p.2.

22 PWC, *Submission 17*, p.3-4. Mr John Fauvet, PWC, *Proof Committee Hansard* 10 June 2009, p.35. KPMG, *Submission 20, p.3*. Similarly Deloitte, *Submission 16*, p.2

this case there is no penalty if the withheld amounts fall short of the eventual tax liability.[23]

- Employees who have foreign tax withheld regularly will be unaffected by non-aligned financial years, since foreign tax is regarded as paid as soon as it is withheld, and thus may count towards a FITO in the corresponding Australian financial year - there is no need to wait for the foreign end of year tax statement which may come later.[24]
- Where foreign tax is not withheld regularly, claiming a FITO is not possible until the foreign tax has actually been paid. Then the taxpayer could amend their latest Australian tax return to include a FITO matching the part of the foreign tax payment which relates to the latest Australian tax year.[25]
- The scenario that a foreign employer of an offshore Australian resident must withhold PAYG amounts 'does not arise in practice', since the employer would not normally know the employee's residency status.[26] [27]

Possible double taxation of fringe benefits

2.23 Where employees are no longer exempt, their employers will have to comply with the *Fringe Benefits Tax Assessment Act 1986.* Submissions argued:

- There is no facility to claim an offset for foreign fringe benefits tax paid;
- There will be significant compliance costs for employers; and
- It would not be practical for employers to cash out fringe benefits as many employers will want to control the benefits provided such as home leave flights, and many have global policies for medical and travel insurance.[28]

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23 Treasury, *Submission* 21, p.5; additional information 15 June 2007, p.3. Mr Peter Nash, ATO, *Proof Committee Hansard*, 10 June 2009, pp 52-3. The reference in submissions to a penalty may be a reference to the possibility of a penalty for false and misleading information in an application for variation. Alternatively, it may be a reference to PAYG instalments paid by business taxpayers. Business taxpayer may choose to vary their instalment rate, but will be liable to pay interest on any shortfall if the varied rate is less than 85 per cent of the benchmark rate.

24 Treasury, *Submission 21,* p.5. Mr Gregory Wood, Treasury, *Proof Committee Hansard* 10 June 2009, p.51. The comment assumes that employees would have acceptable evidence of tax paid (pay slips, presumably) without waiting for the foreign end of year tax statement.

25 Treasury, *Submission 21*, p.5. It is also possible to apply for extension of time to lodge a tax return.

26 Mr Peter Nash, Australian Taxation Office, *Proof Committee Hansard* 10 June 2009, p.59.

27 The PAYG withholding rules are in the *Taxation Administration Act 1953*. There is no suggestion that this Act can impose a legal duty on a foreign national acting outside Australia. Any imposition on foreign employers for the benefit of the ATO would have to be legislated by the foreign country, presumably after agreement with Australia.

2.24 A particular concern is that fringe benefits may be taxed twice. The Taxation Institute's example was:

> If you are living in Kazakhstan, normally your employer would supply you with a set of Western-style accommodation…Normally in most countries around the world, the benefit is taxable to the employee. An estimation of the non-cash benefit is taken into account in determining what is the value of your package and what that value is in terms of being taxed in that particular country. At the same time, the Australian employer who is providing that benefit is providing a non-cash benefit to an employee who is an Australian resident and therefore is required under the FBT rules to pay fringe benefits tax on behalf of that accommodation,… The problem is that there is a mismatch between the individual rules within the particular country where they are actually working and what the Australian system does.[29]

2.25 Deloitte suggested amending the *Fringe Benefits Tax Assessment Act 1986* so that fringe benefits provided offshore remain exempt. KPMG noted that exempting offshore workers from PAYG provisions, as it suggested already for other reasons, would also solve this problem, since individuals exempt from PAYG withholding by definition are not employees for FBT purposes.[30]

2.26 Treasury responded or commented:

- Bringing offshore employees into the fringe benefits net treats them consistently with Australian-based employees;
- It is acknowledged that double taxation could arise where Australia taxes the employer and the foreign country taxes the employee;
- Some of our tax treaties (United Kingdom and New Zealand) contain rules to resolve this problem; and
- 'Treasury is currently working on that issue to see how it could be resolved with the aim of providing advice to the government.'[31]

Other administrative and compliance issues

2.27 Submissions raised a number of other concerns:

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28 Institute of Chartered Accountants in Australia, *Submission 13*, p.4. Deloitte, *Submission 16,* p.4. Association of Consulting Engineers Australia, *Submission 18,* p.7. Taxation Institute of Australia, *Submission 19,* p.4. KPMG, *Submission 20,* p.4.

29 Dr Michael Dirkis, Taxation Institute of Australia, *Proof Committee Hansard*, 10 June 2009, p.4.

30 Deloitte, *Submission* 16, p.3 KPMG, *Submission 20,* p.4.

31 Treasury, *Submission 21,* p.6. Mr William Potts, Treasury, *Proof Committee Hansard* 10 June 2009, p.50.

- possible difficulty of deciding the employee's residency status, which should not be the employer's responsibility;[32]
- need to have payroll teams in both countries able to understand the laws;[33]
- possible difficulty for employees claiming FITOs in documenting foreign tax paid, particularly in jurisdictions where there is no requirement to lodge a tax return;[34]
- possible inequities at the boundary of those who will still enjoy the exemption (for example, comparing AFP and ADF personnel who will enjoy the continuing 'disciplined force' exemption, with civilian contractors giving them logistical support).[35]

2.28 Some submissions suggested extending the use of the section 23AF exemption to mitigate these problems.[36]

2.29 Treasury commented on concerns about compliance costs:

- Some increase in compliance costs is acknowledged;
- However the calculation of a taxpayer's liability using the FITO system may in some cases be less complex than the calculations required by the current 'exemption with progression' rules, which already require keeping track of a taxpayer's onshore and offshore income separately.[37]

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32 Deloitte, *Submission 16,* p.2. Taxation Institute of Australia, *Submission 19,* p.3.

33 Pricewaterhouse Coopers, *Submission 17*, p. 2.

34 Association of Consulting Engineers Australia, *Submission 18,* p.8. Taxation Institute of Australia, *Submission 19,* p.2.

35 Institute of Chartered Accountants in Australia, *Submission 13,* p.3.

36 Pricewaterhouse Coopers, *Submission 17,* p.3. KPMG, *Submission 20,* p.6. Section 23AF gives the same exemption as the current section 23AG to projects approved by the Minister for Trade as being in the national interest.

37 Treasury, *Submission 21,* p.4. Mr William Potts, Treasury, *Proof Committee Hansard* 10 June 2009, p.54. 'Exemption with progression': a taxpayer's tax rate is calculated on their total income; the non-exempt income is then taxed at that rate (which will be higher than would apply if the rate was calculated considering only the non-exempt income).

Committee comment

2.30 The Committee accepts Treasury's responses on most of the matters mentioned above. On some points the Committee is sympathetic to the concerns raised in submissions and comments as follows.

Administrative burden of PAYG withholding

2.31 The ATO will need to clarify acceptable documentation to prove a foreign tax payment to claim a FITO. It should acknowledge the possible difficulty of obtaining documentation for some taxpayers (eg backpackers in casual work). The government should consider means of reducing the compliance burden where it would be disproportionate to the revenue gain. For example, this could be done by exempting the first $X,000 of offshore income (X set at a level which would aim to distinguish backpackers from salaried employees); or by limiting the measure to large employers; or by exempting offshore salaries from PAYG withholding rules, as some submissions suggested.

Recommendation 1

2.32 The government should consider options for limiting the new measure to reduce the compliance burden where it would be disproportionate to the revenue gain.

Possible double taxation of fringe benefits

2.33 The Committee accepts the concerns about this and notes that the government is considering how to deal with this problem.

Recommendation 2

2.34 The Government should make the necessary consequential changes to ensure there is no double taxation of fringe benefits.

Chapter 3

Schedule 2: change to superannuation co-contributions

Description of the measure

3.1 Schedule 2 amends the *Superannuation (Government Co-contribution for Lower Income Earners) Act 2003* to reduce the matching rate and maximum co-contribution for eligible personal superannuation contributions made in the 2009-10 to 2013-14 income years.

3.2 The co-contribution is a superannuation contribution that the government makes for eligible persons on low to middle incomes. Since 1 July 2004, the matching rate and maximum co-contributions have been 150 per cent and $1,500, reducing by 5 cents for each dollar by which the individual's total income for the income year exceeds the lower co-contribution income threshold in the relevant year. The lower income threshold is $31,920 for 2009-10.

3.3 Under the bill -

- in the 2009-10, 2010-11 and 2011-12 income years, the matching rate will reduce to 100 per with a maximum co-contribution of $1,000, reducing by 3.333 cents for each dollar by which the person's total income exceeds the lower income threshold ($31,920 in 2009-10);
- in the 2012-13 and 2013-14 income years, the matching rate will be 125 per cent with a maximum co-contribution of $1,250, reducing by 4.167 cents for each dollar by which the person's total income exceeds the lower income threshold;
- in 2014-15 the scheme will revert to the current matching rate of 150 per cent and maximum co-contribution of $1,500.

3.4 The income thresholds will continue to be indexed.

3.5 The Government argues that '…the temporary reduction in the co-contribution will generate necessary budget savings in the current economic climate thus supporting Government initiatives such as pension reform, whilst maintaining a significant and generous incentive for eligible persons to contribute to superannuation.' The Government estimates that the change will affect around 1.5 million people in 2009-10.[1]

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1 Treasury, *Submission 21*, p.7.

Issues raised in submissions

3.6 Submissions supported the existing arrangements and argued that the change will reduce the incentive to save. They supported the Government's intention that the change is temporary. The Association of Superannuation Funds of Australia argued that the co-contribution should be increased. The Financial Planning Association argued that the co-contribution should not be reduced; in any event, the reduction should be in place for no more than a year, and when reinstated should be increased by 50 per cent. [2]

3.7 Treasury argued that the temporary reduction is not expected to have a significant impact on the level of superannuation contributions as the scheme remains very generous.[3]

Committee comment

3.8 The committee accepts the need for the measure to generate budget savings in the current economic climate to support Government initiatives such as pension reform.

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2 Investment and Financial Services Association, *Submission 14*, p.1. Financial Planning Association, *Submission 15*, p.2. Association of Superannuation Funds of Australia, *Submission 22*, p.1.

3 Treasury, *Submission 21*, p.7.

Chapter 4

Schedule 3: reduction in the concessional contributions cap

Description of the measure

4.1 Schedule 3 amends the *Income Tax Assessment Act 1997* and the *Income Tax (Transitional Provisions) Act 1997* to reduce the cap on concessional superannuation contributions, from 1 July 2009.

4.2 Concessional and non-concessional superannuation contributions have been subject to annual limits since July 2007. In 2007-08 and 2008-09 the concessional contributions cap was $50,000. As a transitional measure persons aged 50 and over may make concessionally taxed contributions of up to $100,000 per year until 30 June 2012. The non-concessional contributions cap is currently set at three times the concessional contributions cap, thus $150,000. The concessional cap (but not the over-50s transitional provision) and the non-concessional cap are indexed.

4.3 The bill halves the concessional cap to $25,000 and the transitional concessional cap for over-50s to $50,000. The non-concessional cap will be set at six times the concessional cap, thus $150,000 in 2009-10. Current indexing provisions will remain. Existing 'grandfathering' arrangements that apply to certain members of defined benefit schemes will remain.[1]

4.4 The Government argues that '…the reduction in the concessional contributions caps will improve equity in the superannuation system as the current caps benefit those who can afford to make large concessional superannuation contributions who are primarily high income earners… the changes are also consistent with the finding the Australia's Future Tax System report into retirement incomes which found that tax-assisted voluntary superannuation contributions should be more fairly distributed….'[2]

4.5 The Government estimates that around 1.8 per cent of individuals making contributions will be affected.[3]

Issues raised in submissions

4.6 Submissions from Association of Superannuation Funds of Australia (ASFA), the Financial Planning Association (FPA) and the Investment and Financial Services

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1 Treasury, *Submission 21*, p.8.

2 Treasury, *Submission 21*, p.8.

3 Treasury, *Submission 21*, p.9.

Association (IFSA) argued against the change. The chief concern was that there will be an undesirable impact on employees with low superannuation balances trying to make substantial 'catchup' contributions shortly before retirement:

> People making these contributions come from across the income range including many who have experienced broken work patterns, such as women and those experiencing unemployment, who then struggle to make up the shortfalls of their superannuation by sacrificing their personal spending.[4]

4.7 ASFA and the FPA dispute the claim that only a few high income earners will be affected:

> It has been claimed that it is very high income earners with relatively high superannuation account balances who make contributions over the proposed caps. However, the provenance of such estimates is not clear. The only public authoritative data available is not supportive of such an assessment.[5]

4.8 IFSA found that in a sample survey that 'of the over 50 year old age bracket who were contributing more than $50,000 to super, the average account balance was approximately $215,000'. ASFA gave examples arguing that 'the current caps are substantially used by those seeking to catch up in their retirement savings. Proposed reduction in the caps will significantly limit their capacity to do so.'[6]

4.9 Other concerns were:

- the caps will constrain people's ability to take out insurance through superannuation, and this may lead to people becoming under-insured and more likely to rely on government support;[7]
- there may be inequities when people make concessional contributions over the cap because of scheme design or because of general remuneration policies of the employer or an industrial award or agreement;[8]
- the short notice of the change will 'leave financial planners only a few weeks to reshape strategies for a large portion of their client base';[9]
- 'a constant changing of the rules impacts on the integrity of superannuation as a savings vehicle.'[10]

4.10 Suggested alternatives or fall-back positions were:

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4 FPA. submission 15, p.3.

5 ASFA. *Submission 22*, p.2.

6 IFSA, *Submission 14*, p.2.

7 ASFA, *Submission 22*, p.2.

8 ASFA, *Submission 22*, p.4.

9 FPA, *Submission 15*, p.4.

10 Mr M. Dwyer, ASFA, *Proof Committee Hansard* 10 June 2009, p.41.

- there should be a higher cap for people with lower balances;[11]
- the higher cap for over-50s should be made permanent (noting that this would have no cost to revenue until 2012-2013);[12]
- 'Parliament should revisit the appropriateness of a single flat contribution limit';[13]
- people should be able to carry forward unused concessional cap space from the last ten years;[14]
- the Superannuation Guarantee should be excluded from the cap; [15]
- there should be grandfathering provisions to preserve the position of people who make concessional contributions over the new cap because of scheme design or because of general remuneration policies of the employer or an industrial award or agreement. [16]

4.11 Treasury submitted:

- those who can afford to make large concessional contributions are primarily high income earners;
- the changes are consistent with the findings of the Australia's Future Tax System report into retirement incomes, which found that tax-assisted voluntary contributions should be more fairly distributed and questioned whether the current cap is appropriate.[17]

4.12 Treasury further specified:

- it is estimated that 170,000 people will be affected in 2009-10 (1.8 per cent of individuals making concessional contributions), and the average remuneration of those affected would be over $220,000 per year;
- of those affected in 2009-10 about 77,000 are under 50, and 73 per cent of these people have annual remuneration over $100,000;
- of those affected in 2009-10 about 93,000 are 50 or over, and 93 per cent of these people have annual remuneration over $100,000;

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11 ASFA, *Submission 22,* p.3.

12 IFSA, *Submission 14,* p.4. FPA, *Submission 15,* p.5.

13 IFSA, *Submission 14,* p.4.

14 FPA, *Submission 15,* p.3.

15 FPA, *Submission 15,* p.3.

16 ASFA, *Submission 22,* p.4.

17 Treasury, *Submission 21,* p.8-9.

- the average superannuation balance of affected people aged 50 and over is $870,000.[18]

4.13 The referenced Australia's Future Tax System report into retirement incomes noted that in 2005-06 around 5 per cent of taxpayers had remuneration over $100,000, and they made around 24 per cent of concessional contributions. Only a quarter of low income earners eligible for the superannuation co-contribution make concessional contributions. The report said that 'there is a case for distributing assistance more equitably between high and low income individuals, including by limiting generous salary sacrifice concessions.'[19]

Committee comment

4.14 The Committee accepts Treasury's statement that the measure will affect less than 2 per cent of people who make concessional contributions, and these are primarily high income earners. The Committee accepts the argument that the measure reduces disproportionate benefits to high income earners who can afford to make large concessional contributions.

Recommendation 3

4.15 Subject to the points raised in the earlier recommendations, the Committee recommends that the Senate pass the bill.

Senator Annette Hurley

Chair

18 Treasury, additional information 16 June 2009

19 K. Henry & others (Australia's Future Tax System Review Panel), *Australia's Future Tax System: the retirement income system - report on strategic issues*, May 2009, p.20,29-30

Additional comments by Coalition senators

Schedule 1 – Exemption of income derived from foreign service

The proposal to remove the long standing general exemption from paying Australian taxation provided under section 23AG *Income Tax Assessment Act* 1936 has been introduced at very short notice, having been announced in the Budget on 12 May.

Considering the evidence given to the Committee of the confusion and inconvenience that will inevitably result from the introduction of this measure which the Government proposes to make effective from 1 July, Coalition Senators believe it would be more appropriate to allow for a longer period of consultation and preparation for those who will be directly affected by this measure. This would include the accounting profession, companies providing workers with work overseas, as well as individuals affected by the proposal.

Coalition Senators are concerned that this is a rushed and poorly thought through measure on the part of the Rudd government with apparently little or no regard having been given to the difficulties the proposed short lead-in time to implementation will cause for those directly affected.

In their submission, the Taxation Institute expressed concerns regarding:

> …the impact of the proposed amendment on:
>
> • Individual taxpayers – it will add complexity to tax law and administration which will impact unfairly on ordinary Australians working overseas and limit opportunities for Australian workers to work overseas; and
>
> • Australian businesses - it will impose additional costs on Australian companies employing Australian residents overseas and therefore reduces their competitiveness and opportunities to expand their businesses internationally.[1]

According to the Treasury submission it is estimated that between 15,000 and 20,000 individuals could lose their exemption from domestic taxation under this measure. By contrast the Taxation Institute states that there are more than one million Australians working overseas – suggesting a much larger number of Australians who will at the very least need to consider or take advice about whether they will be caught by the amended section 23AG.

Coalition Senators have received literally hundreds of emails regarding this proposal from such Australians engaged in work in overseas locations from south-east Asia to Europe, Kazakhstan, Africa and the Americas. All write of the inconvenience the introduction of this measure will cause in disrupting their financial affairs and many regard the failure to give them time to prepare for the introduction of this measure as

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1 Taxation Institute of Australia, *Submission 19*, p. 1.

an indictment of the Rudd government for the lack of consideration shown to them and their families.

Reduced competitiveness of Australian contractors

One group which will be particularly affected by these proposed changes are consulting engineers, who were represented at the Committee Inquiry by their professional association, ACEA.

The ACEA believes the implementation of the proposed amendments to section 23AG will not only adversely affect the financial arrangements of their members working overseas (as mentioned in the previous paragraph) but also will result in a significant reduction in the competitiveness of Australian consulting engineering firms in winning international tenders. ACEA points out that in 2007-08, exports of engineering industries services were $1,334 million, representing 2.6 per cent of Australia's total income in service exports, which is significant. The ACEA also pointed out in their submission that "one international contract can result in flow-on work in the overseas region," thus leading to further business for Australian engineering companies.[2] The implementation of this proposal may accordingly result in reduced business opportunities for Australian contractors.

Coalition Senators are perplexed by the apparent failure of the Rudd government to consider the impact of the proposed measure on the competitiveness of Australian industry in bidding for international contracts. Again this is seen as evidence of this measure having been insufficiently thought through.

The accounting profession was particularly critical of the short timeframe the government has allowed before the planned implementation date of this legislation, 1 July 2009.

Witnesses representing accountants raised numerous concerns regarding the difficulties imposed by the short timeframe (of less than one month) in preparing advice to assist their clients in managing their financial affairs:

> Every single suburban accountant now will have to understand how the offset rules work. They will need to be informed of how tax paid can be estimated or determined in countries like the UK and New Zealand where you do not lodge tax returns for an individual, let alone with treaty countries. The issue is then whether the commissioner will enter into a whole series of arrangements to allow these million Australians to have different lodgement periods so that we do not get mismatches in payments. It is a mess.[3]

The Taxation Institute added further comments on the compliance cost of the measure as follows:

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2 Association of Consulting Engineers Australia, *Submission 18*, p. 5.

3 Dr Michael Dirkis, Taxation Institute of Australia, *Proof Committee Hansard*, 10 June 2009, p. 3.

> With over one million Australians working overseas, the compliance costs associated with this measure will be immense. Given this multi million dollar compliance cost imposition, the Taxation Institute is concerned that there has been no attempt by the Government to mitigate the impact of the new compliance obligations which will arise as a result of this amendment nor deal with the harsh financial effects arising from the interaction between the proposed s 23AG, the Foreign Tax Offset (FTO), Pay-as-you-go (PAYG), Fringe Benefits Tax (FBT) provisions and Australia's tax treaties.[4]

Both the Taxation Institute and KPMG have suggested amendments with respect to PAYG taxation, Fringe Benefits Tax and Foreign Tax Offsets. Coalition Senators are of the opinion that the issues raised in these two submissions are of serious importance and recommend that the government give full consideration to them.

Again, the fact that there are submissions by peak organisations that raise such serious issues does lend weight to the opinion that this legislation has been put together in haste and not adequately thought through.

Relocation issues

The government presumption that this amendment to section 23AG will raise $675 million in additional taxation relies on Treasury modelling which assumes that all taxpayers currently exercising this exemption will remain Australian residents for taxation purposes.

However doubt was cast on this presumption during the hearing when it was suggested that a significant proportion of Australians working overseas might rearrange their affairs to avoid Australian residency for tax purposes and relocate their "residence" to other countries such as France, Spain or the UK and work as fly-in fly-out workers from these countries rather than Australia.

The reason for their doing this would be to preserve their income status and family standard of living, which will be compromised by the introduction of this measure. Were this scenario to occur, it may be that the government may find that the estimated gains in taxation revenue derived from this proposal will prove to be illusionary.

Transition period

Coalition Senators are concerned that in their rush to introduce this measure the Government has not provided sufficient time for individuals who will be affected by these changes to consider the impact of the proposals on their financial affairs or for their financial advisors to prepare advice for them.

Coalition Senators are of the opinion that, in the interests of fairness and equity in dealing with citizens who in good faith have availed themselves of the exemptions provided by section 23AG, the government should consider delaying the commencement of this measure.

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4 Taxation Institute of Australia, *Submission 19*, p. 1.

Coalition Senators believe a transitional period would be appropriate, as this would give the Government sufficient time to consider implementing the amendments proposed by the accounting profession to this Inquiry.

Alternatively the Government could take the approach of 'grandfathering' the exemptions currently in place and apply the new arrangements to taxpayers seeking exemption under section 23AG from a later date by which time the legislation could have been reviewed and amended in keeping with the recommendations of the accounting profession.

Schedule 2 – Government Co-contribution for Low Income Earners

Through this measure the co-contribution scheme for low and middle income earners has been wound back; government contributions have been lowered by a third.

It is regrettable that the matching rate for the super co-contribution has been temporarily reduced from $1.50 to $1, as this compelling incentive has made the scheme enormously successful. Approximately 1.4 million Australians received a co-contribution in 2007-08.

Evidence indicates that the super co-contribution scheme and related matters are issues being considered by the Australia's Future Tax System (Henry) review. As such, Coalition Senators query why the government is acting before that review has been completed. Depending on the findings of the Henry review, these co-contribution changes may prove to be entirely the wrong thing to do and may work contrary to recommendations that may flow.

This measure, which takes effect from 1 July 2009, is called a temporary measure by the government as it has said it will gradually phase the co-contribution rate back up to 150 per cent from 2014-15. From 1 July 2009 the scheme will provide only a 100 per cent co-contribution for each of the financial years 2009-10, 2010-11 and 2011-12. In 2012-13 and 2013-14, 125 per cent of contributions will be provided and 150 per cent of contributions from 2014-15 onwards.

The maximum government contribution will be lowered from $1,500 to $1,000 in the income years 2009-12.

The co-contribution scheme has assisted pending retirees and other eligible workers to boost their account balances. Its removal will notably lower the incentive for individuals to make their own provision for retirement, thereby placing a greater burden on the taxpayers once they retire. This is particularly concerning as it was noted in the submission of The Association of Superannuation Funds of Australia (AFSA) that the level of voluntary contributions to superannuation is already down around 50 per cent on the level achieved a year ago.[5]

Coalition Senators consider the decision to be a retrograde one that may prove to cost more than it saves in the medium to long term.

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5 ASFA, *Submission 22*, p. 1.

Schedule 3 – Excess contributions tax

Concessional contributions which cover the compulsory Superannuation Guarantee and salary sacrificed amounts to super will be halved as at 1 July 2009.

The provision of adequate and sustainable retirement incomes for all Australians will be undermined by this proposal. According to the ASFA's survey statistics, a 55 year old with a balance of $250,000 in their superannuation account, on an actuarial return over 10 years of 5 per cent or less, will not be able to adequately provide for their retirement.

The existing level of concessional contributions was designed to provide a significant incentive for individuals to make their own provision for retirement. Changes to the level have the potential to severely undermine that incentive and, in particular, to remove the actual ability for people close to retirement to be able to afford to make provision for their retirement through large contributions.

The proposed measure sends a clear message to persons who may have had the ability to contribute significantly towards their retirement that the government is not supportive of them doing so.

This message is particularly poignant for those approaching retirement. From evidence at the hearing, not all individuals who take advantage of the existing provisions are particularly high wealth individuals. Indeed ASFA quoted a number of surveys and other data to support their claim that many are average income earners and people who do not have high value superannuation accounts. People who are approaching retirement have a lower need for disposable income (mortgage fully paid, children grown up) and are arguably in a position for the first time in their lives to make large contributions to their super.

In essence, many Australians earning around average incomes are unable to contribute additional amounts to superannuation in their 30s and 40s due to more pressing commitments such as raising children and repaying their mortgage. It is only when many such individuals approach retirement age that contributing extra to super becomes more feasible; and if they are to contribute enough to become self funding at that point, they need to be able to contribute large amounts and this is only a likelihood for most with the favourable tax treatment currently available.

As a partial way of addressing the consequences of the proposed measure, Coalition Senators also saw sense in the suggestion made by ASFA that the government put in place a higher cap for those with relatively low superannuation account balances to enable such individuals to catch up in their retirement savings through salary sacrifice.

Given the dramatic fall in voluntary contributions to superannuation funds over the past 12 months, if the government were serious about ensuring that as many as possible of the increasing proportion of Australia’s population approaching retirement made their own provision for that retirement, it would not be seeking to implement a measure such as this at this time.

A responsible government would see its role as encouraging self-funded retirement for as many Australians as possible. These amendments will likely cost the

Commonwealth significantly more in the long term as there will be more Australians calling on the public purse in the future.

Senator Alan Eggleston

Deputy Chair

Senator David Bushby

Member

Dissenting Report by Senator Nick Xenophon

1.1 This Report is confined to the changes in the concessional contributions cap to superannuation (referred to in the Explanatory Memorandum (EM), chapter 3, pp 27-32).

1.2 As explained in the EM, the cap for concessional contributions to superannuation is $50 000 per annum indexed to AWOTE with a $100 000 transitional cap that applies annually to concessional contributions made by individuals aged 50 and over before 1 July 2012.

1.3 It is proposed that the cap for concessional contributions to superannuation will be $25 000 per annum for the 2009-10 and later financial years, indexed to AWOTE with a transitional cap that applies to individuals aged 50 and over, which will be $50 000 per annum, for contributions made in the 2009-10, 2010-11 and 2011-12 financial years.

1.4 However, members of a defined benefit scheme, which includes politicians who are elected prior to the 2004 election, will be in effect exempt from the changes. As indicated in para 3.24 of the EM,

> Special arrangements will apply to certain members with a defined benefit interest on 12 May 2009 where notional taxed contributions for that interest exceed the concessional contributions cap in the 2009-10 or later financial years. In this case, the notional taxed contributions for that interest will be taken to be at the maximum level of the person's cap. *[Schedule 3, item 4, subsection 292-170(8) of the ITAA 1997]*

1.5 This 'special arrangement' for politicians is inconsistent with the intention and the impact of the changes for all other Australians not in a defined benefit scheme, and as such should be opposed.

Recommendation

1.6 That this bill be withdrawn and redrafted in a form that does not protect politicians from the taxation implications of the superannuation changes the Government is imposing on the broader community.

Senator Nick Xenophon

Independent Senator for South Australia

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Byrnecut Offshore
2	Mr Mike Durack
3	Mr Peter Lewis
4	Mr Bruce Melrose
5	Mr Ross West
6	Mr Cam Seth
7	Mr Sean Fraser
8	Mr Grant Sanders
9	Mr George Nims
10	Mr Craig Dowling
11	Mr Jeremy O'Brien
11a	Mr Jeremy O'Brien
12	Mr Brett Harms
13	The Institute of Chartered Accountants in Australia
14	Investment and Financial Services Association
15	Financial Planning Association of Australia Ltd
16	Deloitte Touche Tohmatsu
17	PricewaterhouseCoopers Australia
18	Association of Consulting Engineers Australia
19	Taxation Institute of Australia
20	KPMG
21	The Treasury
22	Association of Superannuation Funds of Australia Ltd (ASFA)
23	Mercer (Australia) Pty Ltd
24	Minerals Council of Australia
25	Mr George W Gildea
26	Confidential
27	Mr Ray O'Brien
28	Ms Sharon Arena
29	Confidential
30	Mr Glen Ditchmen
31	Mr Anthony Durling
32	Ms Brook Arelette
33	Mr Mark Hunter
34	Mr Kevin Codlin
35	Mr Chris Short
36	Mr Steve Osborne
37	Mr Leslie Schuster
38	Mr Craig Brown
39	Mr John Emmott
40	Mr Steven Didmon
41	Mr Ronald Stanton
42	Ms Sarah Leibbrandt
43	Mr Jason Palmblad

44 Mr Craig Stalley
45 Mr Pete Smith
46 Mr Paul Bellert
47 Mr Bob Webb
48 Mr Michael O'Neill
49 Mr Stephen and Mrs Gloria Graymore
50 Mr John Ryan
51 Mr Drew Thain
52 Mr Brett Guy
53 Mr Kevin Chard
54 Mr Daniel Jelinek
55 Mr Bill Griggs
56 Mr John Hancock
57 Confidential
58 Mr Hamish Blake
59 Mr Bernard Callinan
60 Danni Braddon
61 Mr Bruce Morris
62 Confidential
63 Chris Wack
64 Mr Kristian Bailey
65 Mr Philip Jones
66 Mr Peter Redaelli
67 Mr Stephen Carter
68 Mr Peter Knowles
69 Mr Bevan Reibel
70 Mr Andy Woodford
71 Mr Robert Lunnon
72 Mr Steve Harris
72a Mr Steve Harris
73 Mr John Payne
74 Andrew Huxter
75 Mr Robert Mitchell
76 Ms Jodie Stewart
77 Mr Simon Klopper
78 Mr Ian Hearne
79 Mr Mark Hunter
80 Mr Jamie Armstrong
81 Mr Gavin Murphy
82 L Thompson
83 RMS Engineering & Construction Pty Ltd
84 Ms Kristen Cousins
85 Mr Michael Willesen
86 Mr Michael Holt
87 Mr Allan Nutt
88 Mr Colin Fulton
89 Mr Simon Davis
90 Robin Barker
91 Mr John Wade
92 Mr Simon Hoyle
93 Mr Paul Bowen

94 Vivek Ganesh
95 Mr Dave Rosetta
96 Mr Brad Gray
97 Confidential
98 Stacey Hill
99 Toll Group
100 Confidential
101 Mr Ian Thomson
102 Mr Neil Truebody
103 Lycopodium Minerals Pty Ltd
104 Mr Robert Oates
105 WHK Horwarth
106 Ms Jodi Gardiner
107 Mr Tony Arena
108 Ensign International Energy Services
109 Confidential
110 Mr Nic Jones
111 Mr Jack Smith
112 Leigh Otter
113 Ms Kerrie Jarvie
114 Mr Adam Hamer
115 Mr Kenneth Gear

Additional Information Received

- Received on 10 June 2009 from Pricewaterhouse Coopers. Answers to Questions on Notice taken on notice on Wednesday, 10 June 2009.
- Received on 15 June 2009 from Association of Consulting Engineers Australia. Answers to Questions on Notice taken on notice on Wednesday, 10 June 2009.
- Received on 15 June 2009 from Department of the Treasury. Answers to Questions on Notice taken on notice on Wednesday, 10 June 2009.
- Received on 15 June 2009 from Department of the Treasury. Answers to Questions on Notice taken on notice on Wednesday, 10 June 2009.

TABLED DOCUMENTS

- **10 June 2009, CANBERRA ACT:**

  Association of Superannuation Funds of Australia:

  Letter from Tasplan

APPENDIX 2

Public Hearing and Witnesses

ANDREWS, Mr Gary John, Assistant Commissioner
Australian Taxation Office

CLARE, Mr Ross William, Director of Research
Association of Superannuation Funds of Australia

DIRKIS, Dr Michael James, Senior Tax Counsel
Taxation Institute of Australia

DONNELLAN, Ms Julie, Executive Director
KPMG

DWYER, Mr Michael John, Member, Association of Superannuation Funds of Australia; and
Chief Executive, First State Super New South Wales

EL-ANSARY, Mr Yasser, Tax Counsel
Institute of Chartered Accountants in Australia

FAUVET, Mr John Francis, Partner
PricewaterhouseCoopers

GRAYSON, Mrs Nicola, National Policy Manager
Association of Consulting Engineers Australia

KING, Mr Matthew Samuel, Policy Officer
Association of Consulting Engineers Australia

MURRAY, Mr Nigel Patrick, Manager, Personal and Retirement Income Division
Department of the Treasury

NASH, Mr Peter, Assistant Commissioner
Australian Taxation Office

POTTS. Mr William John, Manager, International Tax Unit
Department of the Treasury

RIEL, Miss Rebecca Christine, Policy Analyst
Department of the Treasury

SPENCER, Mr Mark, Chairman
Christian Super

WOOD, Mr Gregory, Policy Adviser
Department of the Treasury