The Parliament of the Commonwealth of Australia

TAXATION OF TRANSFERS FROM OVERSEAS SUPERANNUATION FUNDS

SENATE SELECT COMMITTEE
ON SUPERANNUATION

July 2002

Commonwealth of Australia

ISBN 0 642 71182 8

This report was printed by the Senate Printing Unit, Parliament House, Canberra, ACT 2600.

Membership of the Committee

Senator John Watson	Chair	(Tasmania, LP)
Senator the Hon Nick Sherry	Deputy Chair	(Tasmania, ALP)
Senator Lyn Allison		(Victoria, AD)
Senator Geoffrey Buckland		(South Australia, ALP)
Senator Grant Chapman		(South Australia, LP)
Senator John Hogg		(Queensland, ALP)
Senator Ross Lightfoot		(Western Australia, LP)

Secretariat

Secretary	Sue Morton
Principal Research Officer	Ian South
Executive Assistant	Jade Ricza

Address: Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

Telephone: (02) 6277 3458

Facsimile: (02) 6277 3130

Email: super.sen@aph.gov.au

Internet: http://www.aph.gov.au/senate/committee/superannuation_ctte

Terms of Reference

On 14 March 2002 the Senate referred the following matter to the Senate Select Committee on Superannuation for inquiry and report by 26 September 2002:

> The taxation treatment applying to transfers from an overseas superannuation fund to an Australian regulated fund, with particular reference to whether the lump sum payment from an eligible non-resident/non-complying superannuation fund, under section 27CAA of the *Income Tax Assessment Act 1936*, should be treated as income and when such tax liability (if any) should accrue and be paid.

Table of Contents

MEMBERSHIP i

TERMS OF REFERENCE iii

PREFACE vii

RECOMMENDATIONS xi

ABBREVIATIONS xv

CHAPTER 1

THE INQUIRY **1**

Background to the inquiry 1
Conduct of the inquiry 2
Main issues arising in the inquiry 2
Structure of the report 3
Acknowledgments 4

CHAPTER 2

OPERATION OF SECTION 27CAA **5**

Policy rationale for section 27CAA 5
Technical operation of section 27CAA 5
Practical impact of section 27CAA 7
Tax policy objectives 8
Scale of the issue 12

CHAPTER 3

WHO PAYS THE TAX? 17

Effects of 'income' character 18
Tax rate 20
Inability to meet the tax liability 27
When should any change have effect? 32
Interaction with Foreign Investment Fund (FIF) regime 34

CHAPTER 4

WHAT IS THE TAXABLE AMOUNT? 37

Exempt payments—six-month exemption period 37
Calculating taxable growth 45

CHAPTER 5

LACK OF AWARENESS 57

Inadvertent triggering 60

CHAPTER 6

ENSURING A RETIREMENT INCOME 65

APPENDIX 1

LIST OF SUBMISSIONS 67

APPENDIX 2

WITNESSES WHO APPEARED BEFORE THE COMMITTEE AT PUBLIC HEARINGS 71

APPENDIX 3

LIST OF COMMITTEE REPORTS 73

Preface

This report addresses some concerns about the taxation treatment of superannuation entitlements that are transferred from overseas to Australia. The inquiry examined the current arrangements applying to the transfer of foreign superannuation, in particular the way it is assessed as the income of an individual and the time any tax liability accrues and is paid.

In making recommendations for change, the Committee has sought to establish a fair and equitable regime which is broadly revenue neutral. However, the Committee has been hindered in its task by the absence of comprehensive data on the revenue raised under the current arrangements.

The Committee considers that the current taxation arrangements have created an anomalous situation which discriminates unfairly against some migrants. The Committee believes that the transfer of foreign superannuation to Australia should be encouraged rather than punished. A feature of the Committee's response is to recommend a reduction in the tax rate that should apply to transfers, as more migrants are encouraged to transfer their superannuation rather than to leave it in their country of origin. Nevertheless, the Committee expects that consequential increases in the number of transfers should offset this reduction in the tax rate. In addition, the Committee's further recommendations to address other inequities in the law and the lack of awareness of the law should ensure that compliance is improved to the extent that its package of recommendations is broadly revenue-neutral.

The main issues examined by the Committee included:

- the alternatives for determining who should pay the tax—for example, the fund or the individual; and
- determining the taxable amount;
  - when a payment is exempt; or
  - how much of it is taxable.

Where a lump sum is paid *directly* to an individual, the Committee considers that the current treatment is appropriate and the growth in those amounts should continue to be assessed as the **income of the individual**. However, the Committee heard that as the tax is levied only when the lump sum is paid, the growth that may have accumulated over several years can push a taxpayer into the highest marginal tax bracket. In addition, the character of the amount as income can create further tax liabilities (for example, the superannuation contributions surcharge), and can affect an individual's eligibility for income-tested government benefits. Accordingly, the Committee considers that the taxable amount should be averaged to ensure that this one-off receipt does not hold these further consequences.

However, the Committee found that the **tax rate** that applies to the growth in a lump sum transferred to an Australian fund exceeds that which applies to other comparable

earnings. In particular, as the taxable growth has often accumulated over several years, the highest marginal tax rate of 47% often applies. In contrast, the tax rate of 15% would have applied if the amount had been earned within an Australian complying superannuation fund, which is *bona fide* and government regulated.

Accordingly, the Committee recommends that the growth in an entitlement that is *transferred* to an Australian complying superannuation fund should be treated as a taxable contribution. That is, the increase in the value of the entitlement, while an individual has been a resident, is to be taxed at a rate of 15%. This would ensure that the amount is taxed the same as if the accumulated entitlement had been transferred into the Australian fund when the individual became a resident, and the subsequent growth was taxed as **income of the fund**.

The Committee heard that under the existing preservation rules an individual could incur a large tax liability **without the ability to meet that tax liability** from the transferred sum. The Committee addressed this difficulty by recommending that the fund be taxed instead of the individual. To ensure that the fund can meet this tax liability (on behalf of its member) the Committee recommends that the preservation rules be amended to allow the release of an amount from the transferred lump sum.

A central concern of the Committee was that the current **six-month exemption period** is insufficient and inflexible. The Committee heard that the current period in which amounts can be transferred tax-free was too short because of delays in transferring entitlements. The Committee makes several recommendations to address the causes of delay. Consistent with the philosophy behind recent Government proposals in relation to the taxation of temporary residents, the Committee also recommends that the exemption period should be extended to two years. The Committee also suggests that there should be a discretion to further extend the exemption period where transfers are delayed through no fault of the individual.

The Committee heard that when an amount is not exempt difficulties exist in **calculating the taxable amount**, due to anomalies and complexity in the law. The Committee recommends amendments to the law, and that public rulings be issued to clarify the amount that is taxable.

The inquiry also revealed a **lack of awareness** of the taxation treatment applying to transfers of foreign superannuation. The Committee heard that few of those that have incurred a liability under section 27CAA were likely to have any knowledge of their obligations under the current law. In response to these concerns the Committee recommends that permanent visa applications advise migrants of the tax consequences of a transfer and that the *Taxpack* provide more accurate guidance on the issue.

The Committee also notes its support for the development of incentives necessary to encourage retirees to take their superannuation benefits as income streams rather than as lump sums. The Committee identifies this area as critical challenge for the Government and industry to **ensure a retirement income** for all Australians.

Finally, the Committee would like to express its appreciation to all those who took part in the inquiry, and particularly to those individuals, professionals and industry representatives who appeared at public hearings. The Committee is also grateful to the Commonwealth departments who responded to the Committee's invitation to present their views.

Senator John Watson
Chair

Recommendations

<u>**Scale of the issue**</u>

Recommendation 1 (paragraph 2.41)

The Committee recommends that the ATO collect and maintain data as to the number and size of transfers of foreign superannuation into Australia.

<u>**Character of income and tax rates**</u>

Recommendation 2 (paragraph 3.33)

The Committee recommends that when a lump sum is *transferred* from a non-resident non-complying superannuation fund to an Australian complying superannuation fund, the amount that is calculated under section 27CAA should be included in the Australian fund's assessable income as a taxable contribution. In this way, that amount should not be included in the assessable income of the individual resident for whom it is transferred.

Recommendation 3 (paragraph 3.40)

The Committee recommends that the tax law be amended to average the income assessed under section 27CAA along the lines of the averaging that applied to net capital gains derived by individuals on or before 21 September 1999. That is, amend the tax law so that the total tax payable under section 27CAA would be fives times the tax payable if only one fifth of the income assessable under section 27CAA were included in taxable income.

<u>**Preservation rules**</u>

Recommendation 4 (paragraph 3.59)

If Recommendation 2 is accepted by Government, the Committee recommends that a superannuation fund be permitted to release so much of the superannuation entitlement as is needed to meet the section 27CAA tax liability when that tax is levied, similar to some superannuation contributions surcharge arrangements.

Recommendation 5 (paragraph 3.62)

If Recommendation 2 is *not* accepted by Government, the Committee recommends that an individual be permitted to access so much of the superannuation entitlement as is needed to meet the section 27CAA tax liability when that tax is levied.

<u>When should any change have effect?</u>

Recommendation 6 (paragraph 3.74)

The Committee recommends that the changes proposed by Recommendation 2 (that funds be liable for the tax on transfers), Recommendation 3 (that the tax on individuals be averaged), and Recommendations 4 and 5 (relaxation of the preservation rules) apply prospectively, from the date of commencement of any legislative change.

<u>Double taxation</u>

Recommendation 7 (paragraph 3.83)

The Committee recommends that, to prevent double taxation, section 23AK of the ITAA 1936 be amended to allow for the exemption of amounts referred to under paragraph 603(1)(h) paid 'in relation to a taxpayer' rather than 'to a taxpayer'.

Recommendation 8 (paragraph 3.85)

The Committee recommends that as an interim measure, the Commissioner of Taxation issue a ruling or determination to clarify that a liability for tax under section 27CAA will be reduced by any tax raised under the Foreign Investment Fund (FIF) regime and so double taxation will not be imposed.

<u>Addressing the causes of delay</u>

Recommendation 9 (paragraph 4.15)

The Committee recommends that APRA, the ATO and the Treasury (in consultation with the superannuation industry) develop with their foreign counterparts bilateral protocols for the transfer of superannuation between the countries. In particular, priority should be given to developing a protocol with the UK.

<u>Length of exemption period</u>

Recommendation 10 (paragraph 4.22)

The Committee recommends that the period in which the payment of a lump-sum from a foreign superannuation fund is exempt from tax under section 27CAA be extended from six months to two years.

<u>**Flexibility of the exemption period**</u>

Recommendation 11 (paragraph 4.28)

The Committee recommends that the law be amended to give the Commissioner of Taxation the discretion to further extend the period for a tax-free transfer in instances where the member has taken reasonable steps to have the benefits transferred and has suffered undue delays which were beyond their control.

<u>**The 'relevant day'**</u>

Recommendation 12 (paragraph 4.51)

The Committee recommends that section 27CAA be amended to ensure that where an individual becomes an Australian resident, then becomes a non-resident before becoming a resident once more, the growth since an individual *first* became a resident is apportioned according to the periods of residence and non-residence that occur after that time. That is, tax should only apply to that growth in the lump sum which is attributable to a period of residence in Australia.

Recommendation 13 (paragraph 4.61)

The Committee recommends that the definition of the 'relevant day' in section 27CAA be amended prospectively so that, for lump sums paid after the date of commencement of any legislative change, only growth since the later of 1 July 1994 and the date an individual became a resident is subject to tax.

<u>**The 'properly payable' amount**</u>

Recommendation 14 (paragraph 4.72)

The Committee recommends that the Commissioner of Taxation issue a public ruling that sets out the Australian Taxation Office's interpretation of the meaning of 'properly payable'. In particular, that ruling should address the situation where a foreign fund from which an amount is transferred refuses to give information about the value of the accumulated entitlement.

Recommendation 15 (paragraph 4.84)

The Committee recommends that, where a lump sum is paid from a foreign defined benefit scheme and the amount which is properly payable cannot be determined, the Government examine the feasibility of apportioning the total growth in the scheme over periods of residence and non-residence of a member, so that a member is only taxed on that growth that is attributable to a period of residence.

Improving awareness

Recommendation 16 (paragraph 5.14)

The Committee recommends that permanent visa applications:

- **require applicants to disclose the foreign superannuation entitlements they hold; and**
- **advise applicants (in some general way) of the taxation treatment applying to their foreign superannuation entitlements.**

Recommendation 17 (paragraph 5.24)

The Committee recommends that the *TaxPack* be redrafted to give more complete and accurate guidance on the circumstances in which a liability may arise under section 27CAA. In particular, question 19 of the *TaxPack Supplement* should note that it applies to both direct payments and *transfers* of foreign superannuation.

Recommendation 18 (paragraph 5.29)

The Committee recommends that the Commissioner of Taxation issue a public ruling or determination to clarify that tax will not be imposed twice under section 27CAA when a foreign superannuation entitlement is transferred from one foreign fund to another and is subsequently transferred to Australia.

Abbreviations

APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ATO	Australian Taxation Office
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
FIF	Foreign Investment Fund
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
SISFA	Small Independent Superannuation Funds Association
UK	United Kingdom

Chapter 1
Introduction

Background to the inquiry

1.1 Superannuation is a form of long term saving and investing which aims to provide income for people in their retirement. Tax concessions play a significant role in encouraging the saving for retirement through superannuation. However, the tax laws feature a number of safeguards to ensure that the Commonwealth's revenues are not eroded by inappropriate access of the tax concessions. Section 27CAA of the *Income Tax Assessment Act 1936* (ITAA 1936) is one such safeguard, which taxes the growth of a foreign superannuation benefit as the income of an Australian resident when it is paid as a lump sum.

1.2 Last year Senator Mark Bishop, Senator for Western Australia, was one of a number of Senators who drew the Committee's attention to problems in the operation of section 27CAA. The Committee considered the matter to be of sufficient importance to seek a reference from the Senate.

1.3 On 14 March 2002 the Senate referred the following matter to the Committee for inquiry and report by 26 September 2002:

> The taxation treatment applying to transfers from an overseas superannuation fund to an Australian regulated fund, with particular reference to whether the lump sum payment from an eligible non-resident/non-complying superannuation fund, under section 27CAA of the *Income Tax Assessment Act 1936*, should be treated as income and when such tax liability (if any) should accrue and be paid.

1.4 The purpose of the Committee's inquiry was to explore whether section 27CAA represents an appropriate balance of the following objectives:

- Promoting economic growth;
  - by encouraging transfers of superannuation so all Australian savings can be harnessed for domestic investment needs; and
  - by attracting workers in the context of a global labour market.
- Ensuring equity and fairness;
  - as between migrants from different countries; and
  - as between migrants and Australian citizens who have accumulated their retirement savings within the Australian superannuation system.
- Limiting complexity of the rules governing superannuation.

Conduct of the inquiry

1.5 On 22 March 2002 the Committee issued a media release announcing its inquiry and inviting submissions by 26 April. The inquiry was also advertised in the *Australian Financial Review* on 5 April and in the *Weekend Australian* on 6 April. Details were also posted on the Committee's website.[1] In addition the Committee also wrote to a number of relevant government departments, superannuation industry organisations, professional advisers, firms and associations as well as others who have a direct interest in these matters.

1.6 The Committee received over 40 submissions. A list of submissions is at **Appendix 1**. Public hearings were held in Canberra on 17 May 2002, and in Sydney on 22 May 2002. Witnesses at those hearings are listed in **Appendix 2**.

Main issues arising in the inquiry

1.7 Generally, from 1 July 1994, when a foreign superannuation benefit is paid as a lump sum, section 27CAA of the ITAA 1936 taxes the growth of that benefit from the time a taxpayer first became an Australian resident.

1.8 The growth in the benefit is treated as assessable income and so is taxed at the taxpayer's marginal tax rate. However, the payment will be exempt from tax if it is made within six months of the time the taxpayer became an Australian resident.

1.9 The main issues that arose during the inquiry included:

- the alternatives for determining who should pay the tax — for example, the fund or the individual;
- determining the taxable amount — when a payment is exempt, and what amount is taxable.

1.10 While examining the question of who should pay the tax, the Committee's attention was drawn to the following:

- the character of the amount as the assessable income of the individual;
- the individual's marginal tax rate that applies;
- the inability of some individuals to meet the tax liability when the amount is preserved; and
- the interaction with the Foreign Investment Fund (FIF) rules.

1.11 While examining the taxable amount, the Committee's attention was drawn to the following:

- the adequacy of the six-month exemption period; and
- the method of calculating the taxable amount.

---

1 http://www.aph.gov.au/senate/committee/superannuation_ctte

Who pays the tax?

1.12 The Committee heard that the characterisation of the amount as income has other 'knock-on' effects, such as the creation of a superannuation contributions surcharge liability. It was submitted that these further effects are unintended consequences and appear to be unfair.

1.13 The Committee also heard that the taxation of the growth in a foreign superannuation entitlement as the income of an individual meant that tax was often levied at the highest marginal rate of 47% (plus the Medicare levy). Evidence suggested that this rate of tax exceeded that of other comparable situations and so was inequitable.

1.14 Another issue presented to the Committee was the inability of individuals to access the transferred amount in order to meet the tax liability that arose from the transfer. Some witnesses likened this situation to the taxation of an unrealised capital gain. The Committee heard that some people were forced to take out personal loans in order to meet the significant tax debts created.

What is the taxable amount?

1.15 The Committee was told that the current six-month exemption period is insufficient to have any practical effect of encouraging prompt transfers. Indeed, the Committee heard that this policy objective is being entirely frustrated as the six-month exemption period is far too short.

1.16 The Committee heard that when an amount is not exempt it is difficult to calculate the tax that is payable, due to anomalies and complexity in the law. The Committee also received evidence that section 27CAA could apply tax retrospectively in certain circumstances.

Lack of awareness

1.17 In addition, the Committee was told that there is very little awareness of section 27CAA amongst those taxpayers who are potentially subject to it. The Committee heard that, as a result, the level of compliance with the law was similarly poor.

Structure of the report

1.18 The overwhelming majority of the evidence presented to the Committee was in respect of benefits transferred from the United Kingdom (UK) to Australia. Transfers from the United States of America, New Zealand, South Africa and Canada were also mentioned but it was widely accepted that the transfers were predominantly from the UK. Accordingly, the majority of the Committee's report is focussed on the transfers of superannuation funds from the UK to Australia.

1.19 The report is comprised of the following chapters:

1.20 **Chapter 2:** outlines the background to the taxation of transfers of foreign superannuation. In particular it introduces the technical and practical operation of section 27CAA. The chapter also sets the context in which section 27CAA operates by identifying the broad tax policy objectives that apply to the Australian system. It also explores the potential scale of the issue.

1.21 **Chapter 3:** examines who is, and who should be, liable to pay tax on a transferred amount. In particular, the chapter focuses on the practical impact of characterising the amount as the income of an individual.

1.22 **Chapter 4:** explores the existing rules that determine when a payment will be exempt. The chapter also addresses some of the issues that arise in calculating the tax payable when the payment is not exempt.

1.23 **Chapter 5:** examines the extent to which taxpayers are aware or unaware of section 27CAA.

1.24 **Chapter 6:** outlines the Committee's concerns that more needs to be done to promote the provision of benefits as income streams, rather than as lump sums.

Acknowledgments

1.25 The Committee is grateful to the many individuals and organisations who took the time to write to the Committee to express their views, make submissions and/or who gave evidence at the public hearings. Their cooperation and willingness to provide additional information to the Committee to assist in its inquiry was much appreciated. In particular, the Committee wishes to thank Senator Mark Bishop for his role in initiating the inquiry, his submission and appearance at a public hearing.

Chapter 2
Operation of section 27CAA

Policy rationale for section 27CAA

2.1 In the absence of a clear policy statement in the Explanatory Memorandum to section 27CAA, the Treasury and the Australian Taxation Office (ATO) advised the Committee that section 27CAA was consistent with the principle that Australian residents are taxed on their Australian and overseas earnings. Indeed, section 27CAA was seen as a concession to the Foreign Investment Fund (FIF) rules which normally tax gains as they accrue, rather than as they are realised. In particular, the ATO advised the Committee that:

> …the policy rationale is that residents should be taxed on their worldwide earnings. This principle is reflected in the Foreign Investment Fund (FIF) rules and, for superannuation, also in s27CAA. Under the FIF rules overseas earnings of an Australian resident are taxed annually on an accrual basis. Under 27CAA a concession is granted in that earnings are not taxed annually but the tax is deferred until payment is made from the fund. Provided any payment from the overseas fund is made within 6 months of the individual becoming resident then Section 27CAA will not apply – this is a further concession on the FIF rules.[1]

Technical operation of section 27CAA

2.2 Generally, from 1 July 1994, when a foreign superannuation benefit is paid as a lump sum, section 27CAA of the *Income Tax Assessment Act 1936* (ITAA 1936) taxes the increase in the value (ie. the growth) of that benefit from the time a taxpayer first became an Australian resident. The terms of the section are set out below:

> **27CAA Assessable income to include component of lump sum payment from an eligible non-resident non-complying superannuation fund**
>
> (1) **[When assessable income includes amount of the excess]** If:
>
> (a) a payment (the **'relevant payment'**) of a lump sum (including a payment made as a result of the commutation of a superannuation pension or of an annuity but not including an **'exempt resident foreign termination payment'** or an **'exempt non-resident foreign termination payment'**) is made from a fund that is an eligible non-resident non-complying superannuation fund in relation to a taxpayer when the relevant payment is made; and
>
> (b) had the fund been a superannuation fund, the relevant payment would, apart from paragraph (ma) of the definition of **'eligible termination**

1 *Submission* 45, Australian Taxation Office, p. 1.

payment' in subsection 27A(1), have been an eligible termination payment; and

(c) the amount (the **'gross amount'**) that was properly payable on the day on which the relevant payment was made before any deduction was made from that amount exceeds the amount worked out using the formula:

Accumulated entitlement *plus* **Additional contributions**;

then the taxpayer's assessable income of the year of income in which the relevant payment is made includes the amount of the excess.

(2) **[Definitions]** For the purposes of the formula in subsection (1):

'Accumulated entitlement' means the amount properly payable to the taxpayer out of the fund on the day immediately before the relevant day.

'Additional contributions' means so much (if any) of the gross amount as represented contributions paid by the taxpayer, or an employer of the taxpayer, on or after the relevant day.

'relevant day' means the day on which the taxpayer became a member of the fund or the first day during the period to which the relevant payment relates on which the taxpayer became a resident of Australia, whichever is the later.

(3) **[Payments made in respect of a taxpayer]** Subsection 27A(3) applies for the purposes of this section in a corresponding way to the way in which it applies for the purposes of the definition of **'eligible termination payment'** in subsection 27A(1).

2.3 An important point to note is that section 27CAA will not apply to exempt payments. Subsection 27A(1) of the ITAA 1936 defines an 'exempt non-resident foreign termination payment'. Broadly this is a payment made within six months of the taxpayer becoming a resident of Australia.

2.4 However, if the payment is not exempt section 27CAA includes in assessable income the gross amount of any lump sum less the accumulated entitlement and any additional contributions. The 'accumulated entitlement' is the amount 'properly payable' to the taxpayer before the 'relevant day'. The 'relevant day' is the later of the day when the taxpayer became a member of the fund and the day when they became an Australian resident. The 'additional contributions' are any contributions made to the fund after the taxpayer became a resident of Australia. So, in simple terms, the assessable amount is the increase in the value of the entitlement since the taxpayer became a resident of Australia. It is treated as assessable income and so is taxed at the taxpayer's marginal tax rate.

2.5 The operation of section 27CAA was described by the ATO in a letter to Pension Transfers Direct using the following example:[2]

Example
A taxpayer had an amount of $10,000 vested in a fund in the United Kingdom at the time he became a resident of Australia. The taxpayer became a member of the United Kingdom fund on 4 February 1990, and a resident of Australia on 1 January 1998. The 'relevant day' is the day the taxpayer became a resident of Australia.
The taxpayer's employer made additional contributions of $2,000 between 1 January 1998 and 1 January 2001.
The taxpayer received a lump sum payment of $15,000 on 1 January 2001.
The assessable portion of the payment is $3,000, and is calculated as follows:
$15,000 – ($10,000 + $2,000) = $3,000 assessable income in Australia.
The assessable portion of $3,000 is included in the taxpayer's assessable income, and is subject to the individual's marginal rate of tax.

Practical impact of section 27CAA

2.6 The practical impact of section 27CAA can perhaps be best illustrated through an example noted by Senator Mark Bishop:

> This constituent has been seeking approval to have her United Kingdom funds transferred to her Australian approved superannuation fund since she left the United Kingdom and arrived in Australia in 1982. In the United Kingdom she had been a shop assistant for 12 years. When she left the United Kingdom there was about £1,000 in the employer sponsored superannuation fund; this is now around about £20,000…
>
> So almost the entire sum to be transferred is growth, which is taxable as income under section 27CAA. The decline in the value of the Australian dollar has further contributed to the size of her tax liability. For reasons beyond her control, and in spite her repeated attempts to gain approval from her United Kingdom super fund and the United Kingdom Inland Revenue to transfer the funds, my constituent did not receive approval to transfer the funds from the United Kingdom super fund until 1999, when a legislative change in the United Kingdom led to her application finally being approved. If the funds had been transferred within six months of acquiring Australian residency—or, in this case, within six months from the commencement of the legislation in 1994—the funds transferred would have been exempt from tax. However, this was not possible in my constituent's case and did not

2 *Submission* 41, Pension Transfers Direct, p. 36.

> occur, even though there were repeated attempts to achieve this. There are many complications associated with acquiring approval to transfer moneys in overseas superannuation funds.
>
> A further inequity for my constituent was that, even though the funds to be transferred would be classified as income for tax purposes, the money from the United Kingdom fund must be paid directly into the Australian superannuation fund. This means that the moneys cannot be used to pay the tax liability that would arise from the transfer. As an employee in the retail industry and a relatively low paid worker, this constituent does not have the means to pay the resultant tax liability. If she has to transfer something in the order of £20,000—roughly equivalent to $A60,000 or $A70,000—and that sum is treated as income, it would mean that her income for the year, if she was an award worker on $30,000 a year, would be close to $100,000. A large amount of that income would be taxed at the highest marginal rate and she would have a taxation liability for the year in addition to normal taxation liability in the order of $24,000 or $25,000.[3]

2.7 The following chapters explore in depth aspects of the practical impact of the existing policy, legislation and administration of the taxation of transfers of overseas superannuation. They highlight the Committee's concerns and outline its recommendations to address those concerns.

Tax policy objectives

2.8 The Government's *Review of Business Taxation* identified a number of policy objectives that provide high level guidance for the design and operation of Australia's tax system.[4] It found that the principal function of the system is to raise revenue but the policy objectives recognise that this has to be achieved subject to important constraints. Therefore, in considering reform of the tax system, or elements of it, the focus should be on a system that delivers socially optimal outcomes over the long term.

2.9 Mindful of the revenue-raising function of the tax system, the Committee has sought to ensure that its recommendations are broadly revenue-neutral. While a key feature of its recommendations is to reduce the tax rate applying to transfers, the Committee believes that consequential increases in the number of transfers and improved compliance will offset the reduction in the tax rate.

---

3 *Committee Hansard,* 17 May 2002, pp. 13-14.

4 Review of Business Taxation, *A Strong Foundation,* November 1998, p. 62.

2.10 Broadly speaking the main policy objectives of Australia's tax system can be described as being:

- to promote economic growth;
- to ensure equity and fairness; and
- to limit complexity.

2.11 The Committee believes that it is in the context of these objectives that the current tax treatment of transfers of foreign superannuation, and the options for the reform of that treatment, should be judged.

2.12 However, in certain circumstances these objectives can overlap and compete with one another. In these cases, it is necessary to reconcile the interactions amongst them, their relative importance, and the way in which they may be implemented, on a case-by-case basis.

2.13 The Committee considers that any changes that may be made to the law on this issue should be made following extensive consultations with professional and industry groups.

Promoting economic growth

Harnessing Australian savings

2.14 Superannuation underpins Australia's long term strategy for supporting the retirement incomes of an increasing aged population. It is also a vehicle for the maximisation of private savings in Australia. As such, superannuation represents an important financial resource to fund the investment requirements of the Australian economy. To minimise foreign debt, it is desirable for Australia to finance its domestic investment needs from domestic rather than foreign savings. Accordingly, Australian savings that are held overseas represent an opportunity cost to the Australian economy. While those sums remain in foreign superannuation funds the economic potential of those funds is not being directed in Australia's national interest.

2.15 Although the Explanatory Memorandum to the Act[5] that created section 27CAA did not expressly describe the policy rationale, the Treasury advised the Committee that section 27CAA was 'seen as a concession'.[6] A key feature of the current law is the six-month period in which a resident may be paid lump sum superannuation from overseas without facing a tax liability. The purpose of this period is to encourage the prompt transfer of benefits. The Treasury advised the Committee that:

> The six month grace period is designed to provide a balance between allowing individuals who become residents of Australia sufficient time to

---

5 *Taxation Laws Amendment Act (No. 4) 1994*.

6 *Committee Hansard*, 17 May 2002, p. 2.

> transfer their superannuation entitlements and minimising the scope for these individuals to avoid paying Australian tax by leaving their money in overseas superannuation funds.[7]

2.16 During this inquiry the Committee heard that the current taxation arrangements are unduly inhibiting the transfer of foreign superannuation. In fact, the Committee received submissions from several private individuals that asserted that the policy objective of encouraging overseas transfers was being entirely frustrated by the practical operation of section 27CAA. For instance, an individual in Victoria wrote:

> The effect of the current legislation is either to discourage such people from coming here in the first place or to encourage them to return to their country of origin so that they can enjoy the superannuation savings which are rightfully theirs. In either case, they are discouraged from bringing potentially large investment funds into this country so that both Australia and its citizens lose out.[8]

2.17 Similarly, the Committee received evidence from an individual in New South Wales, who submitted:

> This is a severe impediment and seems to me inherently unfair and counter productive (given the apparent aim to encourage super accumulation). My partner and I would love to bring our super into Australia, but until this legislation changes it makes no sense for us to do so.[9]

Attracting workers in a global labour market

2.18 The globalisation of the labour market (particularly the skilled labour market) now means that nations compete to attract those workers who can best meet their labour needs. In this increasingly global labour market a country's tax system is an important factor which contributes to its overall attractiveness for international workers.

2.19 The former Senate Select Committee on Superannuation and Financial Services examined issues of the globalised labour market in its report *The opportunities and constraints for Australia to become a centre for the provision of global financial services.* That Committee found that a significant impediment for Australia to achieve its goal of becoming a global financial centre was the taxation treatment of expatriate staff. The rules were seen as inhibiting attempts to attract skilled personnel from overseas.[10]

---

7 *Submission* 9, Department of the Treasury, p. 1.

8 *Submission* 6, J A McCracken-Hewson, p. 1.

9 *Submission* 1, M Dickson, p. 1.

10 Senate Select Committee on Superannuation and Financial Services, *The opportunities and constraints for Australia to become a centre for the provision of global financial services,* March 2001, p. 92.

2.20 Section 27CAA of the ITAA 1936 concerns the taxation of transfers of superannuation into Australia and so applies mainly to those who have worked overseas and have come to Australia to continue employment and to eventually retire. Therefore, the Committee finds itself again investigating the taxation arrangements that affect Australia's international attractiveness as a destination for foreign workers. Mr Dylan Morgan, of New South Wales, described this situation to the Committee:

> We live in a world economy. People, assets and know how are increasingly transferred around the world to meet market demands. The taxation of superannuation should not be an impediment to or disadvantage for the Australian economy.[11]

Committee view

2.21 As discussed throughout the body of this report, the Committee has heard that the current arrangements for the taxation of transfers from foreign superannuation funds are discouraging such transfers. In this way, the tax laws are denying Australia the opportunity to harness those funds for its investment needs and inhibiting Australia's ability to attract skilled migrants. For this reason the Committee considers that the current arrangements under section 27CAA do not appear to meet the tax policy objective of promoting economic growth.

Ensuring equity and fairness

2.22 A further guiding principle to be considered is that the tax law should treat individuals equitably and fairly. In particular, the Committee was mindful that there should be equity in the treatment between:

- migrants and other Australian residents;
- migrants from different countries (ie. to ensure that the taxation treatment of a transfer from, say, Canada is not unduly different from a transfer from the UK).

2.23 An important aspect of this objective is to ensure the integrity of the tax system. That is, equity and fairness will not be achieved if some are permitted to use tax concessions inappropriately or to avoid paying tax at all.

2.24 A further aspect of the Committee's concern was that perceptions of unfairness in the current treatment were being reflected in poor compliance with the law. Mr Ray Stevens of Mercer Human Resource Consulting told the Committee that, of those taxpayers who are liable to pay tax under section 27CAA:

> I suspect there are a lot who decide that they will get back at what they feel is a punitive tax by just not disclosing it.[12]

---

11 *Submission* 4, p. 1.

12 *Committee Hansard*, 17 May 2002, p. 49.

Committee view

2.25 In formulating its recommendations the Committee was mindful that there should be equity in the treatment of migrants. In particular, the Committee was concerned to ensure that there were incentives to encourage the transfer of foreign superannuation into Australia, rather than penalties for not transferring such amounts.

2.26 The Committee believes that compliance with section 27CAA will improve if taxpayers have confidence that they will be treated fairly under the law. In addition, there will be greater compliance if individuals are given advance notice of the tax consequences of their actions, and so have the opportunity to arrange their affairs with full knowledge of their tax obligations.

2.27 The Committee also sought to ensure that its recommendations would achieve equitable results while supporting the integrity of the tax law and not by compromising the Commonwealth's revenue.

Limiting complexity

2.28 The taxation of superannuation, and the broader superannuation law, are undeniably complex. While the focus of this inquiry was to examine the equity of the tax treatment and how that treatment contributed to Australia's economy, the Committee also recognised that the law should not be unnecessarily complex.

Committee view

2.29 Accordingly, the Committee was concerned to ensure that any changes it proposed should not unduly contribute to the further complication of the law. However, as noted above, in certain circumstances this objective may not be consistent with achieving the other objectives. In those cases, the Committee sought to strike an appropriate balance between those criteria.

Scale of the issue

2.30 The overwhelming majority of the evidence presented to the Committee was in respect of benefits transferred from the UK to Australia. Transfers from South Africa[13], New Zealand[14], the United States of America[15] and Canada[16] were also mentioned but it was widely accepted that the transfers were predominantly from the UK.[17]

---

13 R Stevens, *Committee Hansard*, 17 May 2002, p. 48.

14 *Submission* 30, P McIntosh, p. 1.

15 J Ciacciarelli, *Committee Hansard*, 17 May 2002, p. 40.

16 *Submission* 8, V Menkov, p. 1.

17 The Committee was pleased to receive migration data and analysis from Mr Phillip Whiteley. His research supported the anecdotal evidence that migrants from the UK were most affected by section 27CAA. See *Submission* 32.

2.31 The Committee was disappointed that there was no reliable data to indicate the true scale of this issue. The Treasury and the ATO were not able to estimate the number of transfers completed, nor the amount of money transferred and therefore could not advise on the amount of revenue raised under section 27CAA.[18] Importantly, there were also no estimates available to indicate the amount of superannuation benefits that Australian residents now hold offshore, and so could potentially be transferred to Australia. The difficulty for the ATO arises because the income collected under section 27CAA is not separated from all other forms of income. The ATO advised the Committee that it was not possible to dis-aggregate this total to establish how much revenue had been collected under section 27CAA.

> Unfortunately with the way this tax is paid and where it is collected, if you like, through the TaxPack, there are a number of other data information fields that go into that same box, so it is not actually spelt out separately. We do not have any data that specifically tells us how much tax is collected under 27CAA.[19]

2.32 In response to the Committee's further request for revenue estimates, the ATO advised that:

> Unfortunately revenue collected under s27CAA is not separately identifiable on the income tax return, and accordingly we are not able to provide any further information or estimates on the revenue collected under s27CAA. We have looked into this issue in some detail but the information provided on the taxation return is not broken down in sufficient detail to enable us to provide the information you require.
>
> We are also unable to provide you with advice on the amount of foreign superannuation assets held by Australian residents, and the growth in those assets that may be taxed under s27CAA. Individuals are not required to provide this type of information to the ATO and accordingly we do not have this information available.[20]

2.33 The Committee noted a *Sydney Morning Herald* article, which estimated that over a million Australian residents have overseas pension funds.[21] According to Mr Anthony Gribben, this figure includes migrants that become residents, and long-time residents that have spent some time working and accruing superannuation overseas.[22]

2.34 The Committee was grateful to receive evidence from one organisation as to the number and size of the superannuation transfers it had completed. Over the past

---

18 *Committee Hansard*, 17 May 2002, p. 5.

19 N Murray, *Committee Hansard,* 17 May 2002, p. 5.

20 *Submission* 46, Australian Taxation Office, p. 1.

21 L. Bland, 'A right royal tax time bomb', *The Sydney Morning Herald*, 25 February 1998.

22 *Submission* 21, p. 1.

three years, that organisation transferred a total of more than $A21 million, on behalf of over 300 clients. The average amount transferred was in the order of $A60,000.[23]

2.35 The Association of Superannuation Funds of Australia (ASFA) provided evidence of lump sums transferred of between $A20,000 to $A300,000. The growth component of these balances, which is subject to tax, is less certain as it depends on unknown factors such as the investment performance of the fund.[24]

2.36 It was suggested that the impact of the legislation appeared to affect professionals, academics and other highly skilled workers in particular.[25] That is, there was a notion that only relatively high-income earners would have accumulated superannuation savings that they would wish to transfer. However, evidence submitted by ASFA indicated that the issue may have much broader application:

> In countries which do not have compulsory retirement savings, senior employees and professionals are more likely to be transferring pensions. However, in the UK the provision of employer-sponsored funds is quite prevalent, so this issue has wider impact.[26]

2.37 Pension Transfers Direct estimated that almost $1.6 billion of UK superannuation belonging to migrants in Australia could be transferred to Australia over a 5-year period.[27]

Committee view

2.38 In the absence of further, more comprehensive, evidence the Committee relied on the illustrative cases brought by individuals and advisers to garner some indication of the extent of this issue. Without authoritative data from the Treasury or the ATO, the Committee felt compelled to extrapolate from the anecdotal evidence it received in order to get a sense for the true scale of the issue.

2.39 The Committee found it could have little confidence in calculating the absolute magnitude of the issue. Nevertheless, it was satisfied that many people are affected by the measures and that the financial amounts involved are significant, both from the perspective of the individuals affected and the revenue and economy at large.

2.40 The Committee believes the availability of reliable data is essential to monitor ongoing compliance with the law and would assist the further development of policy in this area of the tax law. For these reasons the Committee considers that the ATO should begin to collect data as to the amount of revenue raised under section 27CAA.

---

23 *Submission* 37, name withheld, p. 1.

24 *Submission* 38, p. 4.

25 *Committee Hansard,* 22 May 2002, p. 89.

26 *Submission* 38, p. 2.

27 *Submission* 41, p. 4.

Recommendation 1

2.41 The Committee recommends that the ATO collect and maintain data as to the number and size of transfers of foreign superannuation into Australia.

2.42 In addition, the Committee believes that the ATO should take steps to monitor compliance with section 27CAA in order to determine the scale of the revenue involved. A compliance survey could reveal the extent to which taxpayers are aware of, and are meeting, their obligations under section 27CAA. For instance, the ATO may be able to survey a sample of those who have reported income under the relevant part of the tax return, and from that sample, to estimate the total revenue collected under section 27CAA.

Chapter 3
Who pays the tax?

3.1 A threshold question for the Committee was whether the increase in value of a foreign superannuation entitlement should be included in the income of the individual or the Australian superannuation fund when it is transferred to the Australian fund as a lump sum.

3.2 While examining the question of who should pay the tax, the Committee considered the following issues:

- the character of the amount as the assessable income of the individual;
- the individual's marginal tax rate that applies;
- the ability of individuals to meet the tax liability when the amount is preserved; and
- the interaction with the Foreign Investment Fund (FIF) rules.

3.3 According to the 'source principle' an Australian resident is assessable on income from *all* sources, whether from inside or outside of Australia. In contrast, non-residents are assessed only on income from *Australian* sources, subject to certain exceptions. The source principle is encapsulated within subsections 6-5(1) and (2) of the *Income Tax Assessment Act 1997* (ITAA 1997).

3.4 Currently, the increase in value of the foreign superannuation entitlement is included in the income of the individual. Section 27CAA assesses the 'properly payable' amount of a lump sum paid to a resident from a foreign superannuation fund. In line with the 'source principle', the growth in that amount which is attributable to a period of Australian residence is taxable as income. Mr Raphael Cicchini of the Treasury explained to the Committee that:

> Section 27CAA is consistent with the principle that an Australian resident should be subject to Australian tax on income from all sources and with restricting Australian superannuation tax concessions to resident superannuation funds that comply with the Australian supervisory requirements. As such, only superannuation entitlements that have accumulated since the individual became an Australian resident are subject to Australian tax. This would generally be any investment earnings that have accrued over the period.[1]

3.5 Where the lump-sum is transferred into an Australian fund the amount which is 'properly payable' (not just the growth component) is then treated as an undeducted contribution. As the lump sum is treated as an undeducted contribution it is not part of the taxable income of the Australian superannuation fund which receives it. Also, it is

---

1 *Committee Hansard*, 17 May 2002, p. 2.

not included in an individual's assessable income when withdrawn as a lump sum. This treatment is outlined in the Explanatory Memorandum:

> The member will be assessed on the amount that he or she would be entitled to receive on the day the transfer took place (that is, the amount properly payable to the member on that day) under section 27CD or section 27CAA. Consequently this amount will be member undeducted contributions in the hands of the trustee of the resident superannuation fund.[2]

3.6 The Committee received evidence that there are two aspects of the current treatment which mean that it is inappropriate to tax the lump sum as the income of an individual. As outlined below, several witnesses submitted:

- that the characterisation of the amount as income has inequitable 'knock-on' effects; and
- that the rate of taxation is unduly higher than that applying to other comparable circumstances.

Effects of 'income' character

3.7 Aside from determining the tax rate that will apply, the characterisation of the growth amount as 'income' can have several follow-on effects. In particular, many pensions, allowances, benefits and some liabilities are means-tested using assessable income as a benchmark. The Committee heard that the characterisation of the growth amount as income could have any or all of the following effects:

- to create or increase a superannuation surcharge liability;[3]
- to create or increase a Medicare surcharge liability;[4]
- to create or increase a child support liability;[5]
- to reduce or extinguish a social security pension, benefit or allowance.[6]

3.8 To the extent that taxable income is a useful proxy against which to measure an individual's financial well-being, the Committee heard that this is less so when an amount is included by virtue of section 27CAA. This is because section 27CAA assesses the growth that may have accrued over several years in the year in which it is paid. In this way, the assessable income of a taxpayer will be distorted by the

---

2 Explanatory Memorandum to the *Taxation Laws Amendment Act (No. 4) 1994,* paragraph 7.183.

3 *Submission* 16, P Whiteley, p. 3.

4 *Submission* 7, Pension Transfers Direct, p. 3.

5 B Hutton, *Committee Hansard*, 22 May 2002, p. 128.

Also see *Submission* 44, in which the Child Support Agency confirmed that: 'income under section 27CAA, will be used in an assessment of child support if the income was included when working out the taxable income under the *Income Tax Assessment Act 1936'.*

6 For instance see *Submission* 41, Pension Transfers Direct, p. 33.

inclusion of gains that have been accrued in previous years. This distortion can misrepresent the true earning capacity of an individual in the year of the payment and so may inappropriately affect the individuals entitlement to allowances and liability to make payments.[7]

3.9 Mr Brent Hutton, who advises British migrants on their superannuation and how to transfer it to Australia, explained to the Committee the 'knock-on' effects of characterising the lump-sum as an individual's income:

> …it is personal income and therefore it is assessed as part of their adjustable taxable income when calculating their rate of surcharge. It also counts towards their taxable income with regard to the Medicare levy surcharge and Centrelink benefits. We have many clients, particularly female clients, who have unfortunately been through separations and are relying on Centrelink benefits. If they were to trigger this tax, they would lose those benefits and, potentially, have to repay what has already been paid to them.[8]

3.10 The result of these further consequences is that the effective rate of tax is increased. The following example illustrates this point.

---

7 *Submission* 32, P Whiteley, pp. 5-6.

8 *Committee Hansard*, 22 May 2002, p. 127.

Example[9]

Anna migrated to Australia in 1995. She and her husband George have just welcomed into the family baby Harry, who is a little brother to three year old Matilda. Anna has been on leave without pay to stay at home and look after them. George earns $28,000 per year. When they were both working, Matilda went to day care during the week. As Matilda loves her friends there, both George and Anna are keen for her to stay at day care for 10 hours a week. It’s also a great help to both Anna and George while they get used to being a family of four.

In 2000-2001 the family was entitled to receive these government benefits:

- Family Tax Benefit Part A ($6,059);
- Family Tax Benefit Part B ($2,602.45);
- Child care benefit ($25.80);
- Maternity allowance ($798.72);
- Maternity immunisation allowance ($208);
- Health care card.

During that year Anna was considering transferring her UK superannuation entitlements to Australia. If she had transferred them, the growth since 1995 (in her case, say, $60,000) would have been included in her assessable income under section 27CAA (and $15,580 of tax would have been payable). In addition, the family would have lost all of its government allowances worth almost $10,000 (plus the value of the health care card). In other words, the family would lose $25,000 overall from the $60,000 superannuation gain, representing an effective tax rate of over 40%.

Tax rate

3.11 Under section 27CAA the growth in the lump sum is taxed at an individual taxpayer’s marginal rate. The following table sets out the individual resident income tax rates for the 2001-2002 income year.

---

9 Based on an example from the Family Assistance Office internet site: http://www.familyassist.gov.au/Internet/FAO/FAO1.nsf/Payments/WCFG.html#SIF

Table 3.1: Individual resident income tax rates for 2001-2002 income year

Taxable income $	Tax on this income
0 - 6,000	Nil
6,001 - 20,000	17c for each $1 over $6,000
20,001 - 50,000	$2,380 plus 30c for each $1 over $20,000
50,001 - 60,000	$11,380 plus 42c for each $1 over $50,000
60,000 and over	$15,580 plus 47c for each $1 over $60,000

The rates above do not include the Medicare levy of 1.5%.

3.12 The Committee heard that the maximum rate is particularly relevant because the growth has often accrued over many years, and the size of this accumulated growth commonly pushes a taxpayer into the highest tax bracket.[10]

3.13 Many submissions expressed the belief that this level of taxation is excessive and punitive.[11] In particular, the Committee heard the view that the rate of tax under section 27CAA was unduly higher than the tax rate that applies to the earnings of a resident complying superannuation fund, or the rate payable by an individual on capital gains.[12] Mr Gordon Mackenzie, of the Australian Taxation Studies Program, suggested that the amount should be taxed at the discounted rates that apply to the capital gains of an individual.[13]

3.14 The Committee also heard that, in certain circumstances, a taxpayer may have been better off if they had been taxed under the FIF regime than under section 27CAA. For a low-income earner, less tax would be payable overall if the growth were taxed in each year in which it accrued, since the taxpayer would get the benefit of the tax-free threshold in each of those years.[14] That is, the progressive nature of tax rates means that a low-income earner will pay more tax overall due to the way that section 27CAA defers the assessment until the benefit is paid. This can be demonstrated from the circumstances in the previous example:

10 *Submission* 19, Australian Taxation Studies Program, p. 4.

11 For instance, *Submissions* 2, 5, 8, 10-14, 16, 19-25, 27 and 28.

12 For instance, *Submission* 19, Australian Taxation Studies Program, p. 4.

13 *Submission* 19, Australian Taxation Studies Program, p. 5.

14 *Submission* 20, Mercer Human Resource Consulting, p. 8.

Example

In the previous example, Anna's foreign superannuation entitlements grew by $60,000 over 5 years. The tax payable when these benefits were paid would have been $15,580 under section 27CAA (assuming that she earned no other income).

Assuming that her entitlements grew by $12,000 in each year, had she been subject to the full accruals taxation of the FIF regime instead of section 27CAA, her total income tax payable would have been $5,100 ($1,020 in each of the 5 years, assuming that the 2000-2001 tax rates applied throughout).

That is, Anna pays $10,480 more tax under the 'concessional' section 27CAA, than she would have if it were instead assessed under the FIF regime.

3.15 Mr Peter Morris, a UK financial adviser, suggested to the Committee that this problem may be addressed by applying the average tax rate that applied in years prior to the year in which the lump sum was paid from the foreign fund. This would relieve the burden that would otherwise be imposed by having high marginal tax rates apply in the year in which the lump sum is received. He suggested that the law should:

> …apply the average rate of tax of a taxpayer before adding the Section 27CAA amount, so that taxpayers are not thrown into a higher tax bracket by the amount, similar to what applied under the previous regime of Capital Gains Tax.[15]

3.16 However, Mr Morris suggested that it would be preferable to simply tax the amount at the concessional rate of 15%, which applies to the earnings of Australian complying superannuation funds. Mr Robert Hodge of ASFA outlined the rationale for this alternative:

> We would like to look at it from a different point of view and ask ourselves: had the money been transferred into the Australian fund within the relevant time and had it then grown in the Australian fund, how would that money have been taxed in Australia? It would have been taxed as income to the fund and whether it was a realised capital gain or income growth, it would have been taxed at 15 per cent…[16]

3.17 Senator Mark Bishop submitted that it would be more appropriate for the fund to be taxed on the transferred lump sum since:

---

15 *Submission* 13, P Morris, p. 6.

16 *Committee Hansard,* 22 May 2002, p. 93.

> …although classified as income for tax purposes, the money from the overseas fund must be paid directly into the Australian super fund, and as such, cannot be used to pay the tax liability that will arise from the transfer. Conceivably many people would not have the means to pay the resultant tax liability arising from the transfer of funds. It would be more equitable for the Australian superannuation fund to pay the tax liability.[17]

3.18 Under that proposal the lump sum would be treated the same as if it had been a contribution to an Australian fund on the date the individual became a tax resident. That is, the lump sum (excluding the growth) would be treated as an undeducted contribution in the Australian fund, as is the current treatment for the entire lump sum.[18] The growth in the lump sum would then be treated as assessable income of the fund and taxed at the 15% rate applicable to other earnings of a superannuation fund, rather than the marginal rate of the individual. The Small Independent Superannuation Funds Association (SISFA) expressed their support for this approach.[19]

3.19 CPA Australia also suggested this option to the Committee.[20] A further option it submitted was to tax the amount as a capital gain of the Australian superannuation fund that received the lump sum.[21]

3.20 Andersen submitted to the Committee that retirement benefits should not be penalised (from a tax perspective) by virtue of the fact that the savings accumulated to the individual overseas. It proposed that:

> …a transfer to a complying Australian fund from a foreign fund located in a comparable tax country be treated as undeducted contributions.[22]

3.21 Andersen suggested that this treatment could be allowed on the basis that the benefit has been taxed in the foreign jurisdiction and that the benefit is transferred into an Australian complying fund. In this case, therefore, no further Australian tax should be payable upon entry or exit from the complying Australian fund. Income that is generated within the complying Australian fund would be taxed in the normal manner.

3.22 Where the transfer has not been taxed in a comparable manner in the foreign jurisdiction, Andersen proposed that:

---

17 *Submission* 11, pp. 4-5.

18 Tax deductible contributions are generally taxable in the hands of the fund (at 15%, being taxable contributions). Undeducted contributions are not taxable contributions.

In the present case, the transferred amount which is 'properly payable' is an undeducted contribution as no deduction was allowable in respect of it under the Australian tax law (as it was contributed overseas).

19 *Submission* 26, p. 2.

20 *Submission* 24, p. 7.

21 ibid.

22 *Submission* 25, p. 3.

> …the portion of the transfer which represents the growth in accumulated benefits (excluding additional contributions) from the date of commencement of the individual's Australian tax residency qualify as a roll-over of taxed contributions.[23]

3.23 Andersen explained that the main difference to the current regime under this approach would be the deferral of the tax due. It also suggested that as a safeguard, rollover relief could be limited to a list of countries similar to the system currently used for Controlled Foreign Companies.[24]

3.24 In contrast, AMP submitted that the existing treatment of the amount as income should be maintained:

> …AMP supports the view that the transfer of funds from an eligible non-resident non-complying superannuation fund to an Australian fund should be treated for Australian taxation purposes as an income transfer and should be taxed in Australia in the same manner as other income.[25]

3.25 The Treasury also advised the Committee that the current arrangements:

> …are consistent with the principle that an Australian resident should be subject to Australian tax on income from all sources and with restricting Australian superannuation tax concessions to resident superannuation funds that comply with Australian supervisory requirements. Any reduction of Australian tax on transferred amounts would give transferees more generous tax treatment than other Australian residents who earn income from overseas.[26]

Committee view—character of income and tax rates

3.26 The Committee notes several arguments that support the current arrangements which tax the growth in a sum transferred from a foreign superannuation fund to an Australian fund as the income of the individual resident taxpayer, rather than the income of the Australian fund to which it is transferred.

3.27 One such argument in support of the current arrangements is that it would be inappropriate for the concessional tax rate applying to the earnings of Australian-regulated superannuation funds to apply to the earnings of an individual resident from a foreign superannuation fund that does not comply with Australian regulations.

3.28 The Committee notes that the highest marginal tax rate applicable to the earnings from a foreign superannuation fund under section 27CAA is 47%. Currently the earnings of a *resident* non-complying superannuation fund are also subject to tax

---

23 ibid.

24 ibid.

25 *Submission* 15, p. 4.

26 *Submission* 9, Department of the Treasury, pp. 1-2.

at 47%. Therefore, the current tax rate applicable under section 27CAA is no higher than the rate that applies to *resident* non-complying superannuation funds. That is, had the amount been earned within a *resident* non-complying superannuation fund the amount would be taxed at 47%, the same rate as the highest personal marginal tax rate that commonly applies under section 27CAA (ignoring the Medicare levy). The Committee also notes that, where the growth amount is relatively small, and the taxpayer is not otherwise a high-income earner, a lower rate of tax may apply under section 27CAA than if the amount had been earned in a resident non-complying superannuation fund.

3.29 The Committee also notes that, while an overseas entity may have many of the characteristics of a complying fund, it may be difficult to justify why earnings from such a source should be treated differently from earnings from any other non-complying source. If concessional tax treatment is suggested on the basis that the amount will go to a complying superannuation fund, the same argument could apply to earnings from all sources, not just overseas superannuation funds. Specifically, if the earnings of an overseas non-complying fund are to receive concessional treatment, there may be a presumption that the same should apply to resident non-complying funds. However, the Committee considers that such a move may weaken the current distinction between complying funds which forms the basis of superannuation regulation in Australia.

3.30 In addition, the Committee notes that if a resident's earnings from an overseas fund were granted concessional treatment, the question of whether the overseas fund must meet certain criteria to ensure that it is a genuine superannuation fund may need to be addressed. If concessions were available to all overseas bodies which call themselves superannuation funds opportunities for tax avoidance may arise.

3.31 As noted above, section 27CAA applies to payments of foreign superannuation generally. This includes direct payments as well as transfers to Australian superannuation funds. The Committee considers that where the payment is made to an individual resident *directly* it would be inappropriate for an individual to be taxed at the concessional rate of 15% that applies to the earnings of an Australian complying superannuation fund, in which benefits are preserved for a member's retirement.

3.32 However, the Committee considers there to be merit in the suggestion that a *transfer* to an Australian complying superannuation fund should be taxed at a rate comparable to the earnings of such a fund generally. A number of the problems addressed throughout this report would be lessened if this lower rate of tax applied to an individual. However, those concerns would be further minimised if the sum was assessed to the superannuation fund which received the transfer on behalf of the individual. In particular, the difficulty that arises due to the preservation of the transferred amount (as discussed below) would be more easily addressed if the tax were imposed on the fund which accepted the transfer.

Recommendation 2

3.33 The Committee recommends that when a lump sum is *transferred* from a non-resident non-complying superannuation fund to an Australian complying superannuation fund, the amount that is calculated under section 27CAA should be included in the Australian fund's assessable income as a taxable contribution. In this way, that amount should not be included in the assessable income of the individual resident for whom it is transferred.

3.34 The Committee believes that this change will not come at the expense of the Commonwealth's revenue. It expects that consequential increases in the number of transfers should offset this reduction in the tax rate, as more migrants are encouraged to transfer their superannuation rather than to leave it in their country of origin. That is, by removing disincentives imposed by the current arrangements, more transfers will be subject to tax, albeit at a lower rate. In addition, the Committee's further recommendations to address other inequities in the law and the lack of awareness of the law should ensure that compliance is improved to the extent that this package of recommendations is broadly revenue-neutral.

3.35 Where a lump sum is paid *directly* to an individual resident from a non-resident fund (rather than being *transferred* to an Australian fund) the Committee considers that the amount should continue to be assessable as income of the individual, and subject to the normal marginal tax rates. However, the Committee believes that certain features of the current arrangements need to be addressed to ensure the fair and equitable taxing of a lump sum paid directly to an Australian resident. The remainder of this Chapter outlines those issues and the Committee's view as to how they should be remedied.

3.36 The Committee acknowledges the arguments that can be made in support of the current arrangements, which also tax a transferred amount as the income of the individual resident taxpayer. If the Government were not to accept Recommendation 2 (to tax a transferred amount as a taxable contribution) then the remainder of this Chapter would apply to transferred amounts, in addition to amounts that are paid directly to an individual.

3.37 Of particular concern to the Committee is the inequity that can arise when the assessable growth, which has accumulated over several years, pushes an individual into the highest marginal tax rate. To address this inequity, the Committee supports amendments to ensure the averaging of income. This would recognise the fact that, although the lump sum is paid in a particular year, the growth component has normally accrued over a longer period and it would be unreasonable to tax the gain at the higher marginal tax rate which the taxpayer may be pushed into due only to the derivation of the gain. The averaging that applied to net capital gains derived by individuals on or before 21 September 1999 provides a useful precedent for the implementation of this sort of approach.

3.38 Broadly, averaging could be achieved by determining the amount of tax that would be payable if only one fifth of the income assessable under section 27CAA

were included in taxable income and multiplying that amount by five. The result would be the total tax payable under section 27CAA.

3.39 By averaging the income received from a foreign superannuation fund in this way, the taxable income of an individual in the year they receive the payment will be reduced. This will mitigate the effects of the amount being characterised as income. Specifically, as taxable income will be reduced in the year the payment is made, the consequences for the taxpayer of the Medicare levy surcharge, the superannuation contributions surcharge, and the range of income-tested government benefits will be lessened.

Recommendation 3

3.40 The Committee recommends that the tax law be amended to average the income assessed under section 27CAA along the lines of the averaging that applied to net capital gains derived by individuals on or before 21 September 1999. That is, amend the tax law so that the total tax payable under section 27CAA would be fives times the tax payable if only one fifth of the income assessable under section 27CAA were included in taxable income.

3.41 As noted above, this recommendation will apply only to lump sums paid directly to individual residents if recommendation 2 (to tax lump sums transferred as income of the Australian fund) is accepted. On the other hand, if recommendation 2 is not accepted this recommendation will apply to lump sums either transferred or paid directly.

Inability to meet the tax liability

3.42 The evidence presented to the Committee suggested that an overwhelming majority of transfers of superannuation entitlements come from the UK.[27] Generally, the UK requirement that a transfer be made to an Australian fund that is subject to the Australian preservation rules means that a member will be unable to access the transferred amount to meet the tax liability. This is not a direct result of section 27CAA, rather it is a consequence of its interaction with other Australian and UK rules, as outlined in the Treasury's submission:

> The ITAA36 does not require a lump sum payment from an overseas superannuation fund to be treated as superannuation or preserved in an Australian superannuation account until retirement, it only provides for the taxation of these payments. The concerns above specifically relate to transfers from United Kingdom (UK) pension schemes and not the operation of section 27CAA more generally. [28]

3.43 In brief, the Committee was advised that the UK law requires a transfer to go directly from the UK scheme administrator to the Australian fund trustee and

27 For instance, see *Submission* 17, Unisuper, p. 2.

28 *Submission* 9, Department of the Treasury, p. 2.

precludes the retention of any part of the transfer to meet the section 27CAA income tax liability:

> The UK authorities require that the full transfer amount be paid directly to a scheme which is recognised as a pension scheme by the relevant tax or supervisory authority in the country in which the transferee is residing.[29]

3.44 From 1 July 1999 the *Superannuation Industry (Supervision) Act 1993* has required the preservation of all contributions to Australian resident complying superannuation funds. As the payment from an overseas fund to an Australian fund is formally treated as a contribution, not as a transfer, the whole of the benefit is preserved within the Australian fund until a condition of release is met. The effect of this treatment is that an individual is prevented from accessing the income (that is the subject of the tax) to meet the tax liability. The Treasury explained this to the Committee:

> Taxpayers who have transferred a pension benefit from the UK to Australia generally will be prevented from meeting any tax liability from the transferred benefit. This is because once the amount is transferred to the trustee of a regulated Australian superannuation fund it is subject to the preservation rules. The preservation rules will prevent any of the benefit being withdrawn to pay the tax liability unless a condition of release has been satisfied.[30]

3.45 Submissions likened this situation to taxing the individual on an unrealised capital gain.[31] Capital gains are most commonly taxed on the disposal of an asset, and so are taxed only when realised. The tax law does not generally tax unrealised gains as to do so means the taxpayer will be unable to meet the tax liability from the notional gain, and so may be unable to meet the liability at all. However, there are various exceptions to this principle in the tax law. Most notably, the FIF regime taxes accrued, but unrealised, gains which have a foreign source. The Treasury explained that the FIF regime is the alternative to section 27CAA.[32] Indeed, section 27CAA is seen as a concession to the full accruals taxation of the FIF regime, which would otherwise tax an increase in value of a foreign asset regardless of whether or not a payment was received from that asset.[33]

3.46 According to ASFA, the effect of the preservation is particularly significant for individuals who have been tax residents for a number of years before the transfer is made, and so have a large growth component assessed as income.[34] The Committee

---

29 *Submission* 9, Department of the Treasury, p. 2.

30 ibid.

31 For instance, see *Submission* 12, ASFA, p. 3.

32 *Submission* 9, Department of the Treasury, p. 1.

33 R Cicchini, *Committee Hansard*, 17 May 2002, p. 2.

34 *Submission* 12, ASFA, p. 3.

heard that many taxpayers in this position would have to borrow substantially to meet such liabilities.[35] Furthermore, the Committee notes that the interest expenses for borrowing money to finance a tax debt would not be deductible.[36]

3.47 The Committee heard that these factors were undermining the general policy objective of section 27CAA, which is to promote the transfer of foreign superannuation into Australia. In this respect, the objective of section 27CAA competes with the objective of the preservation rules, which is to save Australian superannuation entitlements for the benefit of a member in their retirement. Mr Simon Edwards, of AMP, discussed the balance between these objectives at the Sydney hearing:

> One objective is to encourage people to take in superannuation funds and preserve them to retirement. In fact, that is the public policy objective overall. Under the current regime, our experience is that requiring people to make payment of their tax liability in that circumstance, from funds other than the transferred funds, is a significant detriment to actually transferring the funds in the first place. So we are not achieving the public policy objective.[37]

3.48 Addressing these concerns the Committee received many submissions proposing that the preservation rules should be relaxed to allow the release of so much of the transferred amount as was required to meet the tax liability.[38]

3.49 Earlier this year the former Senate Select Committee on Superannuation and Financial Services examined the preservation rules applying to Australian superannuation. In its report *Early Access to Superannuation Benefits,* that Committee considered whether the grounds for release of superannuation before retirement were adequate. It reported that:

> …the aim of superannuation is to provide for income during retirement, as an alternative to, or supplementary to, government income support through the age pension or other benefit. As such, the current law seeks to ensure that members are not able to access either their own superannuation contributions or the contributions made by their employers until they have reached the preservation age and have permanently retired from the workforce.
>
> The current exceptions that allow for early release in limited circumstances thus represent a compromise between prohibiting any access to benefits

---

35 *Submission* 27, Institute of Actuaries of Australia, p. 2.

36 Paragraph 25-5(2)(c) of the ITAA 1997.

37 *Committee Hansard*, 17 May 2002, p. 43.

38 For instance, see *Submissions* 2, 5, 7, 10-12, 14-16, 19, 20 and 22-24.

> before a person's preservation age, and abandoning the principle of preservation of benefits until retirement.[39]

3.50 In that report the former Committee recommended that the Government consider extending the criteria that govern early access to superannuation.[40]

3.51 In this inquiry, the current Committee has received submissions and heard evidence seeking the further compromise of the preservation rules. These views were represented by Mr Edwards, who spoke to the Committee of the importance of this change to achieve a more appropriate balance between the objectives of promoting transfer and ensuring preservation:

> …we believe that we should have a public policy objective to get the money into Australia, and we believe that allowing people to make the tax payment from the funds transferred would encourage them to make the transfer in the first place. That said, we think it is a worthwhile objective, and we do not think that it so sufficiently compromises the early release arrangements as to not do it.[41]

3.52 Most submissions supported the view that early release should be allowed in these circumstances. While some submissions favoured the individual taxpayer having direct access to the amount in order to pay the tax liability the majority supported the fund being able to release that part of the amount to pay the member's tax debt.

3.53 The Committee heard that a precedent exists in the current law for relaxing the preservation rules to allow a fund to pay a surcharge liability of an individual fund member.[42] Where the surcharge applies, it is generally payable by the fund, which normally reduces the member's entitlement accordingly.

3.54 CPA Australia suggested a mechanism that would allow the fund to meet the tax liability:

> The mechanism to allow the liability for the tax payable to be passed to the fund could be similar to section 275 ITAA 1936, requiring consent from the relevant superannuation fund. It would assist in ensuring that superannuation funds only accepted these liabilities if they were permitted to do so by the transferring foreign fund, and would also enable superannuation funds to develop other policies as to the extent to which they would accept these liabilities.[43]

---

39 Senate Select Committee on Superannuation and Financial Services, *Early Access to Superannuation Benefits,* January 2002, paragraphs 2.27 and 2.28.

40 Senate Select Committee on Superannuation and Financial Services, *Early Access to Superannuation Benefits,* January 2002, Recommendation 7 (paragraph 4.41).

41 *Committee Hansard*, 17 May 2002, p. 43.

42 *Submission* 20, Mercer Human Resource Consulting, p. 3.

43 *Submission* 24, p. 8.

3.55 Alternatively, CPA Australia suggested a mechanism that would allow the individual to meet the tax liability:

> The mechanism to permit the member to access his or her superannuation benefits to fund the tax payable could be achieved by amending regulation 6.19A(1) of the SIS Regulations by adding to the list of grounds for the making of a payment to include the payment of tax levied pursuant to section 27CAA of ITAA 1936.[44]

Committee view—preservation rules

3.56 The Committee is mindful of the importance of the preservation of superannuation to support retirement incomes. However, as the former Senate Select Committee on Superannuation and Financial Services found, there are certain circumstances in which it would be inequitable to strictly adhere to the principle that superannuation should be accessed only at the time of retirement.

3.57 The Committee finds that the general objective of superannuation, which is to support the retirement income of Australians, would be better served by allowing limited early access to the superannuation benefits. This concession would alleviate the hardship that can arise under the current rules when a taxpayer may be forced to borrow funds to pay a tax debt. In this way, more transfers of foreign superannuation are likely to be completed, to the benefit of those who transfer their entitlements, the Australian economy and community at large.

3.58 Accordingly the Committee recommends that the preservation rules be relaxed in order to allow so much of the transferred amount to be released as to meet a tax liability arising under section 27CAA.

Recommendation 4

3.59 If recommendation 2 is accepted by Government, the Committee recommends that a superannuation fund be permitted to release so much of the superannuation entitlement as is needed to meet the section 27CAA tax liability when that tax is levied, similar to some superannuation contributions surcharge arrangements.

3.60 In the view of the Committee, an advantage of this approach is that it may satisfy the transfer conditions that are commonly imposed by the foreign transferring fund. In other words, a foreign fund which requires the preservation of a transferred sum may be more likely satisfied if it is the Australian fund, rather than the Australian member, who is meeting the tax liability out of the transferred sum.

3.61 If the Government accepts Recommendation 4 the Committee suggests it consider CPA Australia's proposal that a mechanism along the lines of section 275 of the ITAA 1936 be used.

---

44 ibid.

Recommendation 5

3.62 If Recommendation 2 is *not* accepted by Government, the Committee recommends that an individual be permitted to access so much of the superannuation entitlement as is needed to meet the section 27CAA tax liability when that tax is levied.

3.63 If the Government accepts Recommendation 5, the Committee suggests it consider CPA Australia's proposal of amending regulation 6.19A(1) of the SIS Regulations by adding to the list of grounds for the making of a payment to include the payment of tax levied pursuant to section 27CAA of ITAA 1936.

3.64 The Committee does not consider that this concession should be seen as a precedent for the early access to superannuation for other tax liabilities or other debts. The present case is exceptional as the tax liability arises in respect of the transferred amount itself. That is, the tax liability arises only by virtue of the transferred sum and so it is appropriate that a taxpayer have access to that sum in order to meet the liability. In this way, the liability under section 27CAA is much like a liability for the superannuation contributions surcharge, for which there is an existing relaxation of the preservation rules.

3.65 In contrast, the Committee considers that it would remain inappropriate for any general exception to the preservation rules to be allowed for other debts that bear no direct relationship to the superannuation assets of the individual.

When should any change have effect?

3.66 The Committee asked several witnesses for their view as to when any change to the legislation should take effect. In particular, the Committee was interested to know whether any change should be recommended retrospectively, to 1 July 1994 (the commencement date of section 27CAA).

3.67 ASFA suggested that the amendments (to reduce the tax rate to 15%) operate prospectively.[45] Therefore, it considered that any change should operate from the year of income in which the Government announced the change. ASFA noted that taxation rates are generally amended prospectively.

3.68 In considering whether the changes should be retrospective ASFA also noted that before 1 July 1999 members had access to the transferred money and so the inability to pay tax under section 27CAA would not have been an issue. Following the commencement of the new rules, members would again be able to access undeducted contributions to meet the tax liability on the transferred amounts. However, AFSA acknowledged that the new rules would provide no relief for individuals who transferred benefits between 1 July 1999 and the date of operation of the new rules and who borrowed money to meet the tax liability. However, it suggested that the new

---

45 *Submission* 38, p. 2.

rule could apply retrospectively from 1 July 2001, the start of the current income tax year. This would minimise the number falling in this group.[46]

3.69 ASFA told the Committee that it would not favour any approach that tried to compensate (through the release of undeducted contributions) individuals who completed transfers between 1 July 1999 and the date of operation of the new rules as it would prove cumbersome, difficult to legislate and administer, and provide a limited assistance to only a few individuals.[47]

3.70 ASFA also expressed its strong opposition to any call to differentiate between gains accrued before the date of effect of any legislative change and gains accrued after that date for the purpose of taxing those gains at different rates.[48]

3.71 In contrast to the AFSA views, Mr Phillip Whiteley suggested that the changes should apply retrospectively so that individuals who transferred superannuation prior to the changes are placed in the same position as those whose will transfer lump sums after the changes. He suggested that individuals who have been taxed under section 27CAA should have tax refunded and paid into their superannuation fund.[49]

Committee view—when any change should have effect

3.72 The Committee is conscious of the fact that taxpayers who have already transferred their foreign superannuation, and have been taxed under the current terms of section 27CAA, will not be assisted by any changes that are made prospectively. However, the Committee is concerned that any retrospective changes would create further complexity in the law, and may cause further problems in this area.

3.73 Therefore, with an overarching view to improve the treatment of taxpayers who will transfer their entitlements in the future, the Committee considers that section 27CAA should be amended so that the changes proposed in Recommendation 2 (that funds be liable for the tax on transfers), Recommendation 3 (that the tax on individuals be averaged), and Recommendations 4 and 5 (relaxation of the preservation rules) apply prospectively, from the date of commencement of any legislative change.

46 ibid.

47 ibid.

48 ibid.

49 *Submission* 16, p. 5.

Recommendation 6

3.74 The Committee recommends that the changes proposed by Recommendation 2 (that funds be liable for the tax on transfers), Recommendation 3 (that the tax on individuals be averaged), and Recommendations 4 and 5 (relaxation of the preservation rules) apply prospectively, from the date of commencement of any legislative change.

3.75 The Committee considers that there should be no differentiation between gains accrued before and after the date on which these changes are made. That is, when any lump sum is paid after these recommendations are implemented, the growth that accrued on that lump sum before the date of the change should be treated the same as any growth that accrued after the change.

Interaction with Foreign Investment Fund (FIF) regime

Exemption of foreign personal superannuation funds

3.76 Under the FIF regime earnings by an Australian resident on overseas investments are taxed on an accrual basis, even if no payment is actually received by the resident taxpayer. Currently, employer-sponsored superannuation arrangements are exempt from the FIF regime.[50] In contrast, there is no similar exemption for benefits in an overseas personal superannuation fund or any other fund that is not maintained by an employer. Instead there is a four-year exemption that exists for holders of a temporary visa.[51]

3.77 The Committee heard that personal funds are currently being encouraged in the UK following changes in legislation.[52] Such funds have also gained popularity in other countries, including Australia (as master-trusts) in recent years.[53] In light of this trend, several submissions proposed that the FIF legislation be amended to widen the exemption to all foreign superannuation arrangements, both employer-sponsored and personal superannuation arrangements.[54]

Committee view—exemption of foreign personal superannuation funds

3.78 The Committee notes that the current four-year exemption for temporary visa holders only assists temporary residents, and so would not exempt from the FIF regime permanent residents who have foreign personal pension plans. However, it was submitted throughout the course of the inquiry that it was the application of Australian taxation during a time when an individual was no more than a temporary resident that

50 Section 519 of the ITAA 1936.

51 Section 517 of the ITAA 1936.

52 *Submission* 20, Mercer Human Resource Consulting, p. 7.

53 *Submission* 16, P Whiteley, p. 5.

54 For instance see *Submissions* 16, 20 and 23.

was most problematic. Therefore, the Committee is not persuaded that the current FIF exemption should be extended to personal superannuation arrangements.

Double taxation

3.79 Numerous submissions suggested that there was a potential for double taxation of a sum under both the FIF regime and section 27CAA.[55] However, in response to questions from the Committee no witnesses were able to provide evidence of any actual cases in which taxation had been levied twice on superannuation entitlements that had been transferred.

3.80 The Treasury gave evidence that section 27CAA is an alternative to applying the FIF regime, and so double taxation was not possible.[56] Other submissions suggested that there is, at least, a degree of uncertainty as to the boundary between section 27CAA and the FIF regime.[57] The majority of submissions suggested that this interaction be clarified.[58]

3.81 The technical issue was well described by Mrs Elizabeth Goddard in her submission on behalf of the Corporate Super Association. Mrs Goddard advised the Committee that:

> Subsection 23AK(1) exempts from income tax *payments made to* a resident taxpayer (other than a partnership or taxpayer in the capacity of trustee of a trust) out of attributed foreign investment fund ('FIF') income. The exemptions under section 23AK include payments referred to in paragraph 603(1)(h), which refers to amounts assessable under Subdivision AA of Division 2 of Part III of the ITAA 1936 (which includes section 27CAA). One technical difficulty which arises is that in cases of fund-to-fund transfers the amounts are not paid to the taxpayer, as required by s 23AK(1)(a)(i), and therefore, in strict terms, the exemption is unavailable.
>
> Given that any interest in an overseas superannuation or retirement fund which is not maintained by an employer is potentially a FIF interest, it can be expected that any substantial interest in a public offer type fund overseas will result in income attribution under the FIF provisions. In strict terms, when a transfer is subsequently made in respect of the member to an Australian fund, an amount is potentially assessable to the member in respect of the transfer without any exemption being available in respect of the attributed income under section 23AK. It is suggested that section 23AK be amended to allow for exemption of amounts referred to under section 603(1)(h) paid *in respect of* rather than *to* a taxpayer.[59]

---

55 For instance, see *Submissions* 13, 24 and 28.

56 R Cicchini, *Committee Hansard*, 17 May 2002, p. 2.

57 For instance, see *Submission* 24, CPA Australia, pp. 6-7.

58 For instance, see *Submission* 28, Taxation Institute of Australia, p. 2.

59 *Submission* 40, p. 5.

Committee view—double taxation

3.82 The Committee agrees with the technical analysis of Ms Goddard and considers that an amendment to the law may be necessary to ensure that double taxation cannot arise. The Committee notes that section 27CAA applies to a payment made 'in relation to a taxpayer' and so it considers that section 23AK should be amended to exempt amounts paid 'in relation to a taxpayer' rather than just 'to a taxpayer'.

Recommendation 7

3.83 The Committee recommends that, to prevent double taxation, section 23AK of the ITAA 1936 be amended to allow for the exemption of amounts referred to under paragraph 603(1)(h) paid 'in relation to a taxpayer' rather than 'to a taxpayer'.

3.84 In the interim, before any legislative change may be implemented, the Committee considers that the Commissioner of Taxation should provide comfort to taxpayers that taxation will not be imposed twice. The certainty added by a public ruling or determination would remove the current confusion and would assist taxpayers and their advisers to comply with the obligations under the law.

Recommendation 8

3.85 The Committee recommends that as an interim measure, the Commissioner of Taxation issue a ruling or determination to clarify that a liability for tax under section 27CAA will be reduced by any tax raised under the Foreign Investment Fund (FIF) regime and so double taxation will not be imposed.

Chapter 4
What is the taxable amount?

4.1 Once the important issue as to who pays the tax has been addressed, the next question that arises is what is the amount that is to be taxed. This chapter addresses this question. In particular, it focuses on the concerns that were presented to the Committee as to:

- when a payment is exempt from tax—how the six-month exemption period operates; and
- when a payment is *not* exempt from tax—how the taxable growth in a lump sum that is paid from a foreign superannuation fund is calculated.

Exempt payments–six-month exemption period

4.2 Section 27CAA does not apply to payments made from an 'exempt non-resident foreign termination payment'. Subsection 27A(1) defines this as a payment made within six months after the taxpayer became a resident of Australia for tax purposes. This means that there is a six-month period in which the transfer can be made tax-free.

Exemption period is too short

4.3 The submissions to the Committee repeatedly asserted that the six-month exemption period is insufficient to have any practical effect. For instance, the Committee heard of transfers taking between 12 and 18 months to complete, even when they are from a foreign fund that commonly deals with transfers to Australia.[1] Mr Phillip Whiteley advised the Committee that:

> The benefit to be achieved from this concession is small. In 90% of cases it is not possible to achieve a transfer within this time period, even if the client is dealt with before they arrive to take up residency, as many transfers take up to 18 months or longer to complete.[2]

Addressing the causes of delay

Delays caused by bureaucracy

4.4 The Committee heard that transfers may be delayed, or fail to proceed at all, because of the inability of Australian funds to provide the exact information required by the internal bureaucracy of UK pension funds.[3]

---

1 D McCormack, *Committee Hansard,* 17 May 2002, p. 33.

2 *Submission* 16, p. 4.

3 *Submission* 35, R J Aitken, p. 1.

4.5 Until recently, the UK authorities required the fund receiving superannuation transfers to meet certain minimum conditions. In particular, there was a general restriction that benefits held in a UK 'pension benefit only' fund could only be transferred to a foreign fund with a similar restriction. That is, a fund in which there was no provision to pay a lump sum benefit to a retiree, and instead that would only pay benefits as a pension on retirement. Several submissions cited this strict requirement as the reason they had not transferred their UK entitlements to Australia earlier.[4]

4.6 However, the Committee notes that the UK's Inland Revenue no longer applies this restriction. From January 2001, the Inland Revenue will generally accept whatever form the benefits are paid out by an Australian superannuation fund so long as:

- individuals have genuinely left the UK to live, work and retire in Australia;
- the transfers themselves are genuine;
- the Australian fund has been recognised as a pension scheme by APRA or the ATO; and
- the Australian fund is able to accept the transfer.[5]

4.7 Nevertheless, the Committee was advised that the rules of some individual foreign funds may still require guaranteed preservation and minimum pensions before they will permit transfer.[6] In these cases delays may occur while trying to satisfy the foreign fund that its rules for transfer have been met.

Delays caused by differences in terminology

4.8 The Australian superannuation system and the rules that govern it are complex. However, other jurisdictions with mature superannuation systems, such as the UK, are marked by similar complexity. So, it should be of no surprise that even greater complexity is encountered when dealing at the interface of the Australian and UK systems. This point was well made by Mr John Ciacciarelli of the AMP who stated that:

> Even trying to explain it to, for example, an AMP colleague who works in the UK, it looks like I am coming from Mars.[7]

4.9 His colleague, Ms Tracey Burt, observed that the terminology used in the UK pension system is similarly impenetrable.

---

4 For instance, *Submission* 3, A J Walsh, p. 1.

5 UK Inland Revenue, *Personal Pension Schemes Guidance Notes, IR76 (2000)* and *Occupational Pension Schemes Practice Notes, IR12 (2001).*

6 N Kelleher, *Committee Hansard,* 22 May 2002, p. 102.

7 *Committee Hansard*, 17 May 2002, p. 39.

> I suppose what I am getting at is that they talk a different language, even though it is supposedly fundamentally English.[8]

4.10 In response to this difficulty, a number of witnesses suggested that an international protocol, using agreed terminology, would greatly assist transfers and ease delays. It was submitted that this would aid understanding and ensure that UK funds could have confidence that the transfer was going to an approved Australian fund that conformed to their requirements. For instance Unisuper suggested to the Committee that:

> …APRA undertake a program to increase the awareness of non-resident funds of the prudential regulation and operative standards of Australian funds. APRA could assist Australian and non-resident funds in developing a transfer protocol that meets the requirements of the countries where the majority of non-resident fund transfers originate.
>
> APRA could also provide a service to non-resident funds whereby they will confirm the complying status of the Australian fund in a manner that satisfies their requirements.[9]

4.11 The suggestion was that the Australian and UK regulators develop this protocol, in consultation with industry representatives. Accordingly, the Committee sought the advice of the Australian Prudential Regulation Authority (APRA), the prudential regulator of superannuation funds,[10] which advised the Committee that:

> …there would be value in exchanging information with the relevant regulators about the Australian requirements in order to clarify local terminology, so that they in turn could clarify the process to be followed by their funds in responding to the transfer requests. Given the policy, tax and prudential and tax issues involved, we would be pleased to work with Treasury and the ATO in facilitating such an exchange. We believe this is best done through an exchange of correspondence rather than formal protocols, so that future changes to the underlying requirements could be more easily accommodated.[11]

Committee view—addressing the causes of delay

4.12 The Committee considers that the establishment of international protocols for the transfer of superannuation would improve the timeliness in which superannuation entitlements can be transferred. Therefore, the Committee considers that Australian and foreign regulators should, in consultation with the superannuation industry, develop and put in place protocols to facilitate the transfer of superannuation. The protocol should articulate a process for each party to follow in order to complete a

---

8 *Committee Hansard*, 17 May 2002, p. 38.

9 *Submission* 17, p. 4.

10 Other than small self-managed funds, which are regulated by the ATO.

11 *Submission* 36, p. 1.

transfer. Importantly, it should direct superannuation funds and their members to the relevant authorities in each jurisdiction.

4.13 The protocol should also provide guidance on matters such as the regulatory framework that applies to Australian complying superannuation funds. This should assist foreign funds to understand and be satisfied that minimum conditions, such as preservation requirements, are met in the Australian system.

4.14 As noted throughout this report, the Committee has found that this issue is most relevant to the transfer of superannuation from the UK to Australia. Therefore, the Committee suggests that as a matter of priority APRA, the ATO and the Treasury develop a protocol with the UK, which will facilitate the efficient transfer of superannuation between the countries.

Recommendation 9

4.15 The Committee recommends that APRA, the ATO and the Treasury (in consultation with the superannuation industry) develop with their foreign counterparts bilateral protocols for the transfer of superannuation between the countries. In particular, priority should be given to developing a protocol with the UK.

How long is enough?

4.16 The Committee received a range of suggestions as to how long the exemption period should be. While Montfort International suggested that the period should be extended from six months to 10 years, the majority of submissions proposed that the exemption period be extended to two years.[12]

4.17 Dr Michaela Anderson, of Association of Superannuation funds of Australia (ASFA), explained to the Committee that the suggestion for a two-year exemption period was based on practical knowledge of the time taken to transfer superannuation from overseas.[13]

4.18 Mr Anthony Gribben also explained why he considered the extension to two years was warranted:

> That is based on my personal experience dealing with UK pensions. Maybe you would consider two years too generous, but six months is certainly too short. You also have to think about the fact that when people migrate to a country they have many more things to worry about than bringing their superannuation fund with them, especially if they have a family or something.[14]

12 For instance, see *Submissions* 12-14, 21, 24 and 25.

13 *Committee Hansard*, 22 May 2002, p. 93.

14 *Committee Hansard*, 22 May 2002, p. 70.

4.19 Mr Phillip Whiteley explained that two years would be a sufficient period in which to complete the majority of transfers, but that some would inevitably be unable to meet even this timeframe.

> I think it [a two-year exemption period] might not be sufficient in a limited number of cases. In the majority of cases I have managed to get in within 18 months. There have been a couple that have dragged out over that…[15]

Committee view—length of exemption period

4.20 The Committee notes that the purpose of the limited period in which a tax-free transfer can be made is to encourage the prompt transfer of superannuation funds from overseas. However, the Committee considers that the current six-month window is insufficient to serve that purpose. Indeed, the Committee accepts the considerable evidence that suggests the current arrangements are actually discouraging transfers. Evidence presented to the Committee suggested that only a very small proportion of transfers actually undertaken have been completed within six months.

4.21 The Committee believes that the six month exemption period is too restrictive to offer any practical incentive for the completion of most transfers. The Committee considers that an exemption period of two years should apply under section 27CAA. The Committee considers that this would be a more appropriate time in which to expect transfers to be completed.

Recommendation 10

4.22 The Committee recommends that the period in which the payment of a lump-sum from a foreign superannuation fund is exempt from tax under section 27CAA be extended from six months to two years.

Exemption period too inflexible

4.23 The Committee was also advised that there was no flexibility in this aspect of the law.[16] The six-month period is imposed strictly by the legislation and there is no opportunity for an extension when delays (such as those outlined above) are experienced.

4.24 The Committee heard that though an individual may initiate the transfer of their funds to Australia before they left their home country they may still be unable to complete the transfer within the six-month period because of delays in the transfer process. In this way, the Committee heard that many migrants are being denied the opportunity to transfer their superannuation tax-free through no fault of their own.

4.25 Mr Trevor Thomas of the ATO acknowledged these concerns, though he noted that:

---

15 *Committee Hansard*, 22 May 2002, p. 140.

16 For instance, see *Submission* 29, Taxation Institute of Australia, p. 1.

> …the law is the law and there is no flexibility built into the law. I think it is something that is undoubtedly a practical problem in some cases, and we have certainly had it drawn to our attention.[17]

4.26 To address this problem several witnesses suggested that the Commissioner of Taxation should be granted a discretion to extend the exemption period where a transfer was initiated within that period, but was not completed due to delays which were beyond their control.[18]

Committee view—flexibility of the exemption period

4.27 The Committee notes the inflexibility of the current exemption period. The Committee considers that an extension of the tax-free transfer period should be granted when a taxpayer can demonstrate that they have initiated the transfer within that period, but the completion of that transfer has been delayed through no fault of that taxpayer.

Recommendation 11

4.28 The Committee recommends that the law be amended to give the Commissioner of Taxation the discretion to further extend the period for a tax-free transfer in instances where the member has taken reasonable steps to have the benefits transferred and has suffered undue delays which were beyond their control.

4.29 If the Government chooses to implement this recommendation, the Committee also suggests that the Commissioner should issue guidelines as to the circumstances in which the discretion will be exercised in a taxpayer's favour.

Exemption period begins too early

4.30 Subsection 27A(1) of the ITAA 1936 defines an 'exempt non-resident foreign termination payment' as one made 'within six months after the taxpayer became a resident of Australia'. Importantly, the definition of an 'Australian resident' for the purposes of the tax law is considerably broader than the concept of a 'permanent resident' for the purposes of immigration law.

4.31 The Committee heard that a consequence of this difference is that an individual will often become a tax resident prior to becoming, or without necessarily becoming, a permanent resident.[19]

4.32 In addition, the tax laws may treat a person as becoming a resident from the date they arrived in Australia, rather than the later time at which the residence is

---

17 *Committee Hansard,* 17 May 2002, p. 4

18 For instance, D McCormack, *Committee Hansard,* 17 May 2002, p. 28.

19 *Submission* 16, P Whiteley, p. 4.

actually established.[20] For instance, the tax law provides that an individual may become a tax resident by spending more than half an income year in Australia.[21] Once satisfied, this test will treat the individual as a tax resident from the date of arrival not the time when the test is actually satisfied. Therefore in these circumstances, the six-month period for a tax-free transfer will have elapsed as soon as tax residency is established. Mr Andrew Skinner of the Taxation Institute of Australia advised the Committee that:

> The thing with tax residence is that it tends to be somewhat retrospective. If you come to Australia and you end up spending 183 days here in a year you then become a tax resident from the date that you arrived and took up occupancy.[22]

4.33 The following example illustrates this point:

> **Example**
>
> Leo came to Australia from the UK on a temporary visa on 1 December 1998. At that time he had no definite plans to become a permanent resident and was undecided as to where he would ultimately retire. Accordingly he did not arrange for the transfer of his UK pension benefits at that time. At the end of the income year (30 June 1999) Leo had spent more than six months in Australia and so had become a resident for tax purposes. He is taken to have become a tax resident from 1 December and so the six-month period for a tax-free transfer will have already elapsed before 30 June 1999.

4.34 Other factors which may establish that an individual is a resident for tax purposes are that the individual:

- is a resident according to ordinary concepts;[23]
- is domiciled in Australia, unless that person's permanent place of abode is outside Australia;[24] or
- is a member of certain Commonwealth government superannuation schemes.[25]

4.35 Section 27A provides that the tax-free transfer period begins from the time an individual *became* a tax resident. The Committee heard that this six-month period is interpreted as beginning at the time an individual *first* became a tax resident.[26] This

20 Subsection 6(1) of the ITAA 1936.

21 For further detail see ATO Income Tax Ruling IT 2681.

22 *Committee Hansard*, 22 May 2002, p. 79.

23 For further detail see ATO Taxation Ruling TR 98/17.

24 For further detail see ATO Income Tax Ruling IT 2650.

25 For further detail see *AAT Case 8892* (1993) 27 ATR 1136.

26 *Submission* 20, Mercer Human Resource Consulting, p. 4.

interpretation exaggerates the difficulties caused by the fact that the period begins once *tax* residence is established, rather than *permanent* residence.

Example

In 1995 Josh's UK employer sent him to work in Australia for 7 months. Although he had no intention of permanently settling in Australia at that time he was taxed as a resident for this period.

In 2000 he returned to Australia with plans to permanently settle here. However, as Josh had previously been a tax resident, the six-month exemption period began at that earlier time. That is, the time during which he could have transferred his UK superannuation entitlements tax-free expired six months after he arrived in Australia in 1995.

4.36 The Committee heard that the nature of superannuation as a form of retirement savings means that an individual will only choose to transfer those monies when he or she intends to retire in Australia.[27] The Committee received evidence that this decision is more likely to be made when permanent residence is established rather than when tax residence begins. Accordingly, many of the submissions proposed that the period for a tax-free transfer begin at the time of permanent residence, thereby aligning the tax arrangements with the visa status of a migrant.[28] It was also suggested that this change would improve awareness of section 27CAA as:

- 'permanent residence' can be objectively determined and so creates more certainty in the law;[29] and
- 'permanent residence' creates an administrative opportunity to advise migrants of the existence of the tax-free transfer period.[30]

Committee view— when the exemption period should begin

4.37 The Committee notes the evidence that few migrants will be well placed to decide whether or not to transfer their superannuation entitlements when they first become tax residents. However, the Committee is concerned that if the exemption period were to begin after an individual was granted permanent residence then a considerable time may elapse between a migrant's arrival and the time a transfer of their superannuation is made. This result would not be consistent with the objective of section 27CAA, which is to encourage the prompt transfer of superannuation. The Committee is also concerned that any change to the law in this respect may undermine the principle that a resident should be taxable on income from all sources.

27 For instance see S Orchard, *Committee Hansard,* 17 May 2002, p. 55.

28 See for instance *Submissions* 20 and 25.

29 A Skinner, *Committee Hansard*, 22 May 2002, p. 84.

30 S Edwards, *Committee Hansard*, 17 May 2002, p. 41.

4.38 The Committee considers that Recommendation 10, to extend the exemption period to two years, provides an appropriate balance between allowing migrants sufficient time to transfer their entitlements and the general principle that a resident is taxable on income from all sources.

Calculating taxable growth

4.39 Generally, when a lump sum payment of foreign superannuation is not exempt from tax, section 27CAA includes in assessable income the amount by which it exceeds the amount worked out using the following formula:

> Accumulated entitlement + Additional contributions
>
> where:
>
> **Accumulated entitlement** is the amount properly payable (or amount vested) to the taxpayer from the fund on the day before the relevant day;
>
> **Additional contributions** is the amount of contributions that were paid by the taxpayer or the employer on or after the relevant day; and
>
> **Relevant day** is either the day on which the taxpayer became a member of the fund or the first day during the period to which the payment relates that the taxpayer became a resident of Australia, whichever is the later. [31]

4.40 Essentially it is the growth in a foreign superannuation fund that will be subject to taxation under section 27CAA. The growth is measured as the difference between the amount 'properly payable' on the 'relevant day' and the amount 'properly payable' on the date of payment, ignoring any contributions made.

4.41 Therefore, the seminal issues to the calculation of the taxable growth are:

- what is the 'relevant day'?; and
- what is the amount 'properly payable'?

What is the 'relevant day'?

4.42 Typically, when a migrant comes to Australia, the 'relevant day' is the date on which the taxpayer *first* becomes a tax resident.

4.43 Under the 'source principle' an Australian resident should be assessed on income from *all* sources, whether in or out of Australia. Non-residents are assessed only on income from Australian sources, subject to certain exceptions. The corollary of this principle is that a non-resident is not assessed on income from sources outside Australia. Accordingly, the growth in an overseas fund that is attributable to a period of non-residence should not be assessable in Australia. Only the growth that relates to the period(s) of residence should be assessable to a resident.

31 *Submission* 41, Pension Transfers Direct, pp. 35-36.

4.44 The Committee was alerted to anomalies that can arise under the definition of the 'relevant day' when there are periods of tax residence, interrupted by periods of non-residence. Mr Peter Morris submitted that:

> There is a lack of clarity of when a person becomes an Australian resident for a second or subsequent time. For example, an Australian resident moves from Australia to the UK and takes up residency there for a number of years, often in a high paying executive job by Australian standards and taking exchange rates into account. He builds up a pension fund (as there are favourable tax concessions available in the UK – tax deductible contributions and virtually tax free growth) and then at some time they return to Australia to take up Australian residency again. I understand the ATO may interpret "residency" literally and apply Section 27CAA from the date of original residency thereby capturing all the growth in the fund from day 1.[32]

4.45 The example below demonstrates that there is no mechanism in the law to apportion the growth in the foreign superannuation entitlement over periods of Australian residence and non-residence. That is, there is no means by which the total growth since a taxpayer *first* became a resident can be discounted by any growth that is attributable to a time when that taxpayer was not a resident.

---

32 *Submission* 13, pp. 1-2.

Example[33]

On 1 July 1980, Leo was a UK resident and joined a UK pension plan. On 1 July 1990 he became an Australian resident for tax purposes and stopped contributing to the fund. His accumulated entitlement then was $500,000.

For the next five years he worked in Australia before leaving and becoming a non-resident on 1 July 1995. His accumulated entitlement then was $600,000.

On 1 July 2000, he returned to Australia and became a tax resident once again. By this time, his accumulated entitlement had grown to $750,000.

On 1 July 2002, he transferred his accumulated entitlement that had continued to grow and was then worth $1 million.

Under section 27CAA, Leo's assessable income would include the difference between the amount 'properly payable' when he first became a resident ($500,000) and the amount 'properly payable' when the amount was in fact paid ($1 million). That is, Leo's assessable income would include $500,000.

However, this result ignores the fact that some of the growth was attributable to a period when he was not a resident. Specifically, the growth in the entitlement that occurs between 1 July 1995 and 1 July 2000 ($750,000 - $600,000 = $150,000) should not, as a matter of principle, be included in his assessable income. That is, his assessable income should only include the $350,000 of growth that is attributable to a period when he was a resident.

4.46 The Committee received a number of suggestions addressing this issue. Mercer Human Resource Consulting proposed that the growth should be calculated from the date that the individual *last* became a tax resident.[34] However, this approach would ignore any growth which related to an earlier period of residence. That is, in the example above the taxpayer would be assessed only on the $250,000 of growth that related to the most recent period of residence prior to the transfer. The submission noted these difficulties and suggested some supporting anti-avoidance measures.[35]

4.47 The Corporate Super Association suggested that the growth should be measured having regard to the period(s) of residence in which it accrued, instead of being calculated simply by reference to a single period starting on the 'relevant day'.[36] That is, instead of taxing all of the growth since the individual became a tax resident,

33 Based on the example given in *Submission* 29, Taxation Institute of Australia, p. 3.

34 *Submission* 20, p. 10

35 ibid.

36 *Submission* 14, p. 9.

the suggestion was to tax only the growth that related to a period, or periods, of residence.

Committee view— the 'relevant day'

4.48 The Committee is concerned that any changes to address this anomaly in the law may add further complexity to the current treatment. However, this concern must be balanced against the objective of ensuring equity in the application of these rules.

4.49 The Committee notes that the difficulties with Mercer's basic proposal mirror those of the existing law. While the current law fails to embody the 'source principle' by ignoring a period of non-residence, Mercer's proposal similarly fails by ignoring a period of residence other than the latest one. For this reason, the Committee is unable to support that approach.

4.50 The Committee is attracted by the proposal of the Corporate Super Association, which essentially apportions the total growth amount according to the periods of residence and non-residence that occur after the migrant arrives in Australia for the first time. The real strength of this approach is in its conformity with the 'source principle'. That is, it ensures that non-residents are not taxed on gains from a foreign source.

Recommendation 12

4.51 The Committee recommends that section 27CAA be amended to ensure that where an individual becomes an Australian resident, then becomes a non-resident before becoming a resident once more, the growth since an individual *first* became a resident is apportioned according to the periods of residence and non-residence that occur after that time. That is, tax should only apply to that growth in the lump sum which is attributable to a period of residence in Australia.

Retrospectivity

4.52 Many submissions to the Committee expressed concern that the growth assessed under section 27CAA may relate to a period before its commencement date (1 July 1994).[37] That is, as the growth of the fund is taxed from the time an individual *first* became an Australian resident it may apply retrospectively for anyone who had a foreign pension fund and who had taken up residence prior to 1 July 1994 (the commencement date).

4.53 It is generally accepted that laws should not be imposed retrospectively, as such changes mean that an act that was lawful when made can subsequently be deemed unlawful. This principle was described by the Taxation Review Committee in its 1975 report:

---

37 For instance, see *Submissions* 7, 13, 16, 20 and 21.

> There is a well-established, fundamental and sound principle that legislation, especially fiscal legislation, should not have a retrospective operation. That which was lawfully done should not, after the completion of the act by which it was done, be made unlawful and subjected to a penalty. There is a strong presumption against retrospectivity because it manifestly shocks one's sense of justice.[38]

4.54 Witnesses to the inquiry shared this sense of injustice, heightened by the fact that the retrospective change was not well publicised, and has potential to apply very harshly, as detailed throughout this report.[39] The following example demonstrates the retrospective operation of section 27CAA:

Example

Donna became an Australian resident on 30 June 1974, leaving her superannuation entitlements in the UK. At that time her benefits were valued at $50,000.

Over the next 20 years her entitlements enjoyed strong growth and had she chosen to transfer this amount before 1 July 1994 there would have been no Australian tax consequences for this growth. For instance, if Donna's benefits had grown in value to $75,000 by 30 June 1994 and she had transferred them at this time, she *would not* have been taxed on any of the $25,000 pre-1 July 1994 growth.

However, if she chose to transfer her entitlements to Australia on or after 1 July 1994, the growth in her benefit, since she became a resident (30 June 1974), is assessed under section 27CAA. That is, if Donna transferred her foreign superannuation benefits to Australia on 1 July 1994, when the entitlement was valued at $75,000, she *would* be assessed on the $25,000 pre-1 July 1994 growth.

In the same way, if Donna were to transfer her entitlement at any time after 1 July 1994 she would be assessed on the $25,000 pre-1 July 1994 growth, and any subsequent growth that accrued prior to the transfer.

4.55 Of the submissions that raised it as an issue, all suggested that the retrospective operation of section 27CAA should be removed. However, between the various submissions there was a range of suggestions to address this concern.

4.56 For instance, several witnesses suggested that the retrospective element of the provision should itself be amended retrospectively.[40] That is, the Committee heard that the legislation should be amended so that any growth that accrued before 1 July 1994 should never have been taxable under section 27CAA. Under this proposal, taxpayers who had transferred sums and been taxed on an element of growth that

38 *Taxation Review Committee Report* (1975), paragraph 11.48.

39 For instance, see *Submissions* 7, 13, 16, 20 and 21.

40 For instance, A Gribben, *Committee Hansard*, 22 May 2002, p. 73.

accrued from a period of residence prior to 1 July 1994 would have their past tax returns amended and would be refunded the retrospective tax.

4.57 Other witnesses found that the very notion of retrospectivity was so abhorrent that any change to the legislation itself should be strictly prospective. The Committee heard that any amendment to change the way the section has applied to transfers already completed would be complex and add significantly to the burden for those that advise on the operation of section 27CAA. For instance, Mr Andrew Skinner of the Taxation Institute of Australia advised the Committee that:

> As a tax practitioner, anything retrospective—either good or bad—is abhorrent. I suppose if it is in the taxpayer's favour it is not quite as abhorrent but the point is that as an adviser you need a situation of certainty. So if the law says this today, I want to know tomorrow, when I wake up in the morning, that it has not changed with respect to what it said yesterday—nothing fills you with greater horror.[41]

Committee view—retrospectivity

4.58 The Committee does not consider it to be appropriate for section 27CAA to continue to tax earnings that have accrued before 1 July 1994. However, the Committee suggests that any change to remove this retrospective element should itself be made prospectively. That is, the changes should have effect from a time in the future, not from a time in the past.

4.59 The Committee is conscious of the fact that taxpayers who have already transferred their foreign superannuation, and have been taxed under the current terms of section 27CAA, will not be assisted by any changes that are made prospectively. However, for the reasons set out in favour of Recommendation 6, the Committee does not support the retrospective amendment of the law. That is, the Committee's view is that the changes to remove the retrospective nature of section 27CAA should themselves be made prospectively.

4.60 Therefore, with an overarching view to improve the treatment of taxpayers who will transfer their entitlements in the future, the Committee considers that section 27CAA should be amended prospectively so that from the from the date of commencement of any legislative change it no longer has retrospective effect.

Recommendation 13

4.61 The Committee recommends that the definition of the 'relevant day' in section 27CAA be amended prospectively so that, for lump sums paid after the date of commencement of any legislative change, only growth since the later of 1 July 1994 and the date an individual became a resident is subject to tax.

---

41 *Committee Hansard,* 22 May 2002, p. 85.

What is the amount 'properly payable'?

4.62 As noted above, section 27CAA assesses the growth in the foreign superannuation entitlements of a resident when those entitlements are paid. Generally, the growth component is calculated as the difference between the amount which is properly payable on the day before the taxpayer became a resident, and the amount properly payable on the day the payment was made. The concept of 'properly payable' is therefore central to determining the amount to be assessed.

4.63 Several submissions expressed concern that this important concept was undefined in the legislation, and has not been clarified through an ATO ruling.[42] The evidence presented to the Committee suggested that the term 'properly payable' was ambiguous and that the various interpretations that may be given to the term could lead to very different tax results.

4.64 For instance, the Corporate Super Association submitted that when an amount is paid directly to a member or is transferred on their behalf, it would seem reasonable to regard the entire amount actually paid or transferred as the amount 'properly payable'.[43] Indeed, it was submitted that the trustee of a fund has a duty to all members of the fund to provide no more to one member than that to which they are entitled.[44] Nevertheless, the legislation provides that any amount paid in excess of the sum 'properly payable' will be regarded as a taxable contribution in the hands of the resident superannuation fund which receives it.[45]

4.65 However, the Committee heard that there can be no such certainty as to the amount properly payable at the earlier time, that is, the 'relevant day'. At this time there is no actual payment or transfer of an amount so there is no objective standard by which to judge the value of the amount properly payable.[46]

4.66 It was submitted that overseas funds were reluctant to calculate the amount that was properly payable at a time that had since past. The evidence indicated that this reluctance was caused by the considerable administrative costs that would be borne by the foreign fund in respect of a departing member and in relation to the Australian regulatory requirements (which that fund would otherwise have no interaction with). In particular, Dr Michaela Anderson of ASFA advised the Committee of one such case:

> One of the things that has been drawn to our attention about that is that fixing the value of the overseas benefit at that date is sometimes quite difficult. In fact, the overseas funds have on occasions refused to do it. The

---

42 For instance, see *Submission* 23, Institute of Chartered Accountants in Australia, p. 1.

43 *Submission* 14, p. 7.

44 For instance, see *Submission* 23, Institute of Chartered Accountants in Australia, p. 1.

45 Section 274(10)(c) of the ITAA 1936.

46 *Submission* 14, Corporate Super Association, p. 7.

> example that was given to me very recently was that an American fund, the Unilever fund, point-blank refused to do it for an Australian fund: they will not fix the value at a date. They will tell you the figure, but they will not go back and fix the value at the date that we require it on.[47]

4.67 When a foreign fund fails to provide information about the value of an entitlement a taxpayer faces great difficulty in complying with section 27CAA as they have no way of calculating the value of the entitlement themselves and have no way of compelling the foreign fund to provide them with such information. Commenting on this situation Mr Robert Hodge of ASFA advised that the valuation:

> …is something which is required by Australian law but they [the foreign funds] cannot be forced to provide it. That is why we would caution against going down the path of trying to determine what the accumulated benefit was before and after any given date. It is far simpler to work on a date that is known to the fund at a point in time, and that is the point when the member or the individual leaves employment and the membership in the fund is frozen.[48]

4.68 The Committee asked how an Australian fund would deal with the situation of an overseas fund refusing to provide the estimates necessary for the member to comply with section 27CAA. ASFA was able to provide these comments from an organisation that deals with the transfer of foreign superannuation:

> We have consulted the ATO for clarification on this matter (on 4 February 2002) and were informed that a reasonable effort to 'estimate' the growth amount be made on behalf of the overseas scheme. The options discussed were:
>
> - Estimate the balance based on previous account balances, statements, average rates of return etc. The estimates should be substantiated and files along with other tax records may help in this regard.
>
> - Seek actuarial assistance to perform calculations using a discount factor that is based on data as provided by the overseas scheme (ie. average rates of return, a specified defined benefit formula etc.).[49]

4.69 ASFA noted that: 'While neither approach is entirely satisfactory, at least the ATO appears prepared to offer some leeway to assist the transfer process'.[50] In contrast, Pension Transfers Direct submitted advice from the ATO which indicated that if the properly payable amount could not be determined then the entire lump sum may be taxable.[51]

---

47 *Committee Hansard,* 22 May 2002, p. 87.

48 *Committee Hansard,* 22 May 2002, p. 89.

49 *Submission* 38, p. 3.

50 *Submission* 38, p. 4.

51 *Submission* 41, p. 39.

Committee view—definition of 'properly payable'

4.70 The concept of an amount 'properly payable' is fundamental to the operation of section 27CAA. As such, the Committee regards it as essential that further guidance be given to taxpayers and their advisors.

4.71 Where a foreign fund from which an amount is transferred refuses to give information about the value of an entitlement, then the application of section 27CAA is uncertain. This uncertainty should be addressed by the ATO formally confirming its advice to Australian funds for the process of reaching an estimate of the properly payable amount. The Committee considers that the Commissioner of Taxation should issue a public ruling or determination that sets out the ATO's view of the law.

Recommendation 14

4.72 The Committee recommends that the Commissioner of Taxation issue a public ruling or determination that sets out the Australian Taxation Office's interpretation of the meaning of 'properly payable'. In particular, that ruling should address the situation where a foreign fund from which an amount is transferred refuses to give information about the value of the accumulated entitlement.

4.73 Alternatively, the Committee suggests that the Government consider amending the law to provide greater certainty as to what is a 'properly payable' amount.

Defined benefit and unfunded schemes

4.74 A further concern that arose with the 'properly payable' concept was its uncertainty in the context of defined benefit and unfunded foreign superannuation schemes. The issue is closely related to that discussed above, namely, that the growth in a foreign entitlement may relate to a period of non-residence, in which case it should not be taxable in Australia.

4.75 The Committee heard that while there is superficial appeal in measuring 'earnings' for a period of residency by comparing the value of benefits between two dates, it is important to note that there may be a number of factors that may alter the value of entitlements at different times.[52] For instance, the Corporate Super Association advised the Committee of the following circumstances that can affect the value of an entitlement:

- A defined benefit fund will commonly specify benefits in terms of most recent salary levels. Where the individual concerned has had a recent increase in salary, there will be a leap in vested benefits.
- Some funds have vesting scales with significant increases in entitlements at specified ages.
- Other factors may affect the transfer value in respect of a member (for example, a retrospective improvement in benefits from a previous fund surplus).[53]

4.76 Accordingly, the Committee received evidence that there are often circumstances where the level of accrued benefits is nominally low when a member first arrives in Australia, but then increases markedly while the member is a resident. Mr Andrew Skinner, of the Taxation Institute of Australia advised the Committee that this was a common situation in which the provision was applying:

> A lot of foreign superannuation funds are still operated as defined benefits schemes. The trend to accumulation basis or contribution basis is very strong in Australia but in America and the UK they still have a lot of defined benefits schemes which are where your benefit is expressed as a proportion of your years of service, some multiple of salary and some other factors.[54]

4.77 The result is that a relatively large proportion of the transferred entitlement is then regarded as assessable under section 27CAA. The Committee heard that while the entitlement has increased in value during the period of residence, that growth is nonetheless related to the *entire* period of membership. That is, in certain circumstances the growth that is credited during the period of residence is attributable to the entire membership, not just the period of residence in which it crystallises.

4.78 CPA Australia submitted the following example to illustrate the impact of section 27CAA in these circumstances and how the section does not recognise that part of the increase in benefits since arrival in Australia that may relate to the previous overseas service.[55]

---

52 For instance, see *Submissions* 14, 17, 24, 29 and 40.

53 *Submission* 14, p. 8.

54 *Committee Hansard*, 22 May 2002, p. 77.

55 *Submission* 24, p. 6.

> **Example**
>
> A member commenced work in the UK in 1975 and arrived in Australia in 1993. At that time the member's accrued value of entitlements totalled $60,000. Under the rules of the UK pension scheme, when the member reached 55 in 2001, the accrued value immediately jumped from $120,000 to $450,000.
>
> If the member decided to now transfer his entitlement to an Australian superannuation fund, under section 27CAA the assessable amount would be $450,000 less $60,000 less the amount of employer/member contributions since 1993. If these contributions were nil (for example, employer has been on contributions holiday due to surplus in the UK fund), this would seem to result in $390,000 being taxable.

4.79 In this way, section 27CAA fails to recognise that the increase in benefits that accrues in 1993 also relates to the period of overseas service, namely the term between 1975 and 1993. CPA Australia submitted that 'a fairer result would be to tax the share of the total fund that relates to Australian service'.[56] This approach would result in tax being payable on:

$450,000 x (8 years Australian membership)/(26 years total membership) = $138,461

4.80 Under this method, the amount to be included in assessable income would be the amount properly payable, less any contributions, discounted according to the proportion of the membership period of which the taxpayer was not an Australian resident.

Committee view—defined benefit and unfunded schemes

4.81 The Committee notes that in the case of defined benefit funds a further difficulty exists in the measurement of employer (and sometimes member) contributions in the period since arrival in Australia. In turn, this makes the calculation of the assessable growth component difficult. The same difficulties would be faced when the superannuation entitlements are held in unfunded foreign schemes.

4.82 However, the Committee also notes that these issues are not isolated to the application of section 27CAA. Indeed, the same complications are also illustrated in the rules that govern the administration of the contributions surcharge on Australian unfunded defined benefit schemes. In those cases, the absence of defined employer contributions means that the surcharge cannot be levied before a benefit is paid. Instead it is deferred through the establishment of a surcharge debt account.

4.83 Nevertheless, the Committee is attracted by the approach proposed by CPA Australia to apportion the total growth in a foreign defined benefit scheme over periods of residence and non-residence of a member. However, the Committee is

---

56 ibid.

mindful that it may be difficult to objectively determine whether a gain is properly attributable to the entire period of membership, rather than the period in which it actually accrues to the member. For this reason the Committee recommends that the Government examine this proposal in more detail to determine whether this approach would remove distortions in the calculation of the amount 'properly payable' that currently exist for members of these funds.

Recommendation 15

4.84 The Committee recommends that, where a lump sum is paid from a foreign defined benefit scheme and the amount which is properly payable cannot be determined, the Government examine the feasibility of apportioning the total growth in the scheme over periods of residence and non-residence of a member, so that a member is only taxed on that growth that is attributable to a period of residence.

Chapter 5
Lack of awareness

5.1 Australia's income tax system is characterised by self-assessment. The basic premise of the self-assessment system is that returns are not examined in detail by the ATO before assessments are issued. Instead, returns may be subject to a later audit, with penalties and interest applying to underpayments of tax. This system is supported by rulings issued by the Commissioner, which describe the ATO's view as to how the law applies in certain circumstances. A taxpayer can rely on this advice as they bind the Commissioner.

5.2 The overall effect of the self-assessment system is to increase the onus placed on the taxpayer to interpret and apply the taxation law. In this context, education, guidance, warning and advice from the ATO is crucial to support taxpayer compliance with the law.

5.3 An issue that arose during the conduct of the inquiry was the lack of awareness on the part of migrants of the tax consequences to them of bringing their superannuation entitlements to Australia. Of particular concern to the Committee is that it could reasonably be expected that this low level of awareness would translate into low levels of compliance with the law. That is, people may be in the situation that they have unwittingly triggered a tax liability for themselves and remain unaware of their obligations to report that income under the law. Mr Anthony Gribben, an individual from New South Wales, expressed this frustration to the Committee:

> I personally feel wronged in that I would have been happy to comply with the law but I did not know about it.[1]

5.4 Indeed, the Committee received anecdotal evidence from many witnesses to suggest that compliance with section 27CAA was poor.[2] Mr Gribben suggested that the level of non-compliance may be of the order of 90 per cent.[3] As noted above, the Committee was disappointed that the ATO is unable to provide any estimates of the level of compliance with section 27CAA.[4]

5.5 Although section 27CAA has operated for eight years, the ATO has not yet issued a public ruling to clarify its interpretation of the provision. However, in response to the emerging concerns of taxpayers the ATO told the Committee of its strategy to raise awareness amongst the community:

---

1 *Committee Hansard,* 22 May 2002, p. 67.

2 For instance see *Submissions* 2, 7, 13, 16, 17, 18 and 21.

3 *Submission* 21, p. 1.

4 See *Submission* 46, Australian Taxation Office, p. 1.

> We are looking at making some educational materials more widely available so people are aware of their obligations. There is a draft taxation ruling related to this subject that is being prepared at the moment. We are trying to get more information out there so that individuals are aware of the obligations which do exist under the legislation.[5]

5.6 In addition to these initiatives the Committee received a number proposals for educating and improving the awareness of those likely to be affected by section 27CAA.[6] The suggestions included:

- that the permanent visa application advise migrants of the taxation treatment of their foreign superannuation entitlements; and
- that migrants be required to disclose the foreign superannuation benefits they hold on permanent visa applications.

5.7 The first suggestion was that the permanent visa application[7] should include information to advise migrants (in some general way) of the taxation treatment applying to their foreign superannuation entitlements.[8] It was felt that a plain-English explanation of the effect of section 27CAA would give migrants notice that there was an issue that they should consider and seek further advice about.

5.8 The second proposal was that migrants should be required to disclose their foreign superannuation benefits when they decide to settle in Australia. That is, an individual would be required to register the foreign superannuation assets they hold on their permanent visa application.[9] It was thought that this would both raise awareness amongst migrants and also assist the ATO in managing the compliance with the law.

5.9 In respect of these suggestions, the Committee sought the advice of the Department of Immigration and Multicultural and Indigenous Affairs, the agency responsible for the entry and stay arrangements for non-citizens. The Department advised the Committee that migration application packs are entirely focused on the collection of information that will enable applications to be decided. Therefore, they currently contain no information on taxation or superannuation. Despite the limited objective of only collecting information to enable a decision to be made, the business skills migration pack runs to almost 70 pages and 40 pages of forms. The Department advised the Committee that:

> Not surprisingly, some of the most common criticisms of our packs relate to their size, complexity and capacity for a key element to be 'lost' in the sheer

---

5 N Murray, *Committee Hansard*, 17 May 2002, p. 6.

6 For instance, see *Submission* 16, P Whiteley, p. 6.

7 People wishing to live permanently in Australia must apply for, and be granted, a permanent visa. If they apply outside Australia, they are applying to migrate. If they apply in Australia, they are applying for permanent residence.

8 *Submission* 18, R Johns, p. 1.

9 *Submission* 2, Montfort International PLC, p. 1.

> volume of the information provided in the pack. The direction of our efforts to improve the packs is aimed at simplifying them to make them more user-friendly to our clients…
>
> I would suggest that the utility, client impact and cost of changing the forms need to be carefully considered before any decision is made to add additional information or data collection requirement to the department's forms. I also believe that there are alternatives to including detailed information on superannuation in the migration application packs. These include:
>
> - inclusion of a short reference to superannuation matters in one or two pages devoted to 'Living in Australia'…and include a reference to the appropriate (presumably ATO) website;
> - we could work with the Australian Taxation Office to have their targeted information leaflets available in DIMIA offices (both in Australia and overseas) to inform prospective migration applicants about not only superannuation matters of importance but taxation matters as well and allow collection of information on foreign superannuation benefits;
> - it would also be relatively easy (and low cost) to provide a link to the relevant part of the ATO website from different parts of the DIMIA website under a banner along the lines of 'want to know more about taxation or superannuation matters—click here'.
>
> All of these approaches could be pursued either individually or in combination and they should also have more impact on temporary residents and others who become 'tax residents' in Australia without becoming migrants (or coming into contact with any of the migration packs).[10]

Committee view—improving awareness

5.10 The Committee notes that the rules governing superannuation are complex and the level of awareness amongst Australians of many aspects of its regulation is low. One can only expect that this difficulty will be compounded for migrants, for whom there is even less familiarity with the Australian superannuation system.

5.11 Nevertheless, the Committee regards the transparency of tax policy to be paramount. The importance of this is highlighted by the fact that delays can have a real impact on migrants. Therefore, it is imperative that migrants can make informed decisions in regard to their superannuation assets. An awareness of the taxation of those assets is obviously essential to enable a migrant to decide whether or not to transfer that money.

5.12 The Committee notes the advice of the Department of Immigration and Multicultural and Indigenous Affairs and welcomes the proposal that the Department work closely with the Australian Taxation Office to inform prospective migrants of

10 *Submission* 48, pp. 1-2.

superannuation and taxation matters by distributing information brochures and linking website information.

5.13 However, as noted elsewhere in this report, often migrants will consider moving their superannuation when they decide to settle in Australia. In order to live permanently in Australia they must apply for, and be granted, a permanent visa. Therefore, in the view of the Committee, the application for the permanent visa is an appropriate document in which to include information to advise migrants of their tax obligations and to seek information about the foreign superannuation assets they hold.

Recommendation 16

5.14 The Committee recommends that permanent visa applications:

- **require applicants to disclose the foreign superannuation entitlements they hold; and**
- **advise applicants (in some general way) of the taxation treatment applying to their foreign superannuation entitlements.**

Inadvertent triggering

5.15 The Committee's attention was also drawn to the various ways a tax liability may arise under section 27CAA. The growth in a foreign superannuation entitlement is assessed as income when there is 'a payment from a fund in relation to a taxpayer'. The phrase 'in relation to' includes a constructive payment made on behalf of a resident. That is, a 'payment' is not limited to a direct payment to the resident, rather it will include a transfer on behalf of the resident from a foreign fund to an Australian fund. Furthermore, there is no requirement under section 27CAA that the benefit be paid in Australia. Therefore, a transfer of superannuation entitlements from one foreign superannuation fund to another foreign fund would also be regarded as a payment, and any growth would be taxable to the resident.[11]

5.16 Several submissions expressed concern that a liability under section 27CAA may be triggered inadvertently.[12] This is problematic from the perspective of both the revenue and the taxpayer. Mr Gribben submitted that a taxpayer cannot comply with the law if they can have no idea of when it applies to them.[13]

11 ATO Interpretative Decision, ID 2001/9.

12 For instance see *Submissions* 2, 20 and 23.

13 *Submission* 21, p. 1.

5.17 For example, the Committee was advised by Mercer Human Resource Consulting that a member of an employer-sponsored fund in the UK could become liable for the tax if:

- the benefit is automatically transferred to another UK fund on leaving the UK employer (as often occurs in the UK);
- the employer is taken over and as a result, the fund is wound up with benefits being transferred to the new owner's fund; or
- the existing employer/trustee determines that the fund should be wound up and all benefits transferred to a new fund.[14]

5.18 In each of these instances, the member may have had little or no say in the transaction. In many cases the individual may not be aware that any such dealing has occurred. Even when an individual is aware of the transfer they are unlikely to realise that it would result in an Australian tax liability.[15] Furthermore, in most of these cases the individual would have no access to the transferred entitlements from which to pay the tax.

5.19 For these reasons, the Committee received a number of submissions suggesting that tax should not be triggered by transferring a benefit between overseas funds.[16] However, the Committee also heard that this may create a tax avoidance opportunity for superannuation benefits to be transferred to tax havens. Mercer Human Resource Consulting suggested that one way to address this problem would be to provide an exemption only in cases where the transferor and transferee funds are in the *same* country.

> The tax should only be applied in cases where the benefit is transferred to an Australian fund or is taken in cash. If it is considered that this would open up opportunities to transfer benefits to funds in a tax haven, then it may be appropriate to ONLY provide an exemption (more effectively a deferral) in cases where the transferor and transferee funds are in the same country.[17]

5.20 The Committee was also advised that taxpayers were unlikely to realise that a liability had arisen in such circumstances from reading the *TaxPack* alone. Question 19 of *TaxPack 2001* asks 'Did you receive a lump sum payment from a non-resident superannuation fund?'.[18] In contrast to the legislation, the language used in the *TaxPack* would seem to contemplate only *direct* payments made to a resident. Accordingly, it was submitted that a taxpayer may incorrectly interpret this as not to

---

14 *Submission* 20, Mercer Human Resource Consulting, p. 6.

15 ibid.

16 For instance see *Submissions* 2, 20 and 23.

17 *Submission* 20, p. 6.

18 *TaxPack 2001 Supplement*, Question 19, p. S22. Question 19 of *TaxPack 2002 Supplement* is the same.

include an amount transferred from an overseas fund to an Australian fund, let alone an amount transferred from one overseas fund to another overseas fund.[19]

Committee view—inadvertent triggering

5.21 The Committee considers that, consistent with the 'source principle', an Australian resident should be taxed on income from all sources. As such it is appropriate that a tax liability arises in respect of the growth in superannuation entitlements when they are paid to the resident directly, or indirectly by way of a transfer to another fund (whether it be in Australia or overseas). To exclude the income of an Australian resident when it is transferred between foreign superannuation funds would create unjustifiable inconsistencies in the treatment of foreign source income.

5.22 The Committee is also concerned that any change to allow a tax-free transfer of foreign superannuation entitlements may lead to erosion of the Commonwealth's revenue base. Accordingly, the Committee does not consider that transfers between foreign superannuation funds should be excluded from section 27CAA.

5.23 Nevertheless, the Committee notes the concerns raised as to the level of awareness of section 27CAA. The Committee considers that the level of awareness of section 27CAA is unacceptably low amongst those who are potentially subject to it. As individual taxpayers primarily rely on the *TaxPack* for information on how to comply with their tax obligations, the Committee considers that it is imperative that the *TaxPack* (and its supplements) outline the effect of section 27CAA more completely. In particular, the Committee considers that question 19 should note that it applies to both direct payments and transfers of foreign superannuation.

Recommendation 17

5.24 The Committee recommends that the *TaxPack* be redrafted to give more complete and accurate guidance on the circumstances in which a liability may arise under section 27CAA. In particular, question 19 of the *TaxPack Supplement* should note that it applies to both direct payments and *transfers* of foreign superannuation.

Double taxation

5.25 As was noted above, section 27CAA can tax a benefit of an Australian resident that is transferred from one foreign fund to another. Several submissions suggested that where that benefit was subsequently transferred to Australia it was again subject to section 27CAA and so would be taxed twice.[20]

5.26 In response to this suggestion, Mr Nigel Murray, of the ATO, explained:

---

19 *Submission* 20, Mercer Human Resource Consulting, p. 6.

20 For instance see *Submissions* 2, 20 and 23.

> When an amount is paid out of an overseas fund, if it is transferred to another fund, that does trigger 27CAA, so that would be applied then. If there is a later payment from the second fund into Australia, that would again trigger 27CAA, but there are provisions in the tax legislation that ensure that is not taxed twice. In effect, a credit is given for the tax already paid…
>
> There is a provision in the *Income Tax Assessment Act 1997* that generally provides, at section 6-25, that amounts will not be subject to double taxation—they will not be taxed twice—under the same provisions.[21]

Committee view—double taxation

5.27 The Committee notes the advice of the ATO that there is no potential for an amount to be taxed twice under section 27CAA. However, the Committee considers that the confusion experienced by some taxpayers and their advisers should be addressed.

5.28 Accordingly, the Committee recommends that the Commissioner of Taxation issue a taxation ruling or determination to clarify this position.

Recommendation 18

5.29 The Committee recommends that the Commissioner of Taxation issue a public ruling or determination to clarify that tax will not be imposed twice under section 27CAA when a foreign superannuation entitlement is transferred from one foreign fund to another and is subsequently transferred to Australia.

---

21 *Committee Hansard*, 17 May 2002, p. 10.

Chapter 6
Ensuring a retirement income

6.1 As noted throughout this report, one cause of the delay in completing a transfer of foreign superannuation has been the reluctance of foreign funds to release money without the assurance that the sum will be accessible only as an income stream, rather than as a lump sum.

6.2 The Committee has long held a concern that the current law does not include the incentives necessary to encourage retirees to take their superannuation benefits as income streams rather than as lump sums.

6.3 Over the years, the Committee has strongly advocated for the development of superannuation arrangements that aim to provide a secure retirement income stream for all Australians. Consequently, the Committee is disappointed to observe no noticeable trend towards the provision of income streams and away from lump sum payments.

6.4 In this regard, the Committee is particularly concerned that the provision of lump sum benefits will provide an opportunity for 'double dipping', where superannuants, having disposed of their lump sum 'nest egg' unwisely, or having received certain investment advice, will qualify for the aged pension.

6.5 The Committee has previously acknowledged the trend towards superannuation schemes which offer lump sum only benefits. The Committee has also noted its concern that there may not be adequate information available to retirees to sensibly invest their lump sums to generate income streams and that there may not be sufficient mechanisms to provide for the orderly transfer of lump sums into schemes which could generate a retirement income stream.

6.6 The Committee reiterates its view that the real challenge for both industry and the Government is to provide mechanisms for the orderly transfer of lump sum payments into secure and suitable retirement benefit schemes. It again suggests to Government that this might include making greater use of taxation incentives for people to move into retirement pension arrangements.

6.7 The Committee notes with interest the Government's election promise to examine whether certain market linked income streams (known as growth pensions and sometimes referred to as account-based income streams) should receive concessional tax and social security treatment.

6.8 The Committee welcomes this announcement and encourages the development and implementation of any policy that promotes the payment of superannuation benefits as income streams, rather than as lump sums.

Senator John Watson
Chair

Appendix 1
List of Submissions

Submission No.	Submittor
1	Mo Dickson
2	Montfort International plc
3	Mr Anthony J Walsh
4	Mr Dylan Morgan
5	Confidential
6	J A McCracken-Hewson
7	Pension Transfers Direct Pty Ltd
8	Mr Vladamir Menkov
9	Department of the Treasury
10	Mr Clive Herrald
11	Senator Mark Bishop
12	Association of Superannuation Funds of Australia Ltd (ASFA)
13	Mr Peter Morris
14	Corporate Super Association
15	AMP
16	Mr Phillip Whiteley
17	UniSuper Management Pty Ltd
18	Mr Rhodri Johns
19	Australian Taxation Studies Program (ATAX)
20	Mercer Human Resource Consulting Pty Ltd
21	Mr Anthony Gribben

22	PricewaterhouseCoopers
23	The Institute of Chartered Accountants in Australia
24	CPA Australia
25	Andersen
26	Small Independent Superannuation Funds Association (SISFA)
27	Institute of Actuaries of Australia
28	Confidential
29	Taxation Institute of Australia
30	Mr Peter McIntosh
31	Montfort International plc (Supplementary submission)
32	Mr Phillip Whiteley (Supplementary Submission)
33	Taxation Institute of Australia
34	Mr Phillip Whiteley (Supplementary Submission)
35	Mr R J Aitken
36	APRA
37	Confidential
38	ASFA (Supplementary submission)
39	PricewaterhouseCoopers (Supplementary submission)
40	Corporate Super Association (Supplementary submission)
41	Pension Transfers Direct Pty Ltd (Supplementary submission)
42	Australian Taxation Studies Program (ATAX) (Supplementary submission)
43	CPA Australia (Supplementary submission)
44	Child Support Agency, Department of Family and Community Services

45	Australian Taxation Office
46	Australian Taxation Office (Supplementary submission)
47	Department of the Treasury (Supplementary submission)
48	Department of Immigration and Multicultural and Indigenous Affairs

Appendix 2
Witnesses who appeared before the Committee at public hearings

Friday, 17 May 2002, Canberra

Department of the Treasury

Mr Raphael Cicchini, Manager, Superannuation Unit

Australian Taxation Office

Mr Trevor Thomas, Assistant Commissioner, Superannuation

Mr Nigel Murray, Director, Superannuation

Mr Leon Latimore, Assistant Director, Superannuation

Senator Mark Bishop (Senator for Western Australia)

Corporate Super Association

Mrs Elizabeth Goddard, Head of Research

UniSuper

Mr Darren McCormack, Compliance Manager

AMP

Mr Simon Edwards, Manager, Strategic Policy, Government Affairs, AMP Ltd

Ms Tracey Burt, Manager, AMP Superannuation Ltd

Mr John Ciacciarelli, Technical Services Manager, Distribution, AMP Ltd

Mercer Human Resource Consulting Pty Ltd

Mr Raymond Stevens, National Technical Manager, Financial Planning

Institute of Chartered Accountants in Australia

Mr Anthony Negline, Consultant

Mrs Susan Orchard, Superannuation Technical Consultant

Montfort International PLC

Mr Geraint Davies, Managing Director

Mr Jeff Bowman, International Tax Consultant

Wednesday, 22 May 2002, Sydney

Mr Anthony Gribben (Private capacity)

Taxation Institute of Australia

Mr Andrew Skinner, Vice-Chairman, Superannuation Committee

Association of Superannuation Funds of Australia (ASFA)

Dr Michaela Anderson, Director, Policy and Research

Mr Robert Hodge, Senior Policy Adviser (Tax)

ATAX, Faculty of Law, University of New South Wales

Mr Gordon Mackenzie, Senior Lecturer

CPA Australia

Ms Jane Barrett, Superannuation Policy Adviser

Ms Noelle Kelleher, Superannuation Centre of Excellence

PricewaterhouseCoopers

Mr Michael Forsdick, Partner

Andersen

Mr Paul Ellis, Principal, Human Capital

Pension Transfers Direct Pty Ltd

Mr Brent Hutton, Director

Mr Phillip Whiteley (Private capacity)

Appendix 3
List of Committee Reports

Reports of the Select Committees on Superannuation

(1991-1998)

- *Super System Survey* - A Background Paper on Retirement Income Arrangements in Twenty-one Countries (December 1991)
- Papers relating to the Byrnwood Ltd, WA Superannuation Scheme (March 1992) Interim Report on Fees, Charges and Commissions in the Life Insurance Industry (June 1992)
- First Report of the Senate Select Committee on Superannuation - *Safeguarding Super* - the Regulation of Superannuation (June 1992)
- Second Report of the Senate Select Committee on Superannuation - *Super Guarantee Bills* (June 1992)
- *Super Charges* - An Issues Paper on Fees, Commissions, Charges and Disclosure in the Superannuation Industry (August 1992)
- Third Report of the Senate Select Committee on Superannuation - *Super and the Financial System* (October 1992)
- *Proceedings of the Super Consumer Seminar*, 4 November 1992 (4 November 1992)
- Fourth Report of the Senate Select Committee on Superannuation - *Super - Fiscal and Social Links* (December 1992)
- Fifth Report of the Senate Select Committee on Superannuation - *Super Supervisory Levy* (May 1993)
- Sixth Report of the Senate Select Committee on Superannuation - *Super - Fees, Charges and Commissions* (June 1993)
- Seventh Report of the Senate Select Committee on Superannuation - *Super Inquiry Overview* (June 1993)
- Eighth Report of the Senate Select Committee on Superannuation - *Inquiry into the Queensland Professional Officers Association Superannuation Fund* (August 1993)

- Ninth Report of the Senate Select Committee on Superannuation - *Super Supervision Bills* (October 1993)
- Tenth Report of the Senate Select Committee on Superannuation - *Super Complaints Tribunal* (December 1993)
- Eleventh Report of the Senate Select Committee on Superannuation - *Privilege Matter Involving Mr Kevin Lindeberg and Mr Des O'Neill* (December 1993)
- A Preliminary Paper Prepared by the Senate Select Committee on Superannuation for the Minister for Social Security, *Options for Allocated Pensions Within the Retirement Incomes System* (March 1994)
- Twelfth Report of the Senate Select Committee on Superannuation - *Super for Housing* (May 1994)
- Thirteenth Report of the Senate Select Committee on Superannuation - *Super Regs I* (August 1994)
- Fourteenth Report of the Senate Select Committee on Superannuation - *Super Regs II* (November 1994)
- Fifteenth Report of the Senate Select Committee on Superannuation - *Super Guarantee - Its Track Record* (February 1995)
- Sixteenth Report of the Senate Select Committee on Superannuation - *Allocated Pensions* (June 1995)
- Seventeenth Report of the Senate Select Committee on Superannuation - *Super and Broken Work Patterns* (November 1995)
- Eighteenth Report of the Senate Select Committee on Superannuation - *Review of the Superannuation Complaints Tribunal* (April 1996)
- Nineteenth Report of the Senate Select Committee on Superannuation - *Reserve Bank Officers' Super Fund* (June 1996)
- Twentieth Report of the Senate Select Committee on Superannuation - *Provisions of the Social Security Legislation Amendment (Further Budget and Other Measures) Bill 1996 - Schedule 1* (November 1996)
- Twenty-first Report of the Senate Select Committee on Superannuation - *Investment of Australia's Superannuation Savings* (December 1996)
- Twenty-second Report of the Senate Select Committee on Superannuation - *Retirement Savings Accounts Legislation* (March 1997)
- Twenty-third Report of the Senate Select Committee on Superannuation - *Superannuation Surcharge Legislation* (March 1997)

- Twenty-fourth Report of the Senate Select Committee on Superannuation - *Schedules 1, 9 & 10 of Taxation Laws Amendment Bill (No. 3) 1997* (June 1997)
- Twenty-fifth Report of the Senate Select Committee on Superannuation - *The Parliamentary Contributory Superannuation Scheme & the Judges' Pension Scheme* (September 1997)
- Twenty-sixth Report of the Senate Select Committee on Superannuation - *Super - Restrictions on Early Access: Small Superannuation Accounts Amendment Bill 1997 and related terms of reference.* (September 1997)
- Twenty-seventh Report of the Senate Select Committee on Superannuation - *Superannuation Contributions Tax Amendment Bills.* (November 1997)
- *Super Taxing* - An information paper on the Taxation of Superannuation and related matters. (February 1998)
- Twenty-eighth Report of the Senate Select Committee on Superannuation – *Choice of Fund*. (March 1998)
- Twenty-ninth Report of the Senate Select Committee on Superannuation - *Superannuation Legislation (Commonwealth Employment) Repeal and Amendment Bill 1997, Commonwealth Superannuation Board Bill 1997, Superannuation Legislation (Commonwealth Employment - Saving and Transitional Provisions) Bill 1997.* (April 1998)
- Thirtieth Report of the Senate Select Committee on Superannuation - *Workplace Relations Amendment (Superannuation) Bill 1997*. (May 1998)
- Thirty-first Report of the Senate Select Committee on Superannuation - *Resolving Superannuation Complaints* - options for dispute resolution following the Federal Court decision in *Wilkinson v CARE*. (July 1998)

Reports of the Select Committee on Superannuation and Financial Services - 39th Parliament

(1999 - 2002)

- *Choice of Superannuation Funds (Consumer Protection) Bill 1999* (November 1999)
- *Superannuation Legislation Amendment Bill (No. 4) 1999* (November 1999)
- *Roundtable on Choice of Superannuation Funds* (March 2000)
- *Provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000* (April 2000)
- *New Business Tax System (Miscellaneous) Bill No 2 2000* (June 2000)
- *Financial Sector Legislation Amendment Bill (No 1) 2000* (August 2000)
- *Interim report on the Family Law Legislation Amendment (Superannuation) Bill 2000* (November 2000)
- *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (December 2000)
- *Family Law Legislation Amendment (Superannuation) Bill 2000* (March 2001)
- *The opportunities and constraints for Australia to become a centre for the provision of global financial services* (March 2001)
- *A 'reasonable and secure' retirement? The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes* (April 2001)
- *Enforcement of the Superannuation Guarantee Charge* (April 2001)
- *Issues arising from the Committee's report on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (May 2001)
- *Report on the Provisions of the Parliamentary (Choice of Superannuation) Bill 2001* (August 2001)
- *Prudential supervision and consumer protection for superannuation, banking and financial services - First Report* (August 2001)
- *Prudential supervision and consumer protection for superannuation, banking and financial services - Second Report - Some case studies* (August 2001)

- *Prudential supervision and consumer protection for superannuation, banking and financial services - Third Report - Auditing of Superannuation Funds* (September 2001)
- *Early Access to Superannuation Benefits* (January 2002)
- *Investing Superannuation Funds in Rural and Regional Australia - An Issues Paper* (February 2002)

Reports of the Select Committee on Superannuation - 40th Parliament (2002)

- *Taxation Laws Amendment (Superannuation) Bill (No. 2) 2002, and Superannuation Guarantee Charge Amendment Bill 2002* (June 2002)