Taxation Laws Amendment Bill (No. 6) 1988

Date Introduced: 30 November 1988
House: House of Representatives
Presented by: Hon. Peter Morris, M.P., Minister Assisting the Treasurer

Digest of Bill

Purpose
To provide for a tax on contributions to, and the earnings of, all superannuation funds and approved deposit funds (ADF), and to remove certain exemptions for life insurance companies. The Bill will also increase the superannuation deduction available to the self-employed and remove the limit on the deduction of employer contributions. The position regarding certain share cancellations also will be amended.

Background
The decision to tax superannuation funds and ADFs was announced in the 1988 May Statement. Currently, the general rule is that the earnings of such funds are exempt from tax if the fund has satisfied the requirements imposed under the Occupational Superannuation Standards Act 1987 (e.g. vesting and reporting requirements). Similarly, contributions to such funds are currently not taxed, and employers are generally allowed a deduction on their contributions. (The statutory limit is the greater of $400 or 5% of the employee's income. However, the Commissioner has a discretion to allow greater deductions.)

The rationale behind the tax, as outlined in the May Statement, is equity and the desire to raise additional revenue which may be used to finance future tax reductions in other areas. The equity argument is based largely on the deferred payment of tax that currently exists. At present, tax is paid by the recipients of superannuation benefits when they receive the benefit, which will include a portion that results from the earnings of the fund.

The arguments against the proposal are centered largely on the potential effect on the level of benefits provided. It is argued that the proposed tax will reduce the level of benefits provided as the total sum available to the fund will be reduced by the tax paid. While it is very likely there will be some reduction in the total funds available, it is very difficult to quantify the impact of the proposal.

The tax on complying funds will be generally at the relative low rate of 15% and the funds will be able to reduce their liability through the use of the imputation system (i.e. credits on franked dividends may be used to offset liability). Due to this matter, the actual rate of tax paid will vary depending on the amount of franked dividends received from the funds investment portfolio.
Some idea of the impact on the industry can be gained from the estimated revenue that will be raised. In the explanatory memorandum to the Bill, the tax on superannuation funds and ADFs is estimated to raise $980 million in 1989–90 and $1400 million in the next financial year.

This Bill contains part only of the government's proposed tax package for this industry. As announced in the second reading speech, further legislation will be introduced in 1989 to complete the package. The major area that will be involved in that legislation is the treatment of capital gains.

At present, two principal concessions are available to life insurance companies. Under section 115 of the Income Tax Assessment Act 1936 (the Principal Act), a deduction is allowed on the present value of future liabilities, while section 116 provides that tax is not payable if, during a year of income, the company's liabilities exceed its assets. The decision to remove these concessions was announced in the 1988 May Statement and is estimated to raise $70 million in 1988–89.

Also refer to the Digest of the Income Tax Rates Amendment Bill (No. 2) 1988

Main Provisions

A new Part IX, dealing with the taxation of superannuation and related businesses, will be inserted into the Principal Act by clause 9. Proposed section 267 contains definitions, the most important being those for complying and non-complying funds. Basically, a fund will be taken to be a complying fund if it has satisfied the conditions imposed under the Occupational Superannuation Standards Act 1987. Complying funds will pay a lower rate of tax.

Proposed section 270 will make it clear that the Bill will apply to funds established by the Commonwealth and States. However, proposed section 271 will qualify this by stating that it is Parliament's intention that the Bill will not apply if the application would breach section 114 of the Constitution which prohibits the Commonwealth from taxing the property of the States.

Special income is defined in proposed section 273 to be dividends received from a private company, although, having regard to the matters listed in the proposed section, the Commissioner may determine that it is reasonable not to treat such dividends as special income. (Special income will be taxed at normal rates as is the current practice).

The taxable contributions of funds, other than pooled superannuation trusts which are dealt with in proposed Division 7, is defined in proposed Division 2. For superannuation funds, this will generally be employer and employee contributions plus any specified roll-over amount. For an ADF it will be the specified roll-over amount. (This term is defined in proposed section 267 and is, loosely, eligible termination payments paid into the fund.)
Proposed section 275 provides for the transfer of taxable contributions where a fund uses the contributions to purchase a superannuation policy from a registered organisation or uses the contributions to buy shares in a pooled superannuation trust.

Proposed Division 3 deals with complying funds. Proposed section 278 will impose liability for tax on the trustee of such funds. The assessable income of such funds is to include taxable contributions (proposed section 281), though amounts derived before 1 July 1988 will be excluded (proposed section 282). As well, a proportion of income based on the ratio of current pension liabilities (i.e. the amount due in the year to pay pensions) to total liabilities will be exempt (proposed section 283). Amounts paid by funds for insurance policies to cover the potential need to pay benefits on death or disability will be deductible (proposed section 279), but no deduction will be allowed in respect of benefits paid (proposed section 280). There will be two components of income, special income (as defined above) and standard income (the remainder).

Non-complying funds, which are currently taxed, are dealt with in proposed Division 4. Proposed section 288 will make it clear that taxable contributions are to be included in assessable income, while proposed section 287 makes it clear that no deduction is allowable for benefits paid.

Proposed Division 5 deals with complying ADFs. The trustee will be made liable to tax by proposed section 289. Assessable income is to include taxable contributions (proposed section 290), and amounts derived before 1 July 1988 will be excluded (proposed section 291). Again, there will be special and standard components of income.

Proposed Division 6 will make it clear that non-complying ADFs are liable for tax and that their assessable income is to include taxable contributions.

Pooled superannuation trusts (i.e. unit trusts in respect of which the Insurance and Superannuation Commissioner has issued a notice stating that the trust has satisfied the necessary conditions) are dealt with in proposed Division 7. The provisions are similar to those in proposed Division 5.

Clause 10 will amend the Principal Act as set out in Schedule 1 of the Bill. The Schedule will increase the maximum deduction for self-employed people who contribute to their own superannuation from $1500 to $3000 and remove the limit on deductions for employer contributions. In addition, the Schedule will amend and repeal sections of the Principal Act that are no longer necessary due to the amendments contained in this Bill, and apply the imputation system to funds.

Similarly, clause 16 will amend a number of Acts as a consequence of the amendments contained in this Bill.

The amendments to the treatment of life insurance companies is contained in clause 5 which will repeal sections 115 and 116 of the Principal Act.
The Bill also deals with the cancellation of a subsidiary's shares in its holding company. The amendments will provide that where the holding company cancels shares in itself that are held by a subsidiary, and the consideration received by the subsidiary is less than the market value, for all tax reasons the subsidiary will be taken to have received the full value (clause 6).

For further information, if required, contact the Economics and Commerce Group.

17 January 1989

Bills Digest Service
Legislative Research Service

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

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