Date Introduced: 23 May 1985
House: House of Representatives
Presented by: Hon. P.J. Keating, M.P., Treasurer

Short Digest of Bill

Purpose

To amend the Income Tax Assessment Act 1936 (ITAA) in order to modify the arrangements for taxing superannuation, termination of employment and kindred payments.

Background

For taxation purposes, superannuation funds are categorised by certain provisions of the ITAA (e.g. sections 23jja, jaa or jb, 23F, 23FB and 79). Superannuation is a reward for service received on retirement or termination of employment and may be taken in the form of either a pension received in an income stream, or as a lump sum.

Since 1915, only 5 per cent of a lump sum received on retirement or termination of employment from an employee-sponsored scheme has been assessable under section 26(d) of ITAA. The percentage chosen was purely arbitrary and for the purpose of redressing the inequity of taxing a sum wholly in the year of receipt when it arose from employment covering a number of years.

In the past, various Committees have enquired into the treatment of the superannuation benefit. In the early 1950s, the Spooner Committee recommended that it should continue to be assessed only on 5 per cent and without any limit on the amount received.

The National Superannuation Committee of Inquiry (Hancock) in 1976, expressed the view that steps should be taken to achieve parity of treatment for benefits received as pensions and those received as lump sums.

In 1975, the Taxation Review Committee (Asprey) also recognised the inequities in section 26(d) and believed that some attempt should be made at reconciling them. The Committee favoured a "neutral" tax approach i.e. a person
should be able to choose between a lump sum or pension without gaining a tax advantage from either choice.

In 1981, the Campbell Committee also stated that the taxation arrangements for superannuation were not neutral and encouraged long-term saving for retirement. The Committee concluded that "the taxation of superannuation funds could be made more neutral and equitable by adopting a basis of income taxation whereby the funds are taxed on annual 'income received', net of operating expenses, at a rate representative of the weighted average of the marginal rates of members".[1] Pension benefits and lump sums when received would be exempt from tax.

The proposal for the introduction of new taxation arrangements for superannuation and kindred payments was first announced by the Government in its Economic Statement of 19 May 1983. Details of the arrangements were later clarified in Press Statements on 30 May and 7 August 1983.

Taxation Arrangements

Under present arrangements, the taxation treatment of the lump sum depends on what part of the eligible amount is referable to pre-30 June 1983 service or fund membership, what part is post-30 June 1983 membership or service, what part represents post-30 June 1983 contributions by the taxpayer, and whether the amount includes any of the proposed concessional components. For a concise explanation of the new tax arrangements, refer to the attached table.

1. Pre-30 June 1983

The tax treatment of 5 per cent of the amount being included in assessable income applies to that part of the lump sum relating to pre-30 June 1983 service, and to concessional components (amounts paid for bona fide redundancy, approved early retirement and invalidity) which are not subject to the new tax.

2. Post-30 June 1983

a) That part of the eligible amount referable to service or fund membership after 30 June 1983 attracts the new tax, subject to certain exemptions and concessions.

The rate of tax is 30 per cent on this part. However, where the taxpayer is aged 55 or over, the first $50,000 of this part is taxed at 15 per cent, and any remainder at 30 per cent. The $50,000 threshold applies only once for each taxpayer. If a taxpayer receives one payment with a post-30 June 1983 component of less than
$50,000, the balance of the $50,000 may be applied to the post-30 June 1983 portion of a later payment.

b) The component in an eligible amount representing fund contributions made by the taxpayer after 30 June 1983 for which he has not received an income tax deduction is exempt from tax.

c) There are certain concessional components. The concession for bona fide redundancy and early retirement payments applies to that part of the eligible termination payment which exceeds the amount that would have been received had the employee resigned on the date of the retrenchment or early retirement. This "concessional component" is included in assessable income as to only 5 per cent. In the case of an invalidity payment, the concession is by adjustment to the pre-30 June 1983 component of the eligible amount. That component is deemed to include the period between actual retirement and the taxpayer's normal retirement date. This portion is not subject to the new tax, but is included in assessable income as to 5 per cent.

a. Roll-over of eligible termination payments

Whether an eligible termination payment is subject to the appropriate tax treatment depends on to what extent, if any, of the payment is "rolled-over" into any of the following:

a) a superannuation fund providing benefits for the taxpayer, or his dependants in the event of the taxpayer's death;

b) an approved deposit fund maintained by an "approved trustee"; or

c) a life assurance society, friendly society, trade union or other employee association for the purchase of an annuity for the benefit of the taxpayer, or his dependants in the event of the taxpayer's death.

The amount rolled-over is exempt from tax but is taxed later when the taxpayer receives it in a taxable form.

b. Approved deposit funds

An approved deposit fund is a trust fund established as an indefinitely continuing fund to receive, on deposit, amounts of eligible termination payments. These amounts may be kept in the fund, or paid into a
superannuation fund for the taxpayer's benefit or used to purchase an annuity.

A number of institutions are able to establish approved deposit funds namely, banks, life assurance companies, State Government insurance offices, trade unions, employee associations, building societies, finance companies, money market corporations, credit unions, friendly or benefit societies and trustee corporations.

c. Tax Instalment deductions

PAYE deductions are required to be made at the time an eligible termination payment is made to a person. Such deductions are required whether the payment is made by the employer, or by the trustee of a superannuation fund, or by an approved deposit fund.

d. Annuities

An annuity can be best described as the reverse of a life insurance policy. It comprises a series of payments (part capital repayment and part interest payment) made in exchange for a lump sum at the beginning.

An annuity may be purchased with a lump sum and commences to be payable immediately (immediate annuity) or may be purchased in advance, often by instalments over a period (deferred annuity).

Types of annuities include life annuity, term certain annuity, joint life annuity, escalating annuity, life annuity with a guaranteed period, and investment-linked annuities.

The new tax does not apply to any part of the taxable portion that is used to purchase an annuity.

Outline

The Bill proposes various technical changes to the current taxation arrangements for superannuation in order to overcome certain deficiencies in the law and to clarify and reinforce the intended operation of the law with regard to eligible termination payments. A detailed outline of these changes is contained in the Explanatory Memorandum.

Main Provisions

1. Eligible Service

Where none of the pre-1 July 1983 component of an eligible termination payment is rolled-over into a
superannuation fund or approved deposit fund, or used to purchase an annuity, no part of the eligible service period prior to 1 July 1983 is preserved. This amendment is to apply from 1 July 1983. (new sub-section 27(10) of ITAA, inserted by clause 3).

This proposed amendment aims to correct the current practice whereby the entire pre-1 July 1983 eligible service period is included as part of the total eligible service period where none of the pre-1 July 1983 component is rolled-over.

2. **Commutations of annuities and pensions**

   A rolled-over eligible termination payment that is used to purchase an annuity or a superannuation pension will not be treated as unused undeducted purchase price in relation to a commutation or residual capital value of the annuity after 18 February 1985, or superannuation pension after 23 May 1985 (clauses 3 and 6). These changes are designed to close a loophole whereby tax is avoided by those who convert eligible termination payments into an annuity and subsequently cash it in.

3. **Eligible termination payments**

   An amount received in respect of the assignment or transfer, after 23 May 1985, of a superannuation pension or annuity, is to be treated as an eligible termination payment (clause 3).

   Benefits received from employer sponsored employee superannuation funds (cherry picker schemes) will not be treated as eligible termination payments (clause 3).

4. **Redundancy and early retirement**

   The existing premature retirement test to determine whether certain early retirement or redundancy payments qualify for concessional tax treatment will be changed. As from 1 July 1983, the test will enable the concessional treatment to be available where the termination of the taxpayer's employment occurs before the date on which employment would necessarily have been terminated provided that it is not later than the 65th birthday (clauses 4 and 5).

5. **Approved deposit funds**

   Amounts deposited in an approved deposit fund by a taxpayer who has died before his 65th birthday will have to
be paid to the deceased's estate within 90 days of the grant of probate or letters of administration (clause 3).

As from 1 July 1983, a temporary failure by an approved deposit fund to meet any of the statutory tests of establishment may be disregarded by the Tax Commissioner (clause 3).

6. **Annuities**

Where an eligible termination payment is used to purchase a deferred annuity after 23 May 1985, the payment will not be freed from tax unless the annuity is purchased totally from that payment (clause 3).

PAYE tax instalments will be deducted from annuities and supplements to pensions and annuities paid as from the second month after the Bill is enacted (clause 3).

7. **Rebate of Tax**

Eligible termination payments made on or after 1 July 1983 to the trustee of the estate of a deceased person who was 55 or more at the date of death will be made subject to a rebate of tax in order to reduce the tax rate to 15% (clause 7).

For further information, if required, contact the Economics and Commerce Group.
LUMP SUM TAX-EFFECT.

Retirement and Resignation Benefits.

- Service prior to 30.6.83
- Service after 30.6.83

 aged 55

$50,000 Lump Sum

- Service to date of normal retirement
- Service to date of disablement

Redundancy and Early Retirement Benefits.

- Excess Benefit
- Resignation Benefit

Disablement Benefits.

- Member's contribution after 30.6.83 (non-deductible) - Exempt
- Taxed on old basis

- Taxed at 30%
- Taxed at 15%