To introduce new taxation arrangements for superannuation, termination of employment and kindred payments;

to remove deficiencies in section 26(a) relating to profits arising from the sale of property acquired for the purpose of profit-making on resale;

to give effect to the taxation concession for investment in licensed management investment companies;

to tax the income of friendly societies from the investment of funds from life, disability and accident insurance;

to clarify the law relating to deductions for expenditure on repairs, expenses of borrowing, and on lease documents and on the granting of patents;

to reduce the paperwork burdens of the prescribed payments system;

to exempt from tax, rent subsidy payments under the Commonwealth/State mortgage and rent relief scheme;

to authorise deductions for capital expenditure on mineral transport facilities;

to grant income tax deductions for gifts of $2 or more made to the African Famine Appeal.
Background

Taxation of Superannuation Benefits

For taxation purposes, superannuation funds are categorised by certain provisions of the Income Tax Assessment Act 1936 (ITAA) (e.g. sections 23(ja), (jaa) or (jb), 23F, 23FR 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.

Pension benefits are wholly assessable in the hands of the recipient, except for unrebated contributions in excess of $1,200 p.a. Only 5 per cent of a benefit received in a lump sum by employees from an employer-sponsored scheme is assessable under section 26(d) of ITAA. Furthermore, lump sums received by self-employed persons and "unsupported" employees from qualifying funds after 19 August 1980, are only assessable as to 5 per cent. That part of an individual's lump sum benefit derived from contributions made up to 19 August 1980, and from earnings on the investment of these contributions, is tax free.

The principle of assessing, for taxation purposes, only 5 per cent of a lump sum received on retirement or termination of employment has existed ever since income tax was first levied by the Australian Government in 1915. 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 the concessional basis of taxation should be restricted only to that part of the benefit regarded as reasonable, taking into account remuneration and length of service; 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. The Committee proposed that section 26(d) be repealed and replaced with other provisions. It recommended that, subject to transitional arrangements, all lump sum benefits, other than death benefits, should be included in full in taxable income and taxed in the ordinary way. This would be subject to certain conditions e.g. lump sum benefits paid within three months to another approved fund or used to purchase an immediate annuity, (provided it is to be fully taxable when received) would be exempt. One of the transitional arrangements recommended was that lump sum benefits on retirement after age 55 or earlier retirement as a result of ill-health, or on death, would be exempt from tax up to $50,000. The balance up to a maximum of $150,000 would be taxed on a forward spreading basis (i.e. the lump sum would be divided by 15, tax calculated on the result which would then be multiplied by 15 to give the total tax payable. All other lump sum benefits from approved funds would be taxed in full.

In 1981, the Campbell Committee also stated that the existing 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. Quite a few of the recommendations of the Asprey Committee have been incorporated.

Outline and Main Provisions

A. Superannuation, Termination of Employment and Kindred Payments

The key provisions dealing with the new set of rules for the taxation of superannuation and other retirement payments are contained in clause 15.

The taxation treatment of the lump sum will depend 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.

An "eligible termination payment" will include:

1) payments on retirement through age or invalidity or on cessation of employment, "golden handshakes" and other severance payments, contractual termination payments, payments in lieu of unused sick leave and payments in compensation for loss of office or employment;

2) payments not currently taxed, viz., payments in full or partial commutation of pensions and most classes of annuity, payments of residual capital values of pensions and such annuities, distributions made from superannuation funds in accordance with fund rules during an employee's service, and termination payments made otherwise than as a lump sum;

3) payments from an "approved deposit fund". This Bill provides for the establishment of these funds to accept amounts which would otherwise be subject to the new taxation rules. These amounts are exempted from tax provided they are deposited in an approved deposit fund within 90 days of receipt. (These funds are discussed below). The new rules are not limited to payments made in a single amount, although referred to as lump sum.

a. Taxation Arrangements

For a concise explanation of the new tax arrangements, refer to the attached table.

1. Pre-30 June 1983

The existing tax treatment (5 per cent of amount included in assessable income) will apply 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 will attract the new tax, subject to certain exemptions and concessions.
The rate of tax will be 30 per cent on this part. However, where the taxpayer is aged 55 or over, the first $50,000 of this part will be taxed at 15 per cent, and any remainder at 30 per cent (clause 52). 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 will be exempt from tax.

c) There will be certain concessional components. The concession for bona fide redundancy and early retirement payments will apply 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" will be included in assessable income as to only 5 per cent. In the case of an invalidity payment, the concession will be by adjustment to the pre-30 June 1983 component of the eligible amount. That component will be deemed to include the period between actual retirement and the taxpayer's normal retirement date. This portion will not be subject to the new tax, but will be included in assessable income as to 5 per cent.

b. Roll-over of eligible termination payments

Whether an eligible termination payment is subject to the appropriate tax treatment will depend 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 will be exempt from tax but will be taxed later if the taxpayer receives it in a taxable form.
A taxpayer will generally have 90 days from the date of the eligible termination payment in which to make a roll-over payment. The initial roll-over period will cover the period from 30 June 1983 to the date 90 days after the Bill has been enacted. The Commissioner of Taxation will have the power to extend the "roll-over" period in special circumstances.

c. Death Benefit Exemption

Certain death benefits paid to the estate, widow, widower or dependants of a deceased person will be tax exempt. Payments included are those from a superannuation fund, "golden handshakes" and withdrawals from approved deposit funds. The exemption will not apply to commutations of superannuation pensions or annuities (clause 27).

d. Approved deposit funds

An approved deposit fund will be 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 will be 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.

If an approved deposit fund is maintained by an approved institution as an indefinitely continuing fund for approved purposes and under approved rules, then the investment income of the fund will be exempt from tax (clause 8). If the fund fails to comply with the rules, income will be taxed at 46 per cent. Where the fund is not maintained by an approved institution, then the income will be taxed under the general trust provisions of the Income Tax Assessment Act 1936.

e. Tax Instalment deductions

PAYE deductions will be required to be made at the time an eligible termination payment is made to a person, and will apply from 1 August 1984 (clause 54). Such deductions will be required whether the payment is made by the employer, or by the trustee of a superannuation fund, or by an approved deposit fund.
f. **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 Bill contains provisions which will amend the income tax law relating to income received in the form of annuities, including superannuation pensions, and to the investment income derived from annuity business. The new tax will not apply to any part of the taxable portion that is used to purchase an annuity.

Superannuation contributions and other payments towards an annuity or pension that are concessionally rebatable under ITAA are to be treated as part of the undeducted purchase price even though some tax concession by way of rebate at the standard rate may have been allowable for them.

The Bill will extend the exemption available to life insurance companies on income derived from superannuation business to apply to immediate annuities and annuities purchased by the roll-over of an eligible termination payment. Other annuity income will remain taxable.

The Bill will provide equivalent treatment to the investment income derived from the annuity business of other organisations which may issue annuities. The rate of tax to apply to the taxable annuity business of these organisations will be 20 per cent.

g. **Section 79 funds**

Funds governed by section 79 of ITAA are liable for tax at 50 per cent on investment income but are entitled to a deduction of 5 per cent of the cost of assets. It is proposed that these funds will in future be exempt from tax.
B. Speculative Transactions

Under section 26(a) of ITAA, the taxpayer's assessable income includes any profit made on the sale of property acquired for the purpose of profit-making by sale, or from the carrying out of any profit-making undertaking or scheme.

The Government announced, in the 1983-84 Budget speech, its decision to remove technical deficiencies in the existing provision by repealing it, with effect from 24 August 1983, and replacing it with a new section covering both the operation of section 26(a) and the remedial measures (clauses 10, 11 and 17).

C. Subscriptions to Licensed Management and Investment Companies

This Bill provides, to initial subscribers of share capital in companies licensed under the Management and Investment Companies Act 1983, a deduction from assessable income equal to the capital subscribed on their shares after 14 September 1983, plus any share premium.

Deduct ions so allowed, however, will be withdrawn if the taxpayer disposes of his shares within 2 years after the date on which the shares became fully paid-up. If there is a disposal in the third or fourth year, the deduction will be reduced by 50 per cent and 25 per cent respectively (clause 21).

D. Rent Subsidy Payments

The Bill amends the ITAA to permit rent subsidy payments made directly to tenants under the Mortgage Rent Relief Scheme to be tax exempt, effective from 17 August 1982 (clause 6).

E. Expenditure on repairs, borrowings, lease documents and the grant of patents, etc.

The Bill will clarify the deduction for expenditure on repairs in relation to property that is used only partly to produce assessable income. Expenditure will be deductible only to the extent that it is incurred in producing assessable income. This decision was announced by the Government on 18 April 1984, to overcome a decision by the Taxation Board of Review that a deduction was allowable for the whole of the cost of repairs to a car in a year of income, although the car was used only partly for business purposes.
Furthermore the Bill similarly amends provisions in the Principal Act which authorise deductions for expenses of borrowing, those relating to lease documents and to the granting of patents or registration of designs or copyrights, in order to apply this principle. The amendments will apply to expenditure incurred after 18 April 1984 (clauses 18-20).

F. Prescribed Payments System

The Bill provides for the repeal of section 221YHE of the Principal Act which requires a payee to forward with his annual income tax return all deduction forms that relate to prescribed payments made to the payee in that income year (clause 59).

G. Life Insurance business of friendly societies

The investment income of friendly societies from their life, disability and accident insurance business will be taxed at the rate of 20 per cent for the 1983-84 and later income years. The termination of their tax exemption was announced by the Government in its 19 May 1983 Economic Statement.

However, friendly societies will not be assessed on the investment income which they receive from the business of granting annuities issued in respect of a superannuation policy, or which is payable immediately or purchased out of retirement payments. They will continue to be exempt on income derived from sickness and funeral insurance policies.

In determining the friendly societies' taxable income, the assessable income will be reduced by any deductions that relate exclusively to earning that income and by any proportion of any other allowable deductions, other than those that relate exclusively to earning exempt income.

The Bill also provides for a 30 per cent rebate to holders of policies issued by friendly societies who are taxed in 1983-84 or later on proceeds of certain short-term policies (clauses 28, 36 and 51).

H. Capital Contributions to Government-owned Railway Rolling Stock

Deductions will be allowed for capital contributions, made by a taxpayer after 9 March 1984, to the cost of railway rolling-stock owned by a government or government authority and used for the transport of minerals and petroleum (clauses 47 and 48).
I. Gifts

Gifts to the value of $2 or more to the African Famine Appeal conducted by the International Disaster Emergencies Committee, made on or after 27 June 1983 and before 1 December 1983, will be tax deductible (clause 22).

For further information, if required, contact:

11 September 1984
Economics and Commerce Group
LEGISLATIVE RESEARCH SERVICE

References

For a detailed explanation of the provisions of the Bill, refer to the Minister's Explanatory Memorandum.


LUMP SUM TAX-EFFECT.

Retirement and Resignation Benefits.

Aged 55

- Service after 30-6-83
- Service prior to 30-6-83

Less than 55

- Service prior to 30-6-83

Redundancy and Early Retirement Benefits.

Less than 55

- Excess Benefit
- Resignation Benefit
- Service prior to 30-6-83

Disablement Benefits.

Aged 55

- Service to date of normal retirement
- Service to date of disablement
- Service prior to 30-6-83

Less than 55

- Taxed at 30%
- Taxed at 15%
- Member's contribution after 30-6-83 (non-deductible) - Exempt
- Taxed on old basis