A Plan to Simplify and Streamline Superannuation

Detailed Outline

May 2006

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INTRODUCTION AND CONSULTATION PROCESS

The Government is seeking comments on a plan to simplify and streamline superannuation.

This paper describes the changes and how the new system would operate. It also explains the current system to provide the context for the changes. This paper complements and expands on the separate booklet *'A plan to simplify and streamline superannuation'* which provides an overview of the changes being proposed.

The Government's proposed plan would:

- simplify superannuation arrangements for retirees, making it easier to understand;
- improve incentives to work and save; and
- introduce greater flexibility in how superannuation savings can be drawn down in retirement.

If the proposed changes are implemented, the adequacy of retirement incomes would be improved, and over 10 million Australians with superannuation accounts, plus future account holders and their families, would benefit through greater simplicity.

MAKING COMMENTS

The Government is seeking submissions and comments from the community on this paper by Wednesday, 9 August 2006. Comments can be forwarded to the following address:

General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600
Email address: simplersuper@treasury.gov.au

Further copies of this paper can be obtained by writing to the address above or from the website, http://simplersuper.treasury.gov.au.

CONFIDENTIALITY

All submissions received will be treated as public unless the author clearly indicates the contrary. Public submissions may be published on the plan's website.

A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

OVERVIEW

CHAPTER 1 — BACKGROUND AND OVERVIEW OF THE PROPOSAL

This chapter provides the background to the proposal, along with a broad outline of how the proposed superannuation taxation system would operate in different cases. The advantages of the proposed changes are also summarised.

CHAPTER 2 — TAXATION OF BENEFIT PAYMENTS

This chapter describes the proposed taxation arrangements for superannuation benefits paid from a taxed superannuation fund (such funds cover about 90 per cent of fund members). The current taxation treatment of benefit payments is also outlined. The arrangements for benefits paid from an untaxed source (mainly covering public servants) are discussed separately in Chapter 8.

In summary, the proposed taxation treatment would be:

- tax free benefits for those over age 60 (that is, no tax when benefits are paid);
- benefits paid before age 60 would be taxed under rules similar to current arrangements (but simplified by reducing the number of components in a benefit); and
- reasonable benefit limits (RBLs) would be abolished.

The proposed treatment of death benefits is also outlined.

CHAPTER 3 — PAYMENT RULES SIMPLIFIED

This chapter describes how the superannuation payment rules would be relaxed. It also outlines the proposed simplification for the drawdown of superannuation benefits after retirement. The proposed changes are then compared with the existing rules.

In summary, individuals would be given more flexibility over how much of their superannuation they take and when they take it, in particular:

- individuals would not be forced to take their benefits at particular ages (for example, age 75, or from age 65 if they do not meet a work test). Rather, they would be allowed to take their benefits as a regular income stream or lump sum or leave their benefits in the fund and draw on them when they want.

- the complicated set of rules governing the acceptable amounts of pension payments per year and the type of allowable pension products would be simplified. New minimum standards for all pensions would be developed setting simpler basic restrictions such as a minimum amount of payment. If a pension meets the new minimum standards then the earnings on assets supporting that pension would be eligible for an income tax exemption (as is the case currently).

The preservation age (the age at which retired individuals can access their superannuation) will not be changed. The preservation age is already legislated to increase from 55 to 60 between the years 2015 and 2025.

Since 1 July 2005, a person who has reached their preservation age has been able to take their benefits as a non-commutable income stream while they are still working. This measure, which assists individuals' transition to retirement, will continue.

Chapter 4 — Simplified contribution rules

This chapter describes the proposed taxation arrangements that would apply when taxable contributions are made to a complying superannuation fund.

Under the plan, age-based deduction limits would be abolished. Instead, deductible contributions up to a limit of $50,000 per person per annum would be taxed at the concessional 15 per cent rate (a transitional period would apply for people aged 50 and above). Undeducted contributions would be limited to $150,000 in a year. The Government will consider whether the cap should be averaged over three years to allow people to accommodate larger one-off payments.

Employers would receive a full deduction for all superannuation contributions they make for employees up to age 75.

Chapter 5 — Contribution incentives for the self-employed

This chapter describes proposed new contribution incentives for the self-employed. It is proposed that the self-employed (and other eligible persons currently able to claim deductions for contributions made to superannuation) would be able to claim a full deduction for all contributions. It is also proposed that eligible self-employed persons would have access to the Government co-contribution scheme on the basis of an adjusted income test.

Chapter 6 — Age pension arrangements

This chapter describes the proposed changes to the pension assets test taper rate and the assets test exemption applying to certain 'complying' income streams.

To make the assets test fairer, it is proposed to reduce the pension assets test taper rate to $1.50 per fortnight for every $1,000 of assets above the free area from 20 September 2007. The current 50 per cent assets test exemption for complying income streams would be removed from 20 September 2007 to coincide with the reduction in the assets test taper rate. Retaining the assets test exemption under the new arrangements would create scope for wealthier individuals to access the age pension and the associated concessions.

Chapter 7 — Other measures

Some changes are also proposed in related areas. This chapter sets out the Government's proposed approach in these areas.

In particular, certain payments made by employers to individuals in consequence of the termination of employment are currently taxed concessionally as eligible termination payments (ETPs) up to the RBL. Currently, employer ETPs and superannuation benefits are counted together in determining if payments exceed the RBLs. With the proposal that superannuation benefits no longer be subject to RBLs, some changes may be necessary to ensure there would be an appropriate cap on the concessional taxation treatment of large employer ETPs. A proposed approach is outlined in this chapter. It is also proposed that employer ETPs not be able to be rolled over into superannuation.

Chapter 8 — Untaxed schemes

This chapter sets out the rules that would apply to superannuation benefit payments from an untaxed source (mainly affecting public servants). As no tax has been paid on either contributions or earnings, superannuation benefits from these funds have traditionally had a higher tax rate on withdrawal (for example, pensions are taxed at marginal tax rates with no 15 per cent rebate).

For those over age 60, lump sums would be taxed at 15 per cent up to a total amount of $700,000. Amounts above this threshold would be taxed at the top marginal tax rate.

Pensions paid from untaxed schemes would be taxed at the individual's marginal rate less a 10 per cent offset.

CHAPTER 9 — MAKING IT EASIER TO FIND AND TRANSFER SUPERANNUATION

This chapter describes proposals which would make it easier for people to find lost superannuation and transfer benefits to a fund of their choice.

It is proposed that the ATO would take on a more active role in reuniting members with their superannuation and consolidating accounts. To further streamline processes it is proposed to reduce the maximum 90 days for funds to process a transfer request to 30 days. In addition, all funds will be required to use a standard form (including standardised proof of identity checks) for individuals to complete if they wish to directly arrange a transfer request through their fund.

CHAPTER 10 — BENEFITS OF THE PROPOSED CHANGES

This chapter summarises the benefits of the proposed changes.

Removing superannuation benefits tax for those aged 60 or over builds on the introduction of the Government co-contribution as a means of encouraging additional superannuation savings. Simplifying the superannuation rules would also help individuals better understand and become more engaged with superannuation. This would allow better planning for their retirement.

Under a fully mature Superannuation Guarantee (SG) system, a person on $1,000 per week (about average income) is projected to have accumulated superannuation benefits of approximately $466,000 (over a working life of 40 years) through the SG arrangements alone. Under the proposed plan, tax of around $37,000 payable when the benefit is paid would be abolished. This average worker would thus gain around $37,000 in retirement, an increase of approximately 9 per cent if they take a lump sum. If the person chooses to take their benefits as a superannuation pension, they are estimated to have an average of around $136 per week in additional retirement income.

The proposed reforms would also boost incentives to work and save. By making superannuation payments tax free to those aged 60 or over, a person's assessable income would be lower, reducing the tax paid on their other income. Disincentives caused by the pension assets test would also be reduced as a result of the changes to the assets test taper rate. The reduction in taxes proposed in this paper also boosts incentives to save.

The benefits end of superannuation would become simpler for superannuation funds to administer under the proposed changes. Not only are the payment and tax rules complex for individuals, but they also impose significant costs on superannuation funds. These obligations impose costs not only on people aged over 60 but on all fund members.

APPENDICES

Appendix A — Examples of how the proposed changes would increase retirement incomes

This appendix provides examples of how individuals stand to gain from the proposed changes. The appendix shows, for various individuals, how the proposed arrangements would increase retirement incomes.

Appendix B — Examples of how the proposed changes would make superannuation simpler and more streamlined for individuals

This appendix provides examples of how the proposed reforms would make dealing with superannuation simpler and more streamlined for individuals.

GLOSSARY

The glossary contains explanations of a number of terms used in this paper.

In particular, for simplicity this paper refers only to superannuation funds. It is intended that the proposals outlined in this paper apply equally to other types of superannuation entities such as approved deposit funds and retirement savings account providers. In addition, for simplicity this paper refers only to superannuation pensions. It is intended that the proposals outlined in this paper apply equally to superannuation annuities.

1. BACKGROUND AND OVERVIEW OF THE PROPOSAL

1.1 THE GOVERNMENT'S RETIREMENT INCOME POLICY

The Government is committed to Australia's three pillar approach to providing retirement incomes. The three pillars are:

- a taxpayer funded means-tested age pension for people who are unable to fully support themselves in retirement;
- a minimum level of compulsory employer superannuation contributions made in respect of employees; and
- voluntary private superannuation and other savings, supported by incentives to save for retirement and incentives to stay engaged with the workforce.

The policy objective is to assist and encourage people to achieve a higher standard of living in retirement than would be possible from the age pension alone. An example of the assistance provided by the Government towards this objective is the superannuation co-contribution for low to middle income employees. The Government also provides superannuation taxation concessions valued at $15.9 billion in 2005-06.[1]

The Government recognises that individual needs and circumstances vary. As such, the superannuation system should be flexible, adaptable and give individuals choice. Again, the Government has taken action in this area with measures such as the introduction of choice of fund. As staying engaged with the workforce past age 55 is one of the key factors in lifting retirement incomes, the Government has also introduced incentives for older workers such as the Mature Age Worker Tax Offset and allowing drawdowns of superannuation while still working.

The Government also recognises that for the superannuation system to be efficient, the associated taxation arrangements and other rules regulating superannuation must be understandable, send clear signals and provide appropriate incentives. Impediments, complexity and rigid rules should be minimised where possible.

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1 See page 8 of the *Tax Expenditure Statement 2005*.

To this end, the Government has a plan to reduce significantly the complexity of the tax arrangements and the restrictions on superannuation benefits that have built up over time, complicating the superannuation system.

1.2 THE CURRENT COMPLEXITY

Taxation

The current system has different arrangements for tax on contributions, earnings and benefits. In 1988, the then Government brought forward part of the tax which was previously applied to end benefits. This dramatically exacerbated the complex tax treatment of superannuation in Australia.

The report of the Taskforce on Reducing Regulatory Burdens on Business, *Rethinking Regulation,* recommended that high priority be given to comprehensive simplification of the tax rules for superannuation benefits. The report highlighted that the greatest area of complexity is the taxation of end-benefits.

Superannuation benefits tax is by far the most complicated and is the tax that individuals must confront when entering or contemplating retirement. At present, it is difficult for anyone to understand how their superannuation benefits will be taxed.

A lump sum may include up to eight different parts taxed in seven different ways.

The complexity of the benefits tax arrangements not only affects retirees. It affects individual decisions concerning additional superannuation contributions. It also adds to the administration costs of superannuation funds.

Associated rules and regulations on superannuation

The associated rules regulating matters such as how benefits are to be taken and forced payment of benefits are complicated and limit individual choice.

1.3 OUTLINE OF PROPOSAL

The Government is inviting comments on a proposal to sweep away the current raft of complex tax arrangements and restrictions that apply to superannuation benefits. This would improve retirement incomes and increase incentives to work and save.

Under the proposed plan, from 1 July 2007:

- Superannuation benefits paid from a taxed fund either as a lump sum or as an income stream such as a pension, would be tax free for people aged 60 and over.
  - Benefits paid from an untaxed scheme (mainly affecting public servants) would still be taxed, although at a lower rate than they are now for people aged 60 and over.
- RBLs would be abolished.
- Individuals would have greater flexibility as to how and when to draw down their superannuation in retirement. There would be no forced payment of superannuation benefits.
- The concessional tax treatment of superannuation contributions and earnings would remain. Age-based restrictions limiting tax deductible superannuation contributions would be replaced with a streamlined set of rules.
- The self-employed would be able to claim a full deduction for their superannuation contributions as well as being eligible for the Government co-contribution for their after-tax contributions.
- The ability to make deductible superannuation contributions would be extended up to age 75.
- It would be easier for people to find and transfer their superannuation between funds.

To increase further the incentives to save for retirement, it is proposed from 20 September 2007 to halve the pension assets test taper rate to $1.50 per fortnight for every $1,000 of assets above the assets test free area.

The superannuation preservation age would not change. The preservation age is already legislated to increase from 55 to 60 between the years 2015 and 2025. People would still be able to access superannuation benefits before the age of 60, although they would continue to be taxed on their benefits under new simplified rules.

1.4 SUMMARY OF PROPOSED TAXATION SYSTEM FOR DIFFERENT CONTRIBUTIONS/FUNDS

As is the case under the current taxation system, the taxation treatment would vary depending upon whether contributions were made from income that had been subject to income tax. Similarly, separate arrangements would apply to benefits arising from an untaxed source.

A summary of the proposed concessional taxation arrangements is set out below.

Employer contributions, salary sacrifice contributions, or deductible contributions from the self-employed

These contributions are made from income that has not been subject to income tax. They would be subject to the following taxation treatment.

- Contributions up to an annual limit of $50,000 per annum per person would be taxed at a concessional rate of 15 per cent (for members of defined benefit schemes this would also include notional contributions). The ATO would identify any contributions above this limit. These contributions would be taxed at the top marginal tax rate.

- Earnings on these contributions would continue to be taxed at a concessional rate of 15 per cent (10 per cent on capital gains where the asset is held for 12 months or more). Tax payable on earnings would still be able to be reduced through the application of imputation and other credits.

- No tax would be paid when superannuation benefits were paid after age 60 (irrespective of whether the benefit was taken as a lump sum or pension).

Member contributions (paid from after tax income)

These are contributions made from income after the individual has already paid tax on that income. Member contributions would be subject to the following taxation treatment.

- No tax would be payable when the contributions are made (given income tax would have already been paid on the income). These contributions would be limited to $150,000 in an income year (three times the limit on concessionally taxed deductible contributions).

- Earnings on these contributions would continue to be taxed at a concessional rate of a maximum of 15 per cent (10 per cent on capital gains where the asset is held for 12 months). Tax payable on earnings would still be able to be reduced through the application of imputation and other credits.

- No tax would be paid on these contributions when they are paid to the individual as superannuation benefits (irrespective of whether the benefit is taken as a lump sum or pension).
- A Government co-contribution will continue to be paid for eligible persons (now including the eligible self-employed) on incomes up to the co-contribution upper threshold, and no tax is payable on the co-contribution.

Untaxed schemes (mainly for public servants)

In some superannuation schemes run by the Australian Government and the State and Territory governments, no employer contributions are made until a benefit becomes payable and no contributions or earnings tax is paid. Only 10 per cent of all superannuation fund members are members of such schemes and they are nearly all public servants. The majority of such schemes are now closed to new members.

As no contributions or earnings tax is paid there should be a higher level of tax when benefits are paid to fund members. This ensures equity with other superannuation funds where contributions and earnings tax would have been paid. Reflecting this, these types of benefits are already subject to a higher level of tax than other benefits and this distinction would continue. However, consistent with the proposed new concession to remove benefits tax for those aged 60 or over in a taxed fund, the tax on benefits received by members aged 60 or over from an untaxed source would be reduced.

Lump sum benefits paid from an untaxed source to those aged 60 or over would be taxed at 15 per cent on lump sums up to a total of $700,000. Amounts above this threshold would be taxed at the top marginal tax rate. Pensions paid to those aged 60 or over would be taxed at marginal tax rates but receive a 10 per cent offset. For example, a person who received a pension of $50,000 per annum would receive a reduction in their tax of about $5,000.

1.5 THE BENEFITS OF CHANGE

Retirees

There are significant simplicity benefits for retirees. Under the proposed plan, the 100,000 Australians who turn 60 each year and choose to retire would have a much simpler system to face when deciding how to draw on their superannuation. They would no longer need to pay for expensive financial advice on the tax treatment of their superannuation benefits. Independent evidence given to the House Standing Committee on Economics, Finance and Public Administration inquiry into improving superannuation savings of people under age 40, stated that this advice can cost in the order of $3,000 to $10,000 depending on the complexity.

The plan would also have a significant impact on a person's retirement income. An average income earner would have an additional lump sum of around $37,000 or an additional $136 per week if they take their benefit as a superannuation pension. There are greater benefits if a person chooses to make additional superannuation savings. See Appendix A for further details.

Withdrawals would be tax exempt, removing complexity for people aged 60 and over. There would be:

- no need to worry about the complying or non-complying status of income streams for tax purposes;
- no forced payment of superannuation benefits; and
- greater choice and flexibility for Australians planning their retirement.

As many superannuation benefits would no longer be included in assessable income, there would no longer be a disincentive for people to continue with some work while drawing on their superannuation. With no tax on their superannuation, they may pay less tax on any income from work.

Individuals would no longer be forced to draw down on their superannuation benefits after age 65. Subject to fund rules, superannuation could be paid out whenever and however a person wished. People could take as much or as little as they like and it would generally not have to be included in their tax return.

Individuals would have the flexibility to change their arrangements as their circumstances change. If people want to keep some money in their superannuation accounts for other contingencies, then that choice would be left to the individual.

The plan reduces the myriad of rules and red tape that superannuation funds must contend with when paying a benefit. This reduction in complexity could be expected to reduce the costs facing superannuation schemes in delivering their services and therefore contribute to lower fees and charges over the longer term.

Self-employed

Currently, there are different rules on the concessional treatment of contributions made by the unincorporated self-employed. The self-employed can claim a tax deduction for the first $5,000 of superannuation contributions and then 75 per cent of any contributions above this amount until they reach their age-based limit. An employer can claim a full deduction up to the age-based limits of their employees. The self-employed also do not qualify for the co-contribution.

Under the plan, contributions made by the self-employed would be treated in the same way as contributions made for the benefit of employees. This means that the self-employed would be eligible for a full deduction for their superannuation contributions. The self-employed may also be eligible for the Government co-contribution for any personal undeducted contributions. Currently the self-employed are not eligible for the Government co-contribution.

Age pensioners

The plan would not reduce an age pensioner's existing entitlements. Superannuation would still be included as part of the income and assets tests in determining a person's eligibility for the age pension.

However, more generous pension assets test rules are proposed to increase incentives to save.

Currently, a person loses $3 of age pension per fortnight ($78 annually) for every $1,000 of assets above the assets test free area. This is very punitive as retirees must achieve a return of at least 7.8 per cent on their additional savings to overcome the effect of a reduction in their age pension. This acts as a large disincentive to save for retirement.

As superannuation savings increase, as well as the value of other assets such as investment houses and shares, the number of people affected by the assets test is projected to grow with more low to middle income earners having their age pension reduced by the assets test. The current assets test also prevents retirees with relatively modest assets but with low incomes from being able to access the age pension.

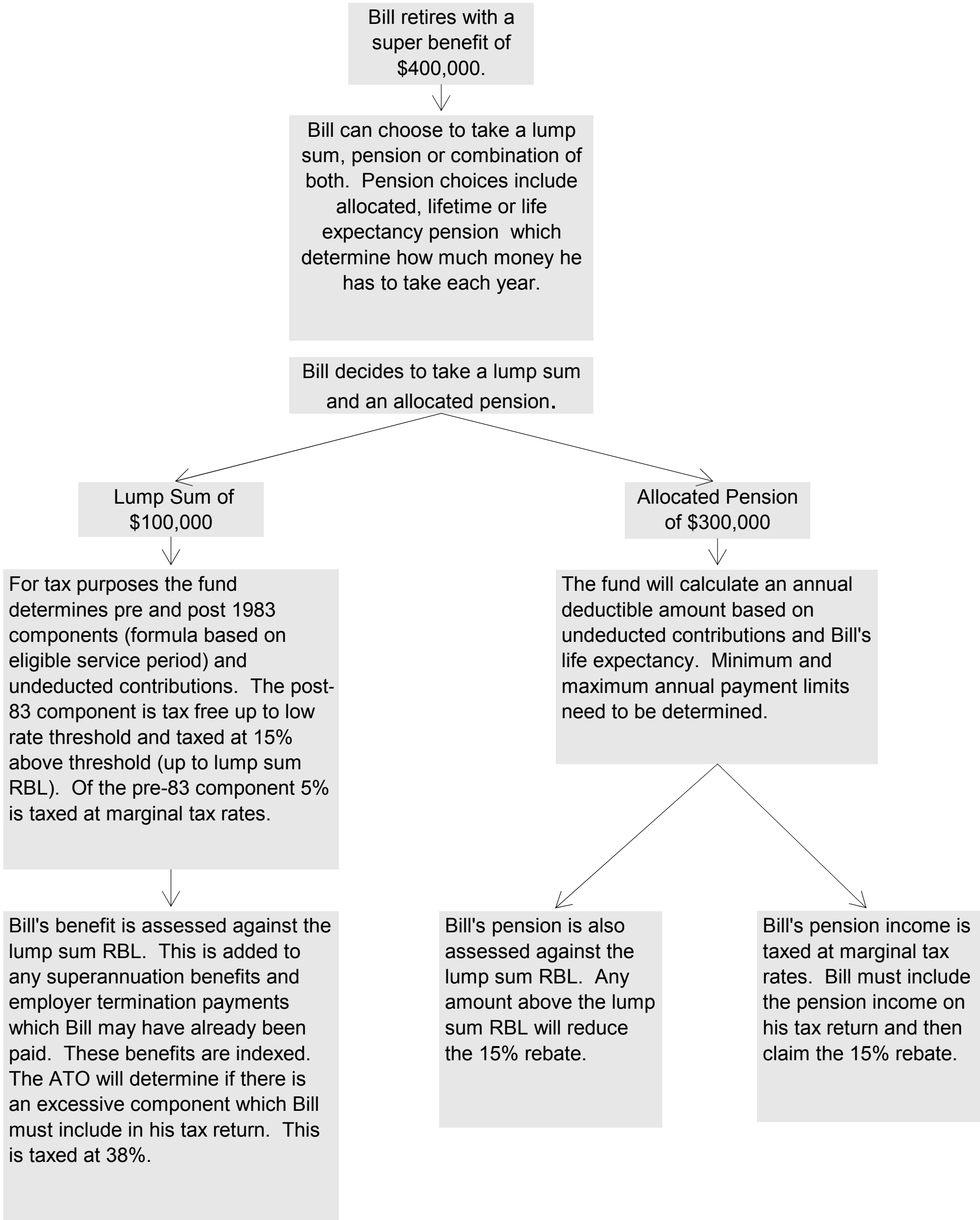
To make the assets test fairer, it is proposed to reduce the pension assets test taper rate to $1.50 per fortnight for every $1,000 of assets above the assets test free area from 20 September 2007. Based on the current age pension, a single retiree homeowner could have around an additional $165,000 of assets before losing the age pension, while a couple could have around $275,000 of additional assets.

The current 50 per cent assets test exemption for complying income streams would be removed from 20 September 2007 to coincide with the reduction in the assets test taper rate. Retaining the assets test exemption under the new arrangements would create scope for wealthier individuals to access the age pension and the associated concessions.

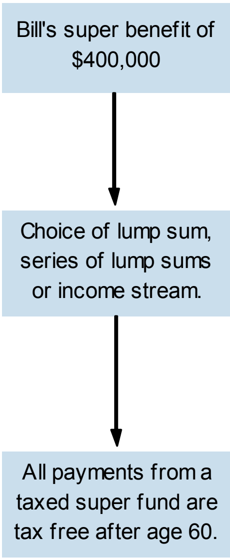
However, people would still be eligible for a 50 per cent assets test exemption for complying income streams purchased before 20 September 2007, and a 100 per cent exemption for those purchased before 20 September 2004.

The complexity that a retiree currently faces when accessing their superannuation benefits compared to the proposed system is illustrated in Diagram 1.

Diagram 1: Current arrangements



Proposed simplified system



2. TAXATION OF BENEFIT PAYMENTS

This chapter describes the proposed taxation arrangements that would apply when superannuation benefits are paid from a taxed source (covering about 90 per cent of superannuation fund members). The arrangements for benefits paid from an untaxed source (mainly covering public servants) are dealt with separately in Chapter 8.

Key Points

- Superannuation benefits paid from a taxed fund either as a lump sum or pension would be tax free when paid to people aged 60 and over.
- Superannuation preservation rules would not change. If an individual reaches preservation age (currently 55), they would still be able to access their superannuation benefits before age 60, although their benefits would be taxed (broadly in the same manner as they are now but under some simplified rules).
- RBLs for superannuation would be abolished.

2.1 CURRENT TAXATION ARRANGEMENTS

2.1.1 Lump sums

The lump sum payment of superannuation benefits is classified as an ETP and is divided into various components, each of which is subject to special tax treatment. The different components could include the: concessional component; post-June 1994 invalidity component; capital gains tax (CGT) exempt component; non-qualifying component; undeducted contributions component; excessive component; pre-July 1983 component; and post-June 1983 component. An explanation of these components is contained in the Glossary. The manner in which each component is taxed is summarised at Table 2.1.

2.1.2 Pensions

Pension payments received by a person in each year are included in the person's assessable income and taxed at marginal tax rates. However, a deduction is allowed for the return of contributions which were made towards the pension from the pensioner's own after-tax income and certain other amounts. The annual deductible amount is determined by apportioning the 'undeducted purchase price' of the pension over the expected term of the pension. The 'undeducted purchase price' of the pension normally comprises the following components of the benefit — undeducted contributions, the CGT exempt component and the post-June 1994 invalidity component.

A flat 15 per cent rebate of tax may be available to recipients aged 55 or over of superannuation pensions paid from a taxed fund. The rebate is available on the amount of the pension which is included in the recipient's assessable income. The rebate is also only available for amounts up to the applicable RBL. The application of the lump sum RBL or higher pension RBL will depend on the type of pension chosen and whether, overall, 50 per cent or more of total benefits are taken as a 'complying' pension. If the benefit is above the relevant RBL, then the applicable rebate will be reduced proportionally reflecting the extent to which the pension exceeds the relevant RBL.

2.1.3 Reporting

Individuals must report details of ETPs and pensions in their tax return. These amounts are included in their income for tax purposes, potentially increasing the amount of tax they pay on other income.

All benefit payments must be reported to the ATO by superannuation funds for RBL purposes.

2.2 Proposed rules for benefits paid to individuals aged 60 and over

2.2.1 Lump sums — proposed arrangements

All lump sum benefits paid from a taxed source to an individual aged 60 or over would be tax free when paid. There would be no RBL.

2.2.2 Pensions — proposed arrangements

All pension payments from a taxed source would be tax free when paid to individuals aged 60 or over, including pensions which commenced before 1 July 2007. There would be no RBL.

2.2.3 Reporting — proposed arrangements

Individuals would not need to include lump sum superannuation benefits and superannuation pensions in their tax return, lowering their taxable income and therefore potentially lowering the tax paid on other income.

Superannuation funds would not need to report benefit payments to the ATO for RBL purposes.

2.3 PROPOSED RULES FOR BENEFITS PAID TO INDIVIDUALS AGED UNDER 60 YEARS

Current arrangements

Currently, if a person aged between 55 and 59 years receives a superannuation benefit, the taxation treatment is the same as for a person aged 60 or over. However, if a person aged less than 55 receives a lump sum superannuation benefit, higher rates of tax are payable on the post-June 1983 component, and if they receive a pension then no rebate is available. The lump sum benefit treatment is summarised at Table 2.1.

Proposed arrangements

Benefits would still be subject to tax if paid before age 60 — this would provide an incentive for individuals to remain in the workforce and leave their superannuation benefits in their fund until this age. If the individual continues to work and contribute to superannuation in this time, their retirement savings would be further boosted through additional contributions and earnings.

To reduce complexity, it is proposed that the number of taxation components of a benefit be reduced for those under age 60. This would mean some components would be taxed at a lower rate than previously.

2.3.1 Lump sums

Proposed arrangements for those aged under 60

The proposed arrangements would simplify lump sum payments for individuals aged under 60, with the payment being divided into only two components — an exempt component and a taxable component.

- The exempt component would be tax free. The exempt component would comprise: the pre-July 1983 component; the CGT exempt component, the post-June 1994 invalidity component, concessional component and undeducted contributions.

- The taxed component (the current post-June 1983 component and the non-qualifying component) would be tax free up to the low-rate threshold ($129,751 in 2005-06) and taxed at 15 per cent above the threshold. For those aged under 55, this component would be taxed at 20 per cent. This is the same treatment as currently applies to the post-June 1983 component.

A comparison of the current system to the proposed system is at Table 2.1.

Calculating the pre-July 1983 component

All funds would be required to calculate a pre-July 1983 amount as at a particular date under the existing legislative formula — that amount would then become a fixed component that would not change in the future and would then form part of the new exempt component.

Table 2.1: Comparison of current system to proposed system

Component	Current tax treatment	Proposal
Pre-July 1983	5 per cent taxed at marginal rates	Exempt component
Concessional	5 per cent taxed at marginal rates	
Undeducted contributions	Exempt	
Post-June 1994 invalidity	Exempt	
Capital gains tax exempt	Exempt	
Non-qualifying	Marginal rates	Taxable component (see below)
Post-June 1983	Taxed as per table below	
Excessive	38 per cent	Abolished

Taxable component

Taxpayers age	Current tax treatment (for post June 1983)	Proposal
Under 55	20 per cent	20 per cent
Age 55-59	Up to threshold ($129,751) — 0 per cent Over threshold — 15 per cent	Up to threshold ($129,751) — 0 per cent Over threshold — 15 per cent
Age 60 and over	Up to threshold ($129,751) — 0 per cent Over threshold — 15 per cent	Exempt

2.3.2 Pensions

Proposed arrangements for those aged under 60

Pension payments for individuals aged under 60 would generally continue to be taxed under current arrangements (see section 2.1.2), although consistent with the simplification of taxation of lump sum payments, tax would be lower in some cases.

As the components of a lump sum payment made to a person aged under 60 are to be simplified (see section 2.3.1), more components of a lump sum would be tax exempt under the proposal. This is more generous treatment than is allowed under the current system. It would be appropriate, therefore, that when the undeducted purchase price of a pension (commenced on or after 1 July 2007) is determined that it includes all the new exempt components. This would mean a higher undeducted purchase price, and thus deductible amount, may apply to these pensions than under the current arrangements. For example, any pre-July 1983 component would now be included in determining the undeducted purchase price and thus the deductible amount. For pensions that commenced prior to 1 July 2007, it is intended that the current arrangements for calculating the deductible amount remain.

The full superannuation pension rebate of 15 per cent would apply to all pensions paid from a taxed fund if the individual is aged 55 to 59 years.

Once the pension recipient turns 60, their pension would be tax free as outlined in section 2.2.2.

2.3.3 Reporting — proposed arrangements

Individuals aged under 60 would still be required to report details of ETPs and pensions in their tax return.

Benefit payments would no longer be reported to the ATO by superannuation funds for RBL purposes.

2.4 Death benefits

Current arrangements

When a lump sum benefit is paid as a result of the death of a person, the payment is a ‘death benefit ETP’.

When a lump sum death benefit payment is paid to a dependant, the payment is tax free up to the pension RBL ($1,297,886 for 2005-06). The excessive amount is taxed as an excessive component.

If the lump sum death benefit payment is paid to a non-dependant, the payment is assessable as an ETP based on the deceased's eligible service period and taxed accordingly. However, of the post-June 1983 component, any amount paid from a taxed fund up to the deceased's pension RBL is taxed at a maximum of 15 per cent (irrespective of the age of the recipient and no low-rate threshold applies) and 38 per cent above the RBL.

When a reversionary pension is paid on death, it is taxed at the reversionary beneficiary's marginal tax rate less any deductible amount and receives the same rebate as the original pension.

Proposed arrangements

Under the proposed arrangements, all lump sum death benefit payments would be tax free if paid to a dependant.

It is proposed that the taxation of a death benefit paid as a reversionary pension would depend on the age of the primary and reversionary beneficiary. If the primary beneficiary was aged 60 or over at the time of death, then payments to the reversionary beneficiary would be exempt from tax (given they were already being paid exempt to the primary beneficiary). If the primary beneficiary was under age 60 at the time of death, the pension would continue to be taxed at the reversionary beneficiary's marginal tax rate (less any deductible amount and pension rebate) unless the reversionary beneficiary is aged 60 or over, in which case it would be tax exempt.

A pension would not be able to revert to a non-dependant on death; rather, death benefit payments to non-dependants would have to be made as a lump sum. Lump sum payments to non-dependants (irrespective of their age) would be taxed in the same manner as other superannuation fund payments to someone in the age 55-59 group (see section 2.3.1), though the entire taxable component (see table 2.1) would be taxed at 15 per cent (as is currently the case for the post-June 1983 taxed element).

2.5 Temporary residents

People who enter Australia on an 'eligible temporary resident visa' and who later permanently leave Australia can claim any superannuation they have accumulated. The payment is subject to withholding tax.

Current arrangements

The rates for payments from a taxed source are:

- undeducted contributions and post-June 1994 invalidity component — 0 per cent; and
- the remainder (in most cases post-June 1983 taxed element) — 30 per cent.

Proposed arrangements

Reflecting the new simplified ETP components (see section 2.3.1), the rates would be:

- exempt component — 0 per cent; and
- taxable component — 30 per cent.

In practical effect, this is no change to the current system. If the payment is from an untaxed source, it would continue to be taxed at 40 per cent.

3. PAYMENT RULES SIMPLIFIED

This chapter outlines the proposals to simplify payment rules so fewer restrictions apply on how and when an individual may take their superannuation benefits.

Key Points

- The rules for when individuals can voluntarily choose to access their superannuation would not change — that is, individuals would still be able to access their superannuation once they reach preservation age and have retired, and from age 65 even if they have not retired.
- An individual would not be compelled to draw down their superannuation once they reach a particular age. They would be free to draw on it as and when they want.
- Pensions would continue to receive favourable tax treatment. However, the rules defining a pension would be greatly simplified.
  - If a person chooses to take a pension, they would be able to take out as much as they like when they like, provided a minimum amount is taken each year.

3.1 WHEN BENEFITS CAN, OR MUST, BE PAID

3.1.1 Current arrangements

Voluntary withdrawal

Under the current rules, a member of a superannuation fund can choose to take their benefits out of their fund once they have reached preservation age and retired or once they have reached age 65.

Compulsory withdrawal

Under the current rules, funds are forced to pay out the benefits of members who have reached age 65 and who do not meet a work test. Specifically, a fund must commence paying a person's benefit if they are over age 65 and have not worked at least 240 hours in the most recent financial year. Funds must be satisfied that members in this age group continue to meet this rule each year in order for benefits to be retained in a fund.

Once a person reaches the age of 75, normally their fund must commence paying out their benefits irrespective of whether or not they are still working.

3.1.2 Proposed new rules

Voluntary withdrawal

The preservation arrangements would not change. The preservation age is already legislated to increase from 55 to 60 between the years 2015 and 2025. Members would still be able to take their superannuation once they have reached preservation age and retired or once they reach age 65.

Compulsory withdrawal abolished

The requirement for compulsory payment of benefits to members over age 65 who do not meet the current work test would be removed — that is, there would be no forced payment of superannuation benefits after age 65. Due to these changes, superannuation funds would no longer have to administer work tests to determine whether the benefits of members aged between 65 and 74 must be paid out.

The requirement that benefits must be paid out regardless of a person's work status from age 75 would also be removed.

These changes would mean that a person would be able to keep their benefits in their superannuation fund indefinitely, taking out as little or as much of their benefits as they choose. If they choose to take their benefits in pension form, then earnings on the assets supporting that pension would continue to be exempt from tax — earnings on other assets would continue to be subject to tax as assessable income of the fund at 15 per cent.

3.2 SIMPLIFYING PENSION RULES

3.2.1 Current arrangements

At present, the superannuation legislation contains rules for five different pension products and seven different annuity products, each with their own separate payment rules. The different income stream products currently include lifetime and life expectancy income streams, market-linked income streams (MLIS) and allocated income streams. The design of the pension will also affect whether the pensioner is eligible for social security or tax concessions. These different rules add significant complexity to the superannuation system, especially for retirees.

3.2.2 Overview of proposed arrangements

Replacing multiple rules for multiple types of pensions with a simple set of rules

The decision to take a pension has in the past been a daunting prospect for many retirees, as different pensions can have different tax treatments and thus produce different retirement income results. In addition, the market's ability to meet consumer demand has been constrained by restrictions that limit flexibility and reduce choice.

Under the proposed arrangements, all pensions that meet simplified minimum standards would be taxed the same on payment. Earnings on assets supporting these pensions would remain tax exempt.

Pensions that meet existing rules and commenced before 1 July 2007 would be deemed to meet the new minimum standards.

The proposed simple standard

The new minimum standards for pensions commencing on or after 1 July 2007 would require:

- payments of a minimum amount to be made at least annually (see section 3.2.3), allowing pensioners to take out as much as they wish above the minimum (including cashing out the whole amount);
- no provision to be made for an amount to be left over when the pension ceases; and
- that the pension could be transferred only on the death of the pensioner to one of their dependants or cashed as a lump sum to the pensioner's estate.

The payment rules would specify minimum limits only. No maximum would apply, with the exception of pensions which are commenced under the transition to retirement condition of release (see section 3.3).

Guaranteed lifetime pensions

Guaranteed lifetime pensions provided on an arm's length basis that meet relevant existing requirements would continue to be acceptable.

3.2.3 Pension payments

Individuals would be able to choose the amount they take from their pension each year. A minimum amount would be required to ensure that the capital is generally drawn down over time. This would enable a larger account balance to accumulate in the early years with a drawdown of capital and income in later life if that suits the pensioner's circumstances. If a pensioner finds they have unexpectedly large expenses in a particular year, they could withdraw as much as required to meet that need, including the whole amount.

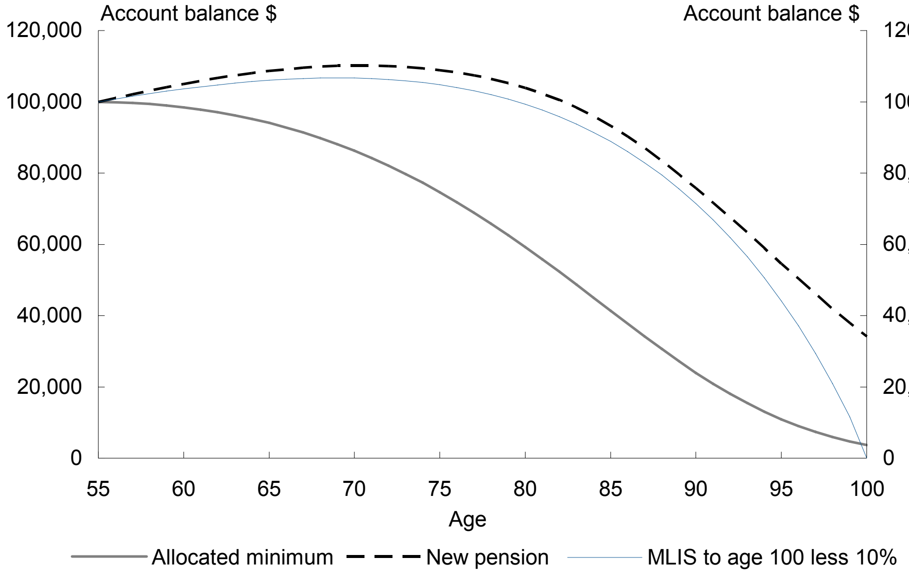
The following minimum pension payments are proposed. These minimum pension amounts would provide greater flexibility for a pensioner as to the amount they choose to withdraw each year.

Proposed minimum annual pension payments (sample only)

Age	Per cent of account balance (average)
55 — 64	4
65 — 74	5
75 — 84	6
85 — 94	10
95 +	14

Chart 3.1 shows the impact on a pensioner's account balance of only taking the minimum compared with two existing products — an allocated pension and a MLIS (payable to age 100, drawing the minimum each year). The chart is based on an initial account balance of $100,000, an assumed 5 per cent earnings rate, income paid at the start of the year, and no fees. The chart reflects a smoothing of payments over the life of the pension.

Chart 3.1: Account balance by age



A pensioner would be able to retain greater amounts in their account to meet expenses in later life while still having choices as to the amount they withdraw for their day-to-day living expenses.

3.3 Transition to retirement

Since 1 July 2005, new regulations have allowed a person who has reached their preservation age (currently 55) to take their benefits in the form of a non-commutable pension while they are still working.

The regulations for this measure allow benefits to be paid out only in the form of a 'complying' pension or an allocated pension which the person is unable to commute to cash prior to satisfying a full condition of release (such as retiring or reaching age 65).

As a consequence of the changes proposed in this paper, these rules would be amended to allow pensions that meet the new minimum standards (see section 3.2.2) to be able to provide transition to retirement benefits.

The current rules enable individuals to draw down around 10 per cent of the account balance each year depending on the pension product and member's age. To simplify these arrangements, the proposed new rule would allow no more than 10 per cent of the account balance (at the start of each year) to be withdrawn in any one year. This caps the amount that could be withdrawn to prevent excessive dissipation of assets. It would also simplify the current rule. The existing non-commutability rules for income streams purchased under the transition to retirement measure would continue to apply. Pensions commenced prior to 1 July 2007 which complied with relevant rules for the transition to retirement measure at the time would be deemed to satisfy the proposed requirements.

3.4 Benefits not withdrawn

3.4.1 Current arrangements

As noted previously, under current rules, funds are forced to pay benefits to members under certain circumstances, such as attaining age 65 and ceasing employment, or attaining age 75.

3.4.2 Proposed new rules

There would be no compulsory draw down rules under the new arrangements. These changes would allow a person to keep their benefits in a fund indefinitely.

Where a person chooses not to draw down on their fund assets as a pension, then earnings on these assets would generally be subject to tax as assessable income of the fund at 15 per cent.

4. SIMPLIFIED CONTRIBUTION RULES

This chapter describes the current rules and the proposed taxation arrangements when contributions are made to taxed superannuation funds. Different rules would apply to untaxed superannuation schemes. Untaxed superannuation schemes generally only apply to public servants and are discussed in Chapter 8.

Key Points

- Concessional deductible contributions to superannuation would be limited to $50,000 per person per annum. These contributions would be taxed at 15 per cent.
  - A transitional period would apply for people who are aged 50 and above to allow those planning to retire soon to make larger contributions.
- Employers would be able to claim a full deduction for all contributions to superannuation on behalf of individuals under the age of 75. The SG would continue to apply only until age 70.
- The personal deduction eligibility rule would be simplified by making it consistent with the rule that currently applies for the Government co-contribution.
- The self-employed (and other persons able to claim deductions for contributions to superannuation) would be able to claim a full deduction for contributions to superannuation until age 75. This is dealt with further in Chapter 5.
- Personal superannuation contributions from an individual's after-tax income (known as undeducted contributions) would continue not to be taxed when contributed and may be eligible for the Government co-contribution (as currently). These contributions would be limited to $150,000 per annum.
  - The Government will consider whether the cap should be averaged over three years to allow people to accommodate larger one-off payments.

Table 4.1: Comparison of taxation on deductible contributions under current system and proposed system

Current contribution rules (as at 1 July 2005) [(a)]		
Contributions below the age-based limits		
<35 years	$14,603 pa	15% contributions tax
35 — 49 years	$40,560 pa	
50 — 69 years	$100,587 pa	
Contributions above the age-based limits		15% contributions tax plus 30% deduction denied

Proposed contribution rules (as at 1 July 2007) [(b)]	
Concessional contributions limited to $50,000 pa	15% tax

(a) Contributions are deductible up to the age-based limits.
(b) Contributions would be fully deductible. The ATO would identify any contributions made above this limit. These contributions would be taxed at the top marginal tax rate.

4.1 CURRENT TAXATION ARRANGEMENTS

Contributions to superannuation are subject to tax in the superannuation fund when made by an individual's employer, including through salary sacrifice arrangements, or when made by a self-employed individual and certain other persons (if they are eligible to, and claim, an income tax deduction for the contribution). Some other less common contributions to superannuation are also subject to tax (see section 4.6).

Contributions are taxed at a rate of 15 per cent. In addition, if an employer makes a contribution above an individual's age-based limit, the contribution is still taxed at 15 per cent but the employer is denied a 30 per cent deduction on that contribution.

These amounts may be subject to tax when withdrawn from superannuation.

4.2 PROPOSED TAXATION ARRANGEMENTS

It is proposed to streamline the rules for deductible contributions. This involves removing the age-based limits on deductible contributions.

Under the proposed arrangements, a limit on concessional deductible contributions of $50,000 per person per annum would apply. These contributions would be taxed at 15 per cent.

Where the ATO identifies that a person's deductible contributions have exceeded $50,000 in a financial year, the amount in excess of $50,000 would be taxed at the top marginal tax rate.

The new threshold would apply per person, irrespective of the number of employers contributing on behalf of the person.

Given the removal of the RBL and tax on benefits, this limit on deductible contributions would play a key role in the fiscal sustainability of the system.

Application to funded defined benefit schemes

In funded defined benefit schemes, contributions are generally not allocated to the account of a specific employee. Rather, employees are entitled to a specified amount upon retirement, usually related to the salary of the employee and the number of years of service.

Where employer funding occurs, these contributions (together with any other deducted contributions) would continue to be treated as deductible contributions and taxed at the concessional 15 per cent rate, except for amounts paid into constitutionally protected funds, which are exempt from tax.

In addition, for the purposes of determining whether the $50,000 cap has been exceeded by members of such schemes, superannuation benefits accruing to an employee during a year in a funded defined benefit scheme, that is notional taxable contributions, would also be added to any other deductible contributions in accumulation schemes for each employee. This would be the subject of consultation with interested parties.

Untaxed defined benefit schemes are discussed in Chapter 8.

4.3 Administrative arrangements for contributions tax

Assessments by the ATO would be based on information provided by superannuation funds.

The 15 per cent contributions tax is currently collected by treating taxable contributions as income of a superannuation fund. The tax payable can be reduced by superannuation funds through the application of imputation and other credits. These arrangements would remain unchanged.

Any additional liability for tax on contributions over $50,000 per annum would be determined in respect of an individual but levied on superannuation funds. Superannuation fund reporting requirements would provide the ATO with enough information to assess contributions tax liabilities as funds, except those that are untaxed, would report all taxable contributions (including notional taxable contributions) made for the benefit of an individual.

Where taxable contributions (including notional taxable contributions) for an individual exceed $50,000 per annum and are made to more than one superannuation fund, the most practical fund(s) on which to levy the tax would need to be determined. It is anticipated that there would be few instances where this would be necessary.

Further details on the administrative arrangements would be determined in consultation with the superannuation industry.

4.4 AGE-BASED LIMITS AND DEDUCTION RULES

4.4.1 Current arrangements

Employers

Employers are entitled to a tax deduction for contributions to superannuation made on behalf of employees, up to the age-based deduction limits. For the 2005-06 financial year, the age-based deduction limits are $14,603 for individuals under the age of 35, $40,560 for individuals aged 35 to 49 and $100,587 for individuals aged 50 to 69. This requires employers to monitor the contributions paid to their employees to ensure they are not over the limit.

Self-employed

The treatment of contributions to superannuation by the self-employed (and certain other persons who are also eligible to claim a tax deduction for their contributions) is dealt with in Chapter 5.

Contributions by or for individuals aged 70 or over

Individuals aged 70 to 74 can contribute to superannuation where they meet the work test requirements, but cannot claim a deduction for such contributions. Further, employers can not claim a deduction for superannuation contributions made on behalf of a person over the age of 70, unless these contributions are required under an industrial award.[2]

2 SG contributions are not required for employees aged 70 and over.

Personal deduction eligibility

The rule that determines a person's eligibility to claim a deduction for personal contributions is complex. It currently involves determining the level of employer superannuation support a person receives (or should receive) during the income year.

4.4.2 Proposed arrangements

Employers

It is proposed that age-based deduction limits be abolished. Employers would be able to claim a full deduction for all contributions to superannuation funds made on behalf of their employees under age 75.

Employees

The proposed removal of age-based limits would provide scope for employees under age 35 to make larger contributions to superannuation through salary sacrifice arrangements, as their employers would be able to claim a full tax deduction for all contributions. The current age-based limit for individuals less than age 35 is $14,603 per annum, compared to the proposed limit of $50,000 per annum.

Self-employed

Under the plan, contributions made by the self-employed would be treated in the same way as contributions made by employers for the benefit of employees. Superannuation contributions would be eligible for a deduction until age 75. This is dealt with more fully in Chapter 5.

Personal deduction eligibility

It is proposed that the rule that determines a person's eligibility to claim a deduction for personal contributions be simplified. The test would be changed so that it would only determine how much of a person's assessable income and reportable fringe benefits is attributable to employment as an employee, mirroring the test currently used for determining eligibility for a Government co-contribution.

Transitional arrangements

Under current arrangements, the age-based deduction limit for people aged 50 and over is $100,587. The proposal is to introduce a uniform concessional contributions limit of $50,000 to be taxed at the concessional 15 per cent rate. A transitional period for people aged 50 and over is proposed. Table 4.2 sets out the amounts individuals aged 50 and over during the transitional period would be able to continue to contribute to superannuation at the concessional tax rate of 15 per cent. Deductible contributions above this amount would be taxed at the top marginal rate. These transitional arrangements would allow people who are planning to retire in the immediate future to continue to make larger contributions at concessional rates.

Table 4.2: Transitional arrangements

Financial year	Individuals aged 50 and over Maximum contribution taxed at 15 per cent
2007-08	$100,000
2008-09	$100,000
2009-10	$100,000
2010-11	$100,000
2011-12	$100,000
2012-13	$50,000

4.5 UNDEDUCTED CONTRIBUTIONS

Not all contributions are currently subject to tax in a superannuation fund. Personal undeducted contributions, which are made from an individual's after-tax income, would remain tax free when contributed to, and withdrawn from, superannuation. Undeducted contributions would also remain eligible for the Government co-contribution.

Once in the fund, the earnings on all contributions are subject to the concessional 15 per cent earnings tax which represents a significant concession designed to encourage and support retirement savings. The removal of benefits tax and RBLs would increase the concessions provided to superannuation.

These proposed changes, in conjunction with the current tax exempt status of superannuation pension assets, would make superannuation an attractive vehicle in which to retain assets to avoid paying tax. There would also be an incentive for high-wealth individuals to transfer large amounts of assets currently held outside superannuation to the concessionally taxed superannuation system.

To ensure the concessions are targeted appropriately, a cap of $150,000 a year (three times the proposed concessional contributions limit) on the amount of post-tax superannuation contributions a person can make would apply. In addition, the Government will consider whether the cap should be averaged over three years to allow people to accommodate larger one off payments.

This cap is expected to impact on very few people. If the proposals in this paper are adopted, this restriction would apply from Budget night, 9 May 2006.

4.5.1 Refund of excessive contributions

Contributions in excess of the cap would be returned to the individual. Any earnings on the excess would be effectively taxed at the top marginal tax rate.

4.5.2 Administration

The ATO would collect the necessary information on contributions in order to determine when a person has exceeded the annual cap. This would trigger a return of the excessive contributions and earnings.

Rules would be developed to determine which contributions are refunded in the case of multiple contributions and funds.

4.5.3 Exemptions to the cap

Scope would be provided for certain exemptions to the cap, such as the CGT exempt component from the sale of a small business (Subdivision 152-D of the *Income Tax Assessment Act 1997*).

4.5.4 Defined benefit funds

Special rules may be needed for defined benefit funds and would be developed in consultation with industry.

4.6 OTHER TAXABLE CONTRIBUTIONS

4.6.1 Transfers from overseas superannuation funds

Where a superannuation benefit is paid from an overseas fund more than six months after the individual becomes an Australian resident, a tax liability may arise. The tax liability arises in respect of an amount (the taxable amount) which reflects earnings on the overseas superannuation while the individual was an Australian resident.

- Where the benefit is paid directly to the individual, the taxable amount is included in their assessable income and taxed at their marginal tax rate.
- Where the benefit is transferred to an Australian superannuation fund, the member can elect to have the taxable amount instead treated as a taxable contribution in the Australian fund (and therefore subject to the 15 per cent tax on contributions).

It is proposed that where an individual elects for the taxable amount to be treated as a taxable contribution, then the taxable amount would remain taxed at the flat rate of 15 per cent when contributed to superannuation. This is appropriate as the taxable amount represents earnings on overseas superannuation during the relevant period. These earnings would have been taxed at 15 per cent if they had been in the Australian superannuation fund.

4.6.2 Transfers from untaxed schemes

Transfers of untaxed benefits from an untaxed scheme into a taxed fund are currently subject to contributions tax when paid into the fund. This will generally continue. New withholding arrangements will apply to the transferring fund (the untaxed scheme) when transferring a benefit. These new arrangements are discussed in Chapter 8.

5. CONTRIBUTION INCENTIVES FOR THE SELF-EMPLOYED

This chapter outlines proposals to allow the self-employed full deductibility for their contributions, and access to the Government co-contribution scheme.

Key Points

- The self-employed (and other eligible persons) able to claim a deduction for personal contributions to superannuation would be able to claim a full deduction for all personal contributions until age 75.
- Eligible self-employed persons would have access to the Government co-contribution scheme.

5.1 AGE-BASED LIMIT AND DEDUCTION RULES

5.1.1 Current arrangements

Contributions to a superannuation fund by the self-employed (and other eligible persons) are an allowable personal income tax deduction subject to certain restrictions. In any year, only the first $5,000 contributed to a complying superannuation fund is fully deductible. Additional contributions above this amount are 75 per cent tax deductible, up to a maximum deduction equal to the relevant age-based limit. The age-based deduction limits for the 2005-06 income year are $14,603 for those aged less than 35, $40,560 for those aged 35 to 49, and $100,587 for those aged 50 to 69.

5.1.2 Proposed arrangements

It is proposed that the deductibility of contributions by the self-employed (and other persons who are currently eligible for a deduction) be treated in the same way as contributions made for the benefit of employees. That is, the self-employed would be eligible to claim a full deduction for all contributions made to accumulation schemes on their own behalf up to age 75.

5.2 Extension of the Government co-contribution scheme to the self-employed

5.2.1 Current arrangements

The co-contribution replaced the taxation offset for personal superannuation contributions made by low-income employees. The offset still applies for eligible personal contributions made prior to 1 July 2003.

To be a qualifying low-income employee for the co-contribution, a person must earn 10 per cent or more of their income from eligible employment. A person must also be less than 71 years of age on 30 June of the year in which the personal contributions are made and not be a temporary resident.

Self-employed persons currently do not have access to the co-contribution if they do not have 10 per cent or more of their income attributable to eligible employment (that is, income earned as an employee).

5.2.2 Proposed arrangements

It is proposed to extend the Government co-contribution scheme to the self-employed, effective from 1 July 2007.

Persons (including the self-employed) would be eligible for a Government co-contribution if they meet certain criteria. First, they must earn 10 per cent or more of their income from carrying on a business, eligible employment or a combination of both. Second, their income must be under the Government co-contribution upper threshold. They must also not be a temporary resident at any time during the income year in which they make the personal undeducted contribution, and be less than 71 years of age at the end of that income year.

Superannuation contributions made by a self-employed person would be matched at $1.50 for every dollar contributed, subject to the maximum co-contribution of $1,500. The maximum co-contribution would be available for those persons on incomes up to the lower threshold, currently $28,000. As is presently the case with employees, the co-contribution would only be payable on undeducted contributions.

The maximum co-contribution is reduced at a rate of 5 cents for every dollar of total income over the lower threshold, and currently phases out at the upper threshold of $58,000.

From 1 July 2007, the co-contribution lower income threshold would be indexed in line with the growth in full-time adult average weekly ordinary time earnings. The upper income threshold would also be increased to maintain the same income range over which the maximum is reduced.

To provide for the self-employed, income would be determined by adding the assessable income of an individual (including any reportable fringe benefits, if applicable) and then reducing that amount by their expenses incurred in carrying on a business.

Eligible self-employed persons seeking a co-contribution would need to consider the component of their contribution for which they intend to claim a deduction and the component they wish to remain undeducted for co-contribution purposes. For a comparison of the retirement income outcomes for the self-employed under current arrangements and the proposed arrangements see Table A5 of Appendix A.

6. AGE PENSION ARRANGEMENTS

Key Points

- The pension assets test taper rate would be halved from 20 September 2007 so that pension recipients only lose $1.50 per fortnight (rather than $3) for every $1,000 of assets above the relevant threshold.
- Retaining the assets test exemption for 'complying' income streams under the new arrangements would create scope for wealthier individuals to access the age pension and the associated concessions. Therefore, this exemption would be removed for future income streams purchased on or after 20 September 2007.

6.1 PENSION ASSETS TEST

6.1.1 Current arrangements

The design of the income and assets tests which apply to eligibility for the age pension, including the pension withdrawal rates, has important implications for incentives to work and save for retirement.

The income test is relatively generous. A single person can earn up to $36,000 per annum and still be eligible for a part-rate pension. Under the current assets test, a person loses $3 per fortnight for every $1,000 of assets above the relevant threshold, starting at $157,000. A single homeowner loses all pension entitlements once their assets exceed $325,500. Assets include most superannuation assets.

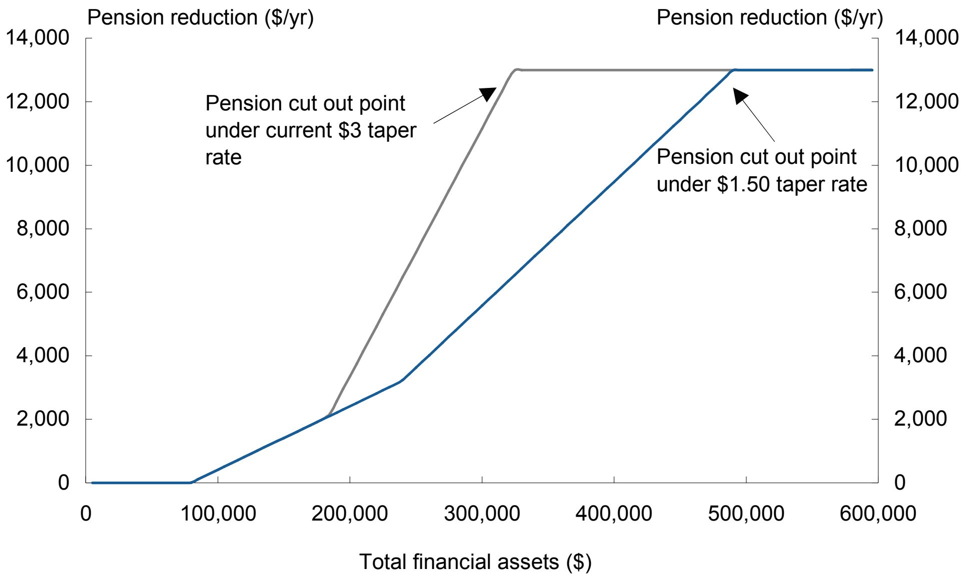
The assets test is very punitive as retirees must achieve a return of at least 7.8 per cent on their additional savings to overcome the effect of a reduction in their pension amount. This high withdrawal rate creates a disincentive to save or build retirement savings.

6.1.2 Proposed new arrangements

It is proposed that the pension assets test taper rate be halved from 20 September 2007 so that recipients only lose $1.50 per fortnight (rather than $3) for every $1,000 of assets above the relevant threshold. This would mean that retirees would need to achieve a return of 3.9 per cent on their additional assets before they are better off in net income terms — that is, after taking account of the withdrawal of the age pension. Under the proposal, a single homeowner would not lose entitlement to the pension until their assets reached approximately $494,000 (based on current pension rates and thresholds). The corresponding figure for a homeowner couple would be approximately $783,500.

The reduction in the assets test taper rate would increase incentives for workforce participation and saving especially for those people nearing retirement who will still depend on the age pension to fund part of their retirement.

Chart 6.1: Pension withdrawal rates (for a single person)



6.2 ABOLITION OF THE 50 PER CENT ASSETS TEST EXEMPTION FOR 'COMPLYING' INCOME STREAMS

6.2.1 Current arrangements

'Complying' income streams which were purchased before 20 September 2004 are eligible for a full assets test exemption. 'Complying' income streams purchased on or after this date are eligible for a 50 per cent exemption. The reduction in the assets test exemption in September 2004 was designed to limit the scope for wealthier individuals to utilise the concession as a way of accessing the age pension and the associated concessions.

6.2.2 Proposed arrangements

The current 50 per cent assets test exemption for 'complying' income streams would be removed from 20 September 2007. Retaining the assets test exemption alongside the reduced assets test withdrawal rate would create scope for wealthier individuals to access the age pension.

This change would only apply to income stream products purchased on or after 20 September 2007 and would not affect the assets test treatment of income streams purchased before this date.

7. OTHER MEASURES

Some changes are also proposed to related areas. This chapter sets out the Government's proposed approach in these areas. In particular, it deals with the taxation of employer ETPs.

Key Points

- Some changes may be necessary to limit concessions on large employer ETPs, reflecting the removal of the RBL system and benefits tax.
- Greater use of tax file numbers will be encouraged.

7.1 EMPLOYER PAYMENTS

7.1.1 Current arrangements for employer ETPs

Employer ETPs are payments made by an employer to their employee on termination of employment. Not all termination payments are employer ETPs. For example, the tax free amounts of bona-fide redundancy and approved early retirement payments are not employer ETPs.

Those employer payments that are ETPs when paid because of termination of employment include the following payments related to:

- unused rostered days off;
- amounts in lieu of notice;
- a gratuity or 'golden handshake';
- an employee's invalidity (permanent disability, other than compensation for personal injury);
- bona-fide redundancy and approved early retirement schemes in excess of the tax free amount; and
- certain payments after the death of an employee.

An employer ETP will have a post-June 1983 untaxed element and potentially a pre-July 1983 component, invalidity component and excessive component — the taxation treatment is as shown in Table 7.1.

Table 7.1: Summary of taxation of employer ETPs under current rules

Component	Assessable portion	Current tax treatment
Post-June 1994 invalidity component	Not assessable	Exempt
Pre-July 1983 component	5%	Marginal rates
Post-June 1983 component (untaxed)	100%	Under age 55 — 30% Age 55 and over Up to threshold ($129,751) — 15% Over threshold — 30%
Excessive component (amount above RBL)	100%	47%

Rollover of employer ETPs to superannuation funds

An individual can currently roll over an employer ETP to a superannuation fund, effectively deferring any tax until it is later paid out as a superannuation benefit.

7.1.2 Proposed new arrangements for employer ETPs

Currently, both superannuation benefits and employer ETPs are counted together in assessing if they exceed the RBL. As the RBL is to be removed for superannuation benefits, it is necessary to consider whether new arrangements should apply for taxation of employer ETPs, particularly the application of an upper limit on the amount of employer ETPs that receive concessional taxation treatment.

It is proposed that employer ETPs be comprised of two components — exempt and taxable. The exempt component would be any post-June 1994 invalidity amount and the pre-July 1983 amount. This would be exempt from tax. The taxable component would be the post-June 1983 amount. This would be taxed at 15 per cent for amounts up to $140,000 for recipients aged 55 and over and at 30 per cent for those aged under 55. Amounts in excess of $140,000 would be taxed at the top marginal tax rate. As there would be no lifetime limit on concessionally taxed payments, employers would not be required to report these payments to the ATO.

Table 7.2 — Summary of proposed taxation of employer ETPs

Component	Assessable portion	Proposed tax treatment
Exempt (post-June 1994 invalidity and pre-July 1983 amounts)	Not assessable	Not applicable
Taxable	100%	Under age 55 Up to $140,000 — 30% Over $140,000 — Top MTR Age 55 and over Up to $140,000 — 15% Over $140,000 — Top MTR

As superannuation benefits paid to those over age 60 would be tax free, it is proposed that employer ETPs would no longer be able to be rolled over into superannuation.

7.1.3 Other employer payments

It is not proposed to change the taxation treatment for bona-fide redundancy payments, approved early retirement scheme payments, or unused leave.

7.2 NON-QUOTING OF TAX FILE NUMBERS

The tax system generally operates on the basis that the highest rate of tax is deducted where an individual has not quoted a tax file number.

7.2.1 Tax on contributions

It is proposed that in cases where a tax file number has not been quoted to a taxed fund, the top marginal tax rate would apply where taxable contributions to that fund for a member exceed $1,000. This threshold would lessen the potential impact on small superannuation account holders who have not quoted a tax file number and minimise compliance costs for the superannuation industry.

7.2.2 Undeducted contributions

It is proposed that superannuation fund trustees would, in future, only be able to accept undeducted contributions for or on behalf of a member, if the member's tax file number has been quoted to the trustee.

7.2.3 Benefit payments

Currently, different withholding rates apply to different components of an ETP. The correct rate is determined by the component, the person's age and whether the person gave the superannuation fund trustee their tax file number. Where the person has not quoted their tax file number, the superannuation fund withholds tax at the top marginal tax rate on any pre-July 1983 component and post-June 1983 component.

It is proposed under the new arrangements, that where a tax file number is not quoted only the post-June 1983 component (the taxable element) would be subject to withholding at the top marginal tax rate, as the pre-July 1983 component would be classed as an exempt component which is tax free.

8. UNTAXED SCHEMES

This chapter deals with untaxed superannuation schemes; in particular benefit payments in untaxed schemes that arise from an untaxed source. These schemes generally apply only to public servants. The chapter describes the proposed taxation treatment when an untaxed scheme pays a benefit including a post-June 1983 untaxed element. Untaxed schemes may be hybrid schemes paying benefits including both amounts that arise from an untaxed source and other elements arising from a taxed source. These other elements (for example, a post-June 1983 taxed element) would be taxed in the manner outlined in Chapter 2.

Key Points

- Lump sum payments arising from an untaxed superannuation source to an individual over the age of 60 would be taxed more concessionally than currently.
- The proposed taxation treatment for lump sum benefit payments is:
  - For those aged 60 or over — a rate of 15 per cent would apply to the total of all payments up to an upper threshold ($700,000 — approximately the lump sum RBL) and the top marginal tax rate above that amount.
  - For those aged 55 to 59 — a rate of 15 per cent would apply for payments up to a lower threshold (the low-rate ETP threshold, currently at $129,751), 30 per cent above this amount up to the upper threshold ($700,000) and the top marginal tax rate above that amount.
  - For those aged under 55, a rate of 30 per cent would apply up to the upper threshold ($700,000) and the top marginal tax rate above this amount.
- Pension payments arising from an untaxed superannuation source to an individual over the age of 60 would be taxed at marginal tax rates with a 10 per cent offset. Payments to those below age 60 would be taxed at marginal tax rates without an offset (as is the case currently).

8.1 CURRENT BENEFIT TAXATION ARRANGEMENTS

In some superannuation schemes run by the Australian Government and the State and Territory governments, no employer contributions are made until a benefit becomes payable and no contributions or earnings tax is paid. Only 10 per cent of all superannuation fund members are members of such schemes and they are nearly all public servants. The majority of such schemes are now closed to new members.

As no contributions or earnings tax is paid there should be a higher level of tax when benefits are paid to fund members. This ensures equity with other superannuation funds where contributions and earnings tax would have been paid. Reflecting this, these types of benefits are already subject to a higher level of tax than other benefits. This distinction would continue.

8.1.1 Lump sums

The lump sum payment of superannuation benefits is classified as an ETP and is divided into various components, each of which is subject to special tax treatment. These components are discussed in detail in Chapter 2. The difference in treatment for untaxed schemes arises with respect to the post-June 1983 component which will have an untaxed element if paid from an untaxed source.

The untaxed element of the post-June 1983 component is taxed at 15 per cent up to the low-rate threshold ($129,751 in 2005-06) and any amount over this threshold is taxed at 30 per cent up to the RBL. If the individual is under age 55, the entire component is taxed at 30 per cent up to the RBL. Amounts above the RBL are taxed as an excessive component. If the scheme is also paying any taxed elements (for example, in hybrid schemes) these would be taxed as outlined in Chapter 2.

Table 8.1: Summary of taxation of post-June 1983 untaxed element

Component	Assessable portion	Rate of tax
Post-June 1983 (untaxed element)	100%	Under age 55 — 30% Age 55 and over Up to threshold ($129,751) — 15% Over threshold — 30%
Excessive component	100%	47%

8.1.2 Pensions

Pension payments received by a person from untaxed schemes in each year are included in the person's assessable income and taxed at marginal rates.

A deduction is allowed for the return of contributions which were made towards the pension from the pensioner's own after-tax income and certain other amounts. The annual deductible amount is determined by apportioning the undeducted purchase price of the pension over the expected term of the pension. The undeducted purchase price of the pension would normally comprise undeducted contributions made by the member.

Pensions paid from untaxed schemes do not receive the 15 per cent rebate of tax available to pensions paid from taxed schemes.

8.1.3 Reporting

Individuals must report details of ETPs and pensions in their tax return. These amounts are included in their income for tax purposes, potentially increasing the amount of tax they pay on other income.

All benefit payments must be reported to the ATO by the scheme for RBL purposes.

8.2 PROPOSED ARRANGEMENTS FOR BENEFITS PAID TO INDIVIDUALS AGED 60 AND OVER

8.2.1 Lump sums

Under the proposed arrangements, the post-June 1983 untaxed element of a benefit paid from an untaxed scheme would be taxed at 15 per cent up to $700,000 (approximately the lump sum RBL) and the top marginal tax rate above that amount.

8.2.2 Pensions

It is proposed that pension payments would continue to be included in assessable income and taxed at marginal rates. However, pension payments (including where the pension commenced before 1 July 2007) would be eligible for a 10 per cent taxation offset — currently they are not eligible for any offset. A deduction would continue to be allowed for the return of contributions which were made towards the pension from the pensioner's own after-tax income and certain other amounts.

8.2.3 Reporting

Individuals would still be required to include ETPs and pensions in their tax return. Schemes would not need to report benefit payments to the ATO for RBL purposes.

8.3 PROPOSED ARRANGEMENTS FOR BENEFITS PAID TO INDIVIDUALS AGED UNDER 60

Currently, if a person aged 55 to 59 years receives a post-June 1983 untaxed benefit, the taxation treatment is exactly the same as for a person aged 60 or over. For a person aged less than 55, higher rates of tax are payable (see table 8.2 below).

8.3.1 Lump sums

Proposed arrangements for those aged under 60

For untaxed post-June 1983 elements paid to those aged 55 to 59, a rate of 15 per cent would apply for payments up to the low-rate ETP threshold (currently $129,751), a rate of 30 per cent above this amount up to $700,000 and the top marginal tax rate above that amount. For those aged under 55, a rate of 30 per cent would apply up to $700,000 and the top marginal tax rate above this amount.

Table 8.2: Comparison of current system to proposed system — post-June 1983 untaxed element

Taxpayers age	Current system	New system
Under 55	30% Excessive component — 47%	30% up to $700,000 Top MTR above
Age 55-59	Up to threshold($129,751) — 15% Over threshold — 30% Excessive — 47%	Up to threshold($129,751) — 15% Over threshold — 30% Over $700,000 — Top MTR
Age 60 and over	Up to threshold($129,751) — 15% Over threshold — 30% Excessive — 47%	Up to $700,000 — 15% Over $700,000 — Top MTR

8.3.2 Pensions

Proposed new arrangements for those aged under 60

Pension payments would continue to be included in assessable income and taxed at marginal rates. Unlike payments for those aged 60 and over, they would not be eligible for the proposed 10 per cent pension offset (until the recipient turns age 60).

8.3.3 Reporting

Individuals who receive benefit payments from untaxed schemes would be required to lodge a tax return and report these payments in the return as assessable income (as currently). Schemes would not need to report benefit payments to the ATO for RBL purposes.

8.3.4 Death benefits

Current arrangements

The rules relating to death benefits are the same whether they are paid from a taxed or untaxed superannuation fund (see section 2.4). Where the death benefit is paid to a non-dependant, the applicable tax rates reflect the source of the payment; that is, payments from an untaxed source are taxed at higher rates as they have not been subject to tax in the fund.

When a reversionary pension is paid on death, it is taxed at the recipient's marginal tax rate less any deductible amount. Payments from untaxed schemes do not qualify for the pension rebate.

Proposed arrangements

Under the proposed arrangements, all lump sum death benefit payments would be tax free if paid to a dependant.

The taxation of death benefit payments as a reversionary pension would depend on the age of the primary and reversionary beneficiary. If the primary beneficiary was aged 60 or over on death, then payments to the reversionary beneficiary would be taxed at marginal tax rates less any deductible amount and less the 10 per cent offset (which would have been the tax treatment applying to the primary beneficiary before death). If the primary beneficiary was under age 60 at death, the pension would continue to be taxed at the reversionary beneficiary's marginal tax rate (less any deductible amount), unless the reversionary beneficiary is aged 60 or over, in which case the 10 per cent offset would apply.

A pension would not be able to revert to a non-dependant on death; rather, death benefit payments to non-dependants would have to be made as a lump sum. Payments to non-dependants (irrespective of their age) would be taxed in the same manner as other superannuation fund payments to someone under age 55 (see section 8.3.1). That is, the post-June 1983 untaxed element would be taxed at 30 per cent up to $700,000 and the top marginal tax rate above that amount.

8.4 Rollovers to taxed schemes

8.4.1 Current arrangements

Currently, when a rollover is made from an untaxed scheme, any untaxed component is taxed as a taxable contribution in the receiving fund.

8.4.2 Proposed arrangements

It is proposed that the transferring fund would withhold tax at the top marginal tax rate for amounts above $700,000. The first $700,000 of the benefit to be transferred would be treated as a taxable contribution by the receiving fund. The remainder would form part of the exempt component in the receiving fund and not be taxed further. These arrangements recognise the difficulty of applying the concessional deductible tax cap to the entire rollover amount (as outlined in Chapter 4).

9. MAKING IT EASIER TO FIND AND TRANSFER SUPERANNUATION

This chapter outlines proposals to make it easier for members to find any lost superannuation and transfer their superannuation to a fund of their choice.

Key Points

- A new standardised form would be introduced to facilitate the transfer of benefits between funds. The maximum time period in which this transfer must occur would be reduced from 90 days to 30 days.
- The ATO would be more proactive in supporting the consolidation of lost member accounts and would move benefits between superannuation funds at the member's request.

9.1 CURRENT ARRANGEMENTS

Since 1 July 2004, members of most superannuation funds have been able to move their superannuation benefits into a fund of their choice, subject to some limited exceptions (portability). The Government further enhanced this policy of portability by removing, effective 1 July 2005, the exception which enabled funds to reject a portability request if employer contributions had been made to the fund in the past six months.

These initiatives on portability complement the introduction of choice of fund which allows employees to choose the fund into which future employer contributions will be made. Together, these measures give Australians greater control over their superannuation and also allow members to consolidate their superannuation benefits in one account, thus avoiding multiple sets of fees and charges.

Portability is further complemented by the Lost Members Register (LMR) maintained by the ATO. The LMR contains details of accounts that individuals may have lost track of (the actual money remains with the relevant funds). Individuals who may have lost track of their superannuation can search LMR (for free) to identify their accounts, and then, using portability, organise for those accounts to be consolidated if desired.

9.2 PROPOSED ARRANGEMENTS

The Government's initiatives on choice and portability have significantly improved the ability of individuals to manage and take control of their superannuation.

However, the Government considers there is scope to make transferring and consolidating accounts simpler and easier by further improving the operation of the portability and LMR arrangements.

9.2.1 Portability

Currently superannuation funds must transfer a benefit as soon as practicable after a request is received, and in any event within 90 days. It is proposed that the maximum time limit be reduced from 90 days to 30 days.

The 90 day time limit is retriggered if the fund seeks additional information from the member (that is, the 90 days will start again from when that information is received). It is proposed that these 'retriggering' provisions be removed so that in all cases benefits must be transferred within 30 days from the date of the initial request.

In addition, the process for requesting a benefit transfer involves completion of relevant forms and meeting any other requirements developed by individual funds. This means the level of information required, including information necessary to establish proof of identity, varies from fund to fund. This can further complicate the portability process. It is proposed that all funds use a standard form for portability requests including standard proof of identity requirements to ensure uniformity amongst funds. This would also potentially reduce the need for funds to seek more information from members which can delay processing.

9.2.2 Lost Members Register

In addition to providing facilities for individuals to search the LMR, the Government is also active in locating and contacting lost members whose address can be found using tax file number information. In this context, the ATO is in the process of undertaking a direct mail out campaign to approximately three million lost members advising them of the existence of their lost superannuation.

However, the Government considers that there is scope to improve further the operation and effectiveness of the current lost member arrangements. It is proposed that the ATO be given a more active role in arranging transfers on behalf of lost members. This would greatly simplify the consolidation process for members by reducing the need for their involvement.

Under such an approach, the ATO would write to lost members advising them of the existence of their lost account and offering them a number of choices, including consolidating the account with an active account, or indicating that they are satisfied with the account's inactive status.

Where the member requests that their lost account be consolidated with an active account, the ATO would deal with the relevant funds and arrange the transfer on the member's behalf. This process would be facilitated by the development of a standard portability form and standardised proof of identity requirements which could be included with the ATO mail out.

10. BENEFITS OF THE PROPOSED CHANGES

Key Points

- Apart from simplifying and streamlining the superannuation system, the proposed changes would result in a number of benefits.
  - The proposed changes would increase retirement incomes and encourage saving.
  - There would be greater incentives to work and save.
  - The significant reduction in complexity could be expected to reduce the costs facing superannuation funds in delivering their services. These costs are ultimately borne by all superannuation fund members.

10.1 INCREASING RETIREMENT INCOMES

The proposed changes would increase further retirement income replacement rates and encourage saving.

Compulsory superannuation, combined with the age pension, will allow many Australians to retire with an adequate retirement income. However, some people may wish to have a higher level of retirement income than they will receive from the age pension and their compulsory superannuation. The proposed changes would provide significant benefits over time to Australians with only compulsory superannuation and would reward people for making additional superannuation contributions to improve their retirement income. Incentives for additional contributions would be significantly increased.

Example 1 — 9 per cent gain in lump sum superannuation benefits for a worker on average earnings with SG contributions made during working life

Under a fully mature SG system, a person on $1,000 per week (about average income) is projected to have accumulated superannuation benefits of approximately $466,000 over a working life of 40 years through the SG arrangements alone. Under the proposed plan, tax of around $37,000 payable when the benefit is paid would be abolished. This average worker would thus gain around $37,000 in retirement, an increase of approximately 9 per cent if they take a lump sum.

Example 2 — 17 per cent gain in superannuation benefits for a worker on average earnings with SG contributions made during their working life who takes a superannuation pension

If the person on average earnings in Example 1 chose to take their benefits as a superannuation pension, they are estimated to have an average of around $136 per week in additional retirement expenditure under the proposed new system. This would represent an increase in retirement expenditure of approximately 17 per cent.

Example 3 — Greater gains if an individual also contributes more to superannuation

If an individual makes additional voluntary contributions to superannuation, they stand to gain even more from the proposed changes.

If the person in Example 1 also made an additional 5 per cent tax deductible (salary sacrifice) contribution to superannuation each year over a working life of 40 years, their retirement benefit would increase from $466,000 to $706,000. Under current arrangements, this extra saving would have provided for a 11 per cent increase in average retirement expenditure. Under the proposed changes, the benefit of saving this extra amount through superannuation would be a gain in average retirement expenditure of 35 per cent (compared with the current arrangements and someone who makes no extra contributions).

Example 4 — Greater incentives for those who have reached age 60 to remain in the workforce

A worker on average earnings of $1,000 per week before age 60 would have significantly increased incentives to work at least part-time rather than fully retiring at age 60. For instance, a person could choose to work part-time (three days per week) and top up their salary by drawing down a pension over their life expectancy purchased with 75 per cent of their retirement savings at age 60. In this case, the person would be able to increase their average income level during these five part-time working years as a result of these changes by some $67 per week (a gain of over 10 per cent).

Appendix A provides further examples of how individuals stand to gain from the proposed system.

10.2 INCENTIVES TO WORK AND SAVE

Background

Improving rewards for working and for saving is an important component of the Government's pro-growth policies and strategy for addressing the demographic challenges facing Australia over the coming decades.

Incentives to work and save are affected by various factors, including the rules concerning when people can access their superannuation and the impact of savings on their age pension entitlement. It is important that the retirement incomes system does not encourage people to leave the workforce early.

More incentives to work and save

The proposed changes would boost incentives to work and save in a number of ways.

- With superannuation benefits tax free from age 60, there would be an incentive to remain in the workforce longer.
- As superannuation benefits received after age 60 would not be included in a person's assessable income, this may reduce the tax paid on other work income — thus increasing the incentive to undertake work while drawing down on superannuation.
- The proposed removal of RBLs and the tax on superannuation benefits after age 60 provides greater incentives to save.
- The proposed changes to the assets test taper rate would also provide a greater incentive to work and save as the current taper rate could result in a person losing more age pension than they can often earn from additional savings. By halving the taper rate, there would be more incentive to work and make additional savings.

10.3 SIMPLER ADMINISTRATION FOR END BENEFITS

Managing the benefits end of superannuation would become simpler for superannuation funds to administer under the proposed changes. Not only are the payment and tax rules complex for individuals, but they also impose significant costs on superannuation funds. These obligations impose costs not only on people aged over 60 but on all fund members.

Under the proposed arrangements:

- Funds would no longer need to ascertain whether the working arrangements of every member aged 65 or over mean their benefits should be paid.
- The requirement to report all benefits paid to members and commutations of pensions for RBL purposes would be abolished. The ATO received around 676,000 reports for RBL purposes in 2004-05.
- Funds would no longer be required to withhold tax from lump sum payments made to a person aged 60 or over or provide payment summaries to these taxpayers.
- As most superannuation pensions would be tax free, funds would no longer be required to withhold tax instalments from these benefits and give pension recipients a payment summary.
- The number of benefit components that funds must keep records of would be reduced from up to eight to two.

Appendix A: Examples of how the proposed changes would increase retirement incomes

Key points

- Under the proposal, there would be significant reductions in tax on retirement benefits for those aged 60 and over.
- The gains from the simplified tax treatment would grow substantially for Australians over time as changes in superannuation take full effect.
- The gains would be substantially increased if people choose to contribute more towards their retirement benefits.
- Generally, the greatest gains would be for people who take their superannuation benefit as a superannuation pension, although there would also be substantial reductions in tax on lump sums.
- The rewards for continuing to participate in the workforce after age 60 would be increased. Working part-time, and supplementing income from retirement savings, would potentially be more attractive to people.

A.1 An explanation of the modelling approach

The tables in this appendix provide estimates of the overall impact on average weekly retirement expenditure for a variety of individuals arising from the Government's proposed superannuation arrangements. The benefits outlined in this section would be in addition to benefits that may be achieved through reduced complexity of the superannuation system or other impacts of improved incentives to save and work.

Estimates are presented for individuals and couples accessing their superannuation through either a lump sum payment (ETP) or pension. The estimates vary according to age, retirement balances, annual incomes, type of superannuation arrangement, and whether there are contributions in addition to the standard SG. Estimates are also presented for individuals aged between 60 and 65 who continue to work part-time while accessing some of their superannuation to top up their income.

The following provides the estimated results, including an explanation of some factors underlying these results. Section A.6 details the assumptions used in the modelling, including current superannuation balances and level of member contributions.

A.2 Lump sum benefits

The top section of Table A1 shows the distributional impact of the proposed scheme on lump sum benefits for those retiring shortly (age 65 in table) and for younger Australians (ages 25 and 45) that contribute only their SG payments. There would be significant reductions in tax for people aged 60 or over currently paying tax on their lump sum retirement benefits. These benefits reflect the cut in tax rate from 15 per cent to 0 per cent for lump sums between $129,751 and the lump sum RBL of $648,946, and from 38 per cent to 0 per cent for amounts over the RBL. The range of percentage increases in the after-tax lump sum payment reflects the existing tax free lump sum entitlement (so that someone with a $100,000 lump sum benefit already pays no tax, and therefore a further tax cut is not possible) and the proposed removal of the RBL. The reduction in the age pension assets test taper rate would also provide benefits to some retirees.

Table A1 also shows that the gains to individuals from the proposed simplification of the superannuation system would grow over time. As Australia's superannuation arrangements fully mature, most workers would benefit significantly from the proposed reforms. For example, under a fully mature SG system, a person on $1,000 per week (about average income) is projected to have accumulated superannuation benefits of approximately $466,000 over a working life of 40 years through the SG arrangements alone. Under the proposed plan, tax of around $37,000 payable when the benefit is paid would be abolished. This average worker would thus gain around $37,000 in retirement, an increase of approximately 9 per cent if they take a lump sum.

For those on higher incomes, retirement benefits are also estimated to be significantly improved. For example, under a fully mature system, an individual earning $2,000 per week would have around $116,000 more in retirement benefits as a result of the removal of the benefits tax and lump sum RBL, an overall increase of 14 per cent.

The bottom section of Table A1 shows the potential benefits for an individual who increased their superannuation with the best mix of either member contributions added to by the Government co-contribution, and additional tax deductible contributions of 5 per cent of their salary (lifting them from 9 per cent to 14 per cent). For a person on $1,000 per week (about average earnings) who increases their superannuation contributions by an additional 5 per cent of their salary over a working life of 40 years, their projected retirement benefit would total around $706,000, an increase of around $240,000 from the $466,000 estimated above. The tax benefit from these changes for this person, putting in some extra superannuation contributions, would be almost $77,000, a gain of around 12 per cent. Importantly, as illustrated in the next section, this person would generally gain even more from these changes if they took their retirement benefits as a superannuation pension. The benefits for couples taking their retirement benefits as a lump sum would be determined by summing the gains for individuals.

Table A1: Individual — Lump sum payment

Income ($/wk)	Benefit at retirement ($)	ETP tax Current ($)	ETP tax New ($)	ETP (after tax) Current ($)	ETP (after tax) New ($)	Change in after tax benefit $	Change in after tax benefit Per cent
Age 65							
	100,000	0	0	100,000	100,000	**(c)**	**(c)**
	150,000	2,272	0	147,728	150,000	**2,272**	**1.5**
	200,000	10,522	0	189,478	200,000	**10,522**	**5.6**
	250,000	18,772	0	231,228	250,000	**18,772**	**8.1**
	400,000	43,522	0	356,478	400,000	**43,522**	**12.2**
Age 45 - Superannuation Guarantee[a,b]							
400	95,125	0	0	95,125	95,125	**(c)**	**(c)**
600	144,603	0	0	144,603	144,603	**(c)**	**(c)**
800	194,082	2,400	0	191,682	194,082	**2,400**	**1.3**
1,000	243,575	10,567	0	233,008	243,575	**10,567**	**4.5**
1,500	367,270	30,976	0	336,294	367,270	**30,976**	**9.2**
2,000	490,981	51,389	0	439,592	490,981	**51,389**	**11.7**
Age 25 - Superannuation Guarantee[b]							
400	179,228	0	0	179,228	179,228	**(c)**	**(c)**
600	274,881	5,744	0	269,137	274,881	**5,744**	**2.1**
800	370,535	21,527	0	349,008	370,535	**21,527**	**6.2**
1,000	466,242	37,318	0	428,924	466,242	**37,318**	**8.7**
1,500	705,376	76,775	0	628,601	705,376	**76,775**	**12.2**
2,000	944,563	116,241	0	828,322	944,563	**116,241**	**14.0**
Age 45 - Superannuation Guarantee and member contributions[a, b]							
400	208,202	0	0	208,202	208,202	**(c)**	**(c)**
600	288,476	13,380	0	275,096	288,476	**13,380**	**4.9**
800	353,592	26,773	0	326,819	353,592	**26,773**	**8.2**
1,000	424,035	40,100	0	383,935	424,035	**40,100**	**10.4**
1,500	636,076	75,162	0	560,914	636,076	**75,162**	**13.4**
Age 25 - Superannuation Guarantee and member contributions[a, b]							
400	384,199	17,482	0	366,717	384,199	**17,482**	**4.8**
600	514,741	40,196	0	474,545	514,741	**40,196**	**8.5**
800	595,300	57,441	0	537,859	595,300	**57,441**	**10.7**
1,000	706,417	76,799	0	629,618	706,417	**76,799**	**12.2**
1,500	1,055,024	134,467	0	920,557	1,055,024	**134,467**	**14.6**

(a) See section A.6 for assumptions, including assumed current superannuation balances and level of member contributions.

(b) Incomes above the maximum level shown could be expected to generate a lump sum benefit in excess of the lump sum RBL. Consequently, under current policy, an individual in this position is unlikely to take a benefit solely as a lump sum as excessive benefits tax would be incurred. Instead the individual could be expected to take a benefit as a part pension (Table A2) in order to qualify for the pension RBL.

(c) People on these income levels would continue to pay no tax.

A.3 Superannuation pensions

A.3.1 Individual — SG only

The proposed arrangements provide significant benefits for those who choose to take their superannuation benefit as a pension in retirement. In particular, pension payments from a taxed fund will be tax free for individuals aged 60 and over. In addition, the reduced age pension assets test taper rate provides further benefits.

The top of Table A2 shows the distribution of superannuation pension benefits for those retiring shortly (age 65 in Table A2) and for younger Australians (ages 25 and 45) that contribute only their SG payments. The extent of gains projected from these changes for those retiring shortly depends critically on their level of accumulated superannuation savings. People currently entering retirement with superannuation balances in the order of $100,000 to $150,000 are paying little or no tax under the current arrangements as a result of tax concessions previously introduced by the Government such as the Senior Australians Tax Offset. They are already usually receiving the full age pension (assuming they do not have any other major asset holdings such as a share portfolio outside of superannuation — if they had such holdings, their gains would be greater than shown in Table A2). As there is little or no tax currently payable, there would be limited gains from further concessional tax treatment.

People entering retirement with higher current superannuation balances would receive a significant gain through reduced benefits tax and the reduction in the age pension assets test taper rate. For example, a person with a superannuation balance of $400,000 would have an estimated increase in average retirement expenditure of around $94 per week or around 17 per cent.

As with the lump sum scenarios, the benefits from the proposed system would increase as Australia's superannuation system matures, because people would have significantly greater superannuation balances. Under a fully mature system (age 25 in Table A2), a person on $1,000 (about average earnings) over a working life of 40 years, is projected to have accumulated retirement benefits of around $466,000. If they choose to take the entire retirement benefit as a pension, they are projected to have on average around $136 per week in additional retirement expenditure as a result of the Government's proposed changes. This would be an increase in average retirement expenditure of around 17 per cent. This gain would be greater than the 9 per cent gain they would achieve if they took the benefit purely as a lump sum payment.

Table A2: Individual — Superannuation pension

Income ($/wk)	Benefit at retirement ($)	Average tax paid Current ($/wk)	Average tax paid New ($/wk)	Average retirement expenditure Current ($/wk)	Average retirement expenditure New ($/wk)	Change in average retirement expenditure ($/wk)	Change in average retirement expenditure Per cent
Age 65							
	100,000	0	0	419	419	**(b)**	**(b)**
	150,000	6	0	466	472	**6**	**1.3**
	200,000	9	0	512	523	**11**	**2.2**
	250,000	17	0	532	563	**31**	**5.8**
	400,000	25	0	568	662	**94**	**16.6**
	600,000	28	0	682	784	**102**	**14.9**
Age 45 - Superannuation Guarantee(a)							
400	95,125	8	0	504	511	**8**	**1.5**
600	144,603	13	0	550	563	**13**	**2.3**
800	194,082	27	0	586	614	**28**	**4.8**
1,000	243,575	32	0	609	653	**44**	**7.2**
1,500	367,270	38	0	644	736	**92**	**14.3**
2,000	490,981	39	0	676	814	**138**	**20.4**
Age 25 - Superannuation Guarantee							
400	179,228	30	0	705	735	**31**	**4.3**
600	274,881	40	0	750	809	**59**	**7.9**
800	370,535	42	0	778	873	**95**	**12.3**
1,000	466,242	44	0	798	934	**136**	**17.0**
1,500	705,376	45	0	886	1,078	**192**	**21.7**
2,000	944,563	69	0	1,024	1,223	**199**	**19.4**
Age 45 - Superannuation Guarantee and member contributions(a)							
400	208,202	22	0	600	626	**25**	**4.2**
600	288,476	30	0	629	684	**55**	**8.8**
800	353,592	36	0	643	728	**85**	**13.2**
1,000	424,035	38	0	656	772	**117**	**17.8**
1,500	636,076	39	0	754	902	**148**	**19.6**
2,000	849,399	71	0	884	1,043	**159**	**18.0**
Age 25 - Superannuation Guarantee and member contributions(a)							
400	384,199	37	0	786	882	**96**	**12.2**
600	514,741	40	0	810	964	**153**	**18.9**
800	595,300	44	0	833	1,013	**180**	**21.6**
1,000	706,417	45	0	887	1,079	**192**	**21.7**
1,500	1,055,024	90	0	1,092	1,302	**210**	**19.3**
2,000	1,410,798	194	0	1,304	1,594	**290**	**22.3**

(a) See section A.6 for assumptions, including the assumed current superannuation balances and level of member contributions.
(b) People on this income level would continue to pay no tax.

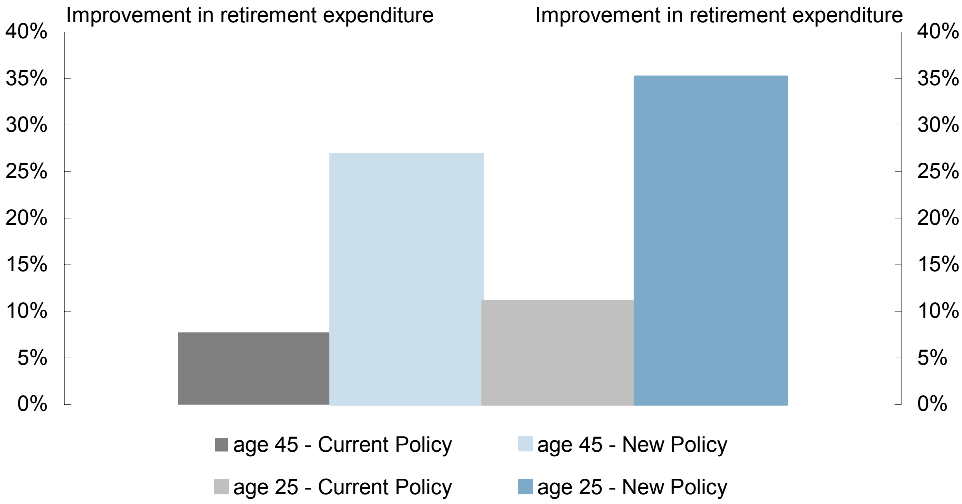
A.3.2 Individual — SG topped up with member contributions

The bottom of Table A2 shows the benefits for a person who increases their superannuation contributions with member contributions matched by the Government co-contribution, or additional tax-deductible contributions of 5 per cent of their salary. The results show the gains from the proposed system would increase significantly where people choose to contribute more towards their retirement.

For a person on average earnings who increases their contributions by an additional 5 per cent of their salary, their retirement benefit would increase for two reasons. First, as a result of the additional contributions, their total retirement benefit would increase from $466,000 to $706,000, a gain of $240,000. By itself, this leads to a significant increase in average retirement expenditure. Secondly, these changes produce significant gains for someone with $706,000 in retirement benefits. As indicated in Table A2, this part of the gain for this person would be on average $192 per week, a gain in retirement expenditure of around 22 per cent.

The combined impact of these two effects is illustrated in Chart A1. A person on average earnings and aged 45, who contributes an extra 5 per cent of salary into superannuation for 20 years, currently gets an 8 per cent increase in retirement expenditure. The combined impact of the additional contributions and the proposed changes would be an increase of 27 per cent in average retirement expenditure. For someone aged 25, the gains in average retirement expenditure would increase from 11 per cent under existing policy to 35 per cent under the proposed scheme.

Chart A1: Impact of additional contributions and new policy for person earning $1,000 a week



Additional contributions of 5 per cent of salary

A.3.3 Individual — working part-time

The proposed changes would provide incentives for those who have reached age 60 to remain in the workforce. All superannuation benefits paid from a taxed fund and received at age 60 or over would be exempt from tax and also excluded from a person's assessable income. These arrangements would result in a significant reduction in tax for most individuals aged between 60 and 65 who continue to work while accessing their superannuation.

In addition to the increases in average expenditure for a person aged between 60 and 65, their retirement benefits continue to grow (see the first two columns of Table A3). This is because the drawdowns would be less than their SG contributions and the earnings on the accumulating benefits and pension. The higher retirement benefit also provides increased average retirement expenditure once the person retires.

Table A3: Part-time work implications for individuals aged 60 to 64[(a)]

Benefit at Age 60 ($)	Benefit at Age 65 ($)	Average part-time income[(b)] ($/wk)	Average super pension[(c)] ($/wk)	Average expenditure Current ($/wk)	Average expenditure New ($/wk)	Change in average expenditure ($/wk)	Change in average expenditure Per cent
100,000	115,596	300	85	344	358	**14**	**4.1**
150,000	172,226	400	127	455	484	**28**	**6.2**
200,000	228,856	500	169	553	606	**53**	**9.7**
250,000	285,486	600	211	650	717	**67**	**10.2**
300,000	344,452	800	254	816	896	**80**	**9.8**
400,000	457,712	1,000	338	1,011	1,118	**107**	**10.5**
600,000	688,903	1,600	507	1,480	1,690	**210**	**14.2**
800,000	915,424	2,000	676	1,813	2,094	**281**	**15.5**

(a) Estimates are presented in nominal terms.
(b) Part-time income is 60 per cent of previous full-time income (that is, working three days per week).
(c) Assumes accessing 75 per cent of their benefit at age 60 as a pension.

Table A3 illustrates the projected impacts of these changes in real terms for a male earning $1,000 per week when working full-time, who decides to work part-time (three days a week) from age 60 to 65 and top up his salary with a superannuation pension based on accessing 75 per cent of their retirement savings at age 60 (the superannuation pension would be $211 per week). At age 65 he retires. The proposed changes provide him with an extra $67 a week in retirement (more than 10 per cent) due to the removal of benefits tax.

A.3.4 Couples

Table A4 shows that couples who take their retirement benefits as pensions would generally receive even greater benefits than singles as a result of the proposed changes. For these examples, we assume that one person has two-thirds of the retirement benefit or income, and the spouse has the remaining one-third.

The gains from the proposed changes for couples generally would be higher than the combined gains for two individuals with the same retirement balances, because the asset threshold for the age pension for couples is lower than the asset threshold for two individuals.

For instance, the gain for a couple currently entering retirement with a combined superannuation balance of $600,000, ($400,000 and $200,000 respectively) would be around $130 per week. The combined benefit for two individuals with equivalent balances (Table A2) would be $105 per week, while the benefit for a single individual with a balance of $600,000 is around $102 per week.

The extent of gains from these changes would increase if additional superannuation contributions are made.

Table A4: Couple — Superannuation pension

Income ($/wk)	Combined benefit at retirement ($)	Total average tax paid Current ($/wk)	Total average tax paid New ($/wk)	Total average retirement expend. Current ($/wk)	Total average retirement expend. New ($/wk)	Change in total average retirement expenditure ($/wk)	Change in total average retirement expenditure per cent
Age 65							
	300,000	8	0	786	800	**13**	**1.7**
	600,000	32	0	870	1,000	**130**	**14.9**
	900,000	45	0	1,019	1,183	**165**	**16.2**
	1,200,000	87	0	1,202	1,395	**193**	**16.1**
Age 45 - Superannuation Guarantee[(a)]							
600	140,757	4	0	790	793	**4**	**0.4**
900	214,974	10	0	858	867	**10**	**1.1**
1,200	289,207	23	0	906	933	**26**	**2.9**
1,800	437,656	38	0	961	1,035	**75**	**7.8**
2,400	586,092	47	0	997	1,130	**133**	**13.3**
Age 25 - Superannuation Guarantee							
600	262,749	38	0	1,092	1,130	**38**	**3.5**
900	406,229	51	0	1,154	1,232	**78**	**6.8**
1,200	549,763	60	0	1,194	1,323	**130**	**10.9**
1,800	836,779	72	0	1,255	1,498	**243**	**19.4**
2,400	1,123,738	89	0	1,363	1,667	**304**	**22.3**
Age 45 - Superannuation Guarantee and member contributions[(a)]							
600	317,679	20	0	927	954	**27**	**2.9**
900	443,812	32	0	968	1,040	**71**	**7.4**
1,200	546,953	41	0	993	1,106	**113**	**11.4**
1,800	773,568	55	0	1,048	1,245	**197**	**18.8**
2,400	1,019,227	73	0	1,162	1,392	**230**	**19.8**
Age 25 - Superannuation Guarantee and member contributions[(a)]							
600	599,495	54	0	1,214	1,354	**140**	**11.5**
900	804,549	63	0	1,255	1,479	**224**	**17.8**
1,200	939,197	71	0	1,292	1,559	**267**	**20.7**
1,800	1,300,871	104	0	1,453	1,770	**318**	**21.9**
2,400	1,700,237	145	0	1,692	2,030	**338**	**20.0**

(a) See section A.6 for assumptions including assumed current superannuation balances and level of member contributions.

A.4 Self-employed

The proposed arrangements provide significant benefits to the self-employed, whether they take their benefits as a lump sum or a pension in retirement. This arises from a combination of increased deductibility of contributions, the Government co-contribution, no tax on benefits and the reduced age pension assets test taper rate, as these are applicable to individual circumstances.

Table A5 illustrates how these factors interact for some individuals. It shows that the gain is considerable for someone aged 25 with 40 more years in the workforce such that where a person has an income of $28,000 per annum, the proposed system would deliver an increased benefit of 34 per cent or over $88,000. Where the time remaining in the workforce is less, for instance 20 years, the benefit for a high income earner is still considerable with an increased benefit of over $83,000 or 16 per cent.

Table A5 also shows the improvement from taking a benefit as a superannuation pension is considerable at both income levels. The table shows an improvement in average retirement expenditure of between approximately 8 and 27 per cent.

Table A5: Self-employed

Income ($/pa)	Contribution	Benefit at retirement: Current ($)	Benefit at retirement: New ($)	Change in after tax benefit at retirement ($)	Change in after tax benefit at retirement per cent
Age 25					
28,000	2,500	259,473	347,940	88,467	34.1
90,000	12,000	1,129,349	1,416,326	286,977	25.4
Age 45					
28,000	2,500	139,648	169,441	29,793	21.3
90,000	12,000	532,741	616,375	83,634	15.7

Income ($/pa)	Contribution	Weekly average retirement expenditure: Current ($)	Weekly average retirement expenditure: New ($)	Change in weekly average retirement expenditure ($)	Change in weekly average retirement expenditure per cent
Age 25					
28,000	2,500	754	866	113	14.9
90,000	12,000	1,264	1,599	335	26.5
Age 45					
28,000	2,500	548	595	47	8.5
90,000	12,000	735	895	160	21.7

It is assumed that individuals would adjust their contribution behaviour to ensure they maintain the same level of take home income.

A.5 Untaxed superannuation schemes

Table A6 illustrates the improvement under the proposed changes for a person receiving a pension from an untaxed superannuation scheme, generally former public servants. This reflects the introduction of a 10 per cent offset for recipients of these pensions. As the age pension assets test does not apply to pensions paid from an untaxed superannuation scheme, the reduction in the assets test taper rate generally would not affect these people.

People over age pension age (or veteran/war widower/widow pension age) on lower superannuation pensions may already be eligible for the Senior Australians Tax Offset. As a result, the tax savings from the 10 per cent offset for a person with a $400 per week superannuation pension may be lower — 4.7 per cent rather than 8.8 per cent — than for a person on a similar superannuation pension aged 60 to 64 years.

Table A6: Untaxed superannuation funds

Average super pension ($/wk)	Average tax paid: Current ($/wk)	Average tax paid: New ($/wk)	Average retirement expenditure: Current ($/wk)	Average retirement expenditure: New ($/wk)	Change in average retirement expenditure ($/wk)	Change in average retirement expenditure Per cent
Over 65 years old						
200	0	0	396	396	**(a)**	**(a)**
300	2	0	454	456	**2**	**0.4**
400	23	0	493	516	**23**	**4.7**
500	52	2	524	574	**50**	**9.6**
600	81	21	556	616	**60**	**10.8**
700	112	42	590	660	**70**	**11.9**
800	159	77	643	723	**80**	**12.5**
900	193	103	709	800	**90**	**12.7**
1,000	225	124	778	878	**100**	**12.9**
1,200	288	168	915	1,036	**120**	**13.1**
1,400	351	211	1,053	1,193	**140**	**13.3**
1,600	430	270	1,174	1,334	**160**	**13.7**
1,800	514	333	1,291	1,472	**181**	**14.0**
2,000	597	396	1,409	1,609	**201**	**14.2**
60 to 64 years old						
200	35	15	361	381	**20**	**5.6**
300	45	15	411	441	**30**	**7.3**
400	61	21	455	495	**40**	**8.8**
500	90	40	486	536	**50**	**10.3**
600	109	49	527	587	**60**	**11.4**
700	130	60	572	642	**70**	**12.3**
800	162	81	641	721	**80**	**12.5**
900	193	103	709	800	**90**	**12.7**
1,000	225	124	778	878	**100**	**12.9**
1,200	288	168	915	1,036	**120**	**13.1**
1,400	351	211	1,053	1,193	**140**	**13.3**
1,600	430	270	1,174	1,334	**160**	**13.7**
1,800	514	333	1,291	1,472	**181**	**14.0**
2,000	597	396	1,409	1,609	**201**	**14.2**

(a) People on this income level would continue to pay no tax.

A.6 Assumptions

The estimates were generated by Treasury, generally using RIMHYPO[3]. For those individuals continuing to work (Table A3), estimates were generated using a spreadsheet model based on RIMHYPO. This section outlines the assumptions underpinning the analysis presented in this appendix.

The results presented are generally based on real average weekly retirement expenditure.[4] Average annual retirement expenditure is calculated as average annual superannuation drawdowns and age pension benefits less average annual tax payable over an individual's retirement. For most of the examples, the retirement period varies between 20 years for males and 25 years for females, depending on life expectancy. Over this retirement period, the pattern of drawdowns is based on an allocated pension with minimum drawdowns (the most common existing pattern). Although the new arrangements would provide much greater flexibility in determining the pattern of drawdowns, all examples are based on this assumption for comparative purposes.

As the drawdown amounts vary over each year of retirement, there would also be variations in items such as age pensions. These are averaged over the period of retirement to give a single number (see Chart A2 for an example of the type of pattern of retirement income). This average annual amount is divided by 52 for average weekly retirement expenditure.

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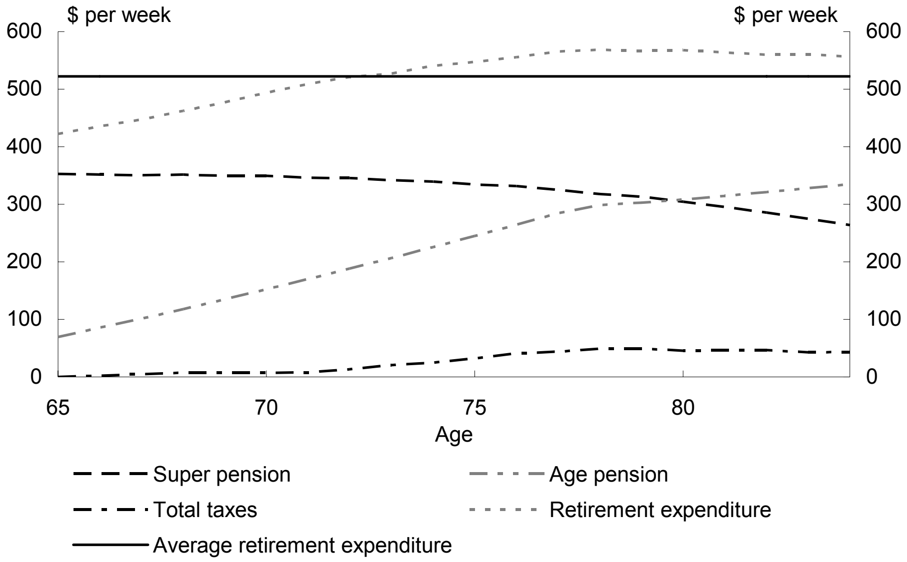
3 RIMHYPO is an individual hypothetical model of the interaction of superannuation accumulations with the tax and social security systems, applied over the lifetimes of hypothetical individuals and couples. The model has been developed by Treasury's Retirement and Income Modelling Unit. Further information about RIMHYPO can be found at www.rim.treasury.gov.au.

4 For lump sums and individuals working part-time, the after tax lump sum and average weekly expenditure for ages 60 to 65 are presented respectively.

Chart A2: Average weekly retirement expenditure
Age 65 to 84



A.6.1 General assumptions

Base

All estimates (except Table A3) are in 2007-08 dollars deflated by the Consumer Price Index (CPI) and are for a homeowner with no other income or assets.

Individual examples are based on a male retiring at age 65.

Couple examples are based on both partners retiring at age 65 with one partner having two-thirds of the retirement benefit or income, and the other partner having the remaining one-third.

SG is 9 per cent per annum capped at the maximum contribution base of $134,880 per annum.

Financial

The modelling assumes an investment return of 7 per cent per annum after fees and charges; wage growth of 4 per cent per annum; and CPI of 2½ per cent per annum.

Current superannuation balances

For individuals under a mature system (aged 25), their current superannuation balance was assumed to be zero. For individuals currently in the workforce (aged 45), an assumed current superannuation balance was required to reflect the compulsory superannuation arrangements in place since 1992. The assumed current balances for those aged 45 are outlined below.

Individual — SG

Current balances were assumed to be $20,000 for the $400 per week case, $30,000 for the $600 per week case, $40,000 for the $800 per week case, $50,000 for the $1,000 per week case, $75,000 for the $1,500 per week case and $100,000 for the $2,000 per week case.

These are approximately the balances likely for someone that has been in the compulsory superannuation arrangements since 1992. If balances are larger than this due to additional superannuation contributions, then the overall gains would be greater than shown.

Individual — SG and member contributions

Current balances were assumed to be $40,000 for the $400 per week case, $60,000 for the $600 per week case, $80,000 for the $800 per week case, $100,000 for the $1,000 per week case, $150,000 for the $1,500 per week case, and $200,000 for the $2,000 per week case. These greater balances reflect an assumed history of making member contributions beyond the SG level.

Couples — SG

Current balances were assumed to be $30,000 for the $600 per week case, $50,000 for the $900 per week case, $60,000 for the $1,200 per week case, $90,000 for the $1,800 per week case, and $120,000 for the $2,400 per week case.

All current balances are assumed to be split one-third, two-thirds between each partner. For example, for the $600 per week case, balances are assumed to be split $20,000 and $10,000.

Member contributions

Individual

Member contributions were assumed to be 5 per cent of gross salary. This is achieved through the optimal use of the Government co-contribution, where available, and salary sacrifice arrangements.

Couples

Member contributions were assumed to be 5 per cent of salary for both partners. Where one or both partners are eligible for the Government co-contribution, the amount contributed is optimised to achieve the maximum benefit and the remainder of 5 per cent of salary is sacrificed equally by both partners. As a consequence, the total level of saving is typically greater than 5 per cent for the low income partner, such that the overall saving level for the couple is 5 per cent of their combined salaries.

Tax and age pension

Superannuation benefits from deductible contributions are assumed to be 100 per cent post-June 1983 (taxed element) contributions; tax scales are based on the 2007-08 tax scales announced in the 2006-07 Budget indexed to CPI; age pension is indexed to wage growth; age pension income and asset test thresholds are indexed to CPI.

Appendix B: Examples of how the proposed changes would make superannuation simpler and more streamlined for individuals

Example 1: Jim is 63 years of age and decides to retire with $140,000 in superannuation

Now

Jim is 63 years of age and decides to retire. He has $140,000 in superannuation. Jim can choose to take a lump sum, a pension or a combination of both. Jim thinks about his options and decides to take the $140,000 as a lump sum payment.

This lump sum payment is an ETP. Jim's superannuation fund determines the pre-July and post-June 1983 components based on his eligible service period. The superannuation fund also determines the amount of undeducted contributions.

Jim receives the post-June 1983 component tax free up to the low-rate threshold ($129,751 for 2005-06) and is taxed at 15 per cent for any amounts above the threshold. Jim needs to include 5 per cent of any pre-July 1983 component in his assessable income to be taxed at his marginal tax rate.

Jim also needs to report the ETP on his tax return and this affects his total income and tax rate.

Finally, Jim's lump sum payment is assessed against the lump sum RBL and added to any superannuation benefits and employer termination payments which Jim may have already been paid. If the ATO determines there is an excessive component, this must also be included in Jim's tax return and it would be taxed at 38 per cent plus the Medicare levy.

Proposal

Jim takes his $140,000 in superannuation as a lump sum and pays no tax. He does not need to disclose the ETP on his tax return.

Jim could also choose to leave some of his superannuation money in his account and take a series of lump sum payments. All of these lump sum payments would be tax free.

Example 2: Larry is 67 years of age with $800,000 in superannuation and has ceased work

Now

Larry is 67 years of age, decides to retire and has $800,000 in superannuation. Because Larry is no longer working, he must take his superannuation now.

Larry needs to decide whether to take a lump sum, a pension or a combination of both. Larry thinks about his options and decides to take a lump sum of $200,000 and a life expectancy pension of $600,000.

Larry's lump sum payment is an ETP and is divided into the various ETP components. Larry has a concessional component and a pre-July 1983 component rolled over from a previous superannuation fund. Larry's concessional component is calculated first. The fund then determines the pre-July and post-June 1983 components based on Larry's eligible service period. Larry's undeducted contributions also form another component.

The post-June 1983 component is taxed at 0 per cent, up to the low-rate threshold. Any amount above the threshold is taxed at 15 per cent.

The lump sum payment needs to be reported on Larry's tax return, and Larry also needs to include 5 per cent of the concessional component and 5 per cent of the pre-July 1983 component in his assessable income on his tax return to be taxed at his marginal tax rate.

The annual deductible amount of Larry's pension is based on the amount of undeducted contributions, Larry's life expectancy and could include his concessional and pre-July 1983 component because of the previous rollover.

Larry's pension income also needs to be included in his tax return. These payments are taxed at Larry's marginal tax rate, and Larry can also claim the 15 per cent pension rebate.

Larry's lump sum payment and pension is assessed against the pension RBL. If the ATO determines there is an excessive component, then Larry will need to include this in his tax return to be taxed at 38 per cent plus the Medicare levy. Larry's pension rebate of 15 per cent will also be reduced.

Proposal

Larry's lump sum payment would be tax free and his pension payments would be tax free. Larry would not need to report these payments on his tax return. If he wished, Larry could decide to not draw down on his superannuation at all until some later time.

Example 3: Deidre is 59 years of age and thinking of retiring

Now

Deidre is 59 years of age and has been thinking about retiring and taking her superannuation as a pension.

Under the current system, Deidre would calculate an annual deductible amount for her pension based on her undeducted contributions and her life expectancy. This amount would be excluded each year from Deidre's assessable income.

Deidre's pension income would then be taxed at her marginal tax rate and Deidre would have to include these payments in her tax return. Deidre may also be eligible for the 15 per cent pension rebate.

Deidre's pension would also be assessed for RBL purposes, and if Deidre's pension was higher than the RBL, her 15 per cent pension rebate would be reduced.

Proposal

Deidre decides to defer taking her superannuation until she reaches at least age 60 as she would then receive her superannuation pension payments tax free and would not be required to report these payments on her tax return.

Example 4: Geeta is 62 years of age, retired due to disability and purchases a lifetime pension

Now

Geeta retires at 62 years of age because of invalidity (a permanent disability) and rolls over her lump sum payment to purchase a lifetime pension.

Geeta calculates an annual deductible amount for her pension based on her undeducted contributions, the post-June 1994 invalidity component and her life expectancy. This amount is excluded each year from Geeta's assessable income.

Geeta includes her pension payments in her tax return as they are assessable income and are taxed at her marginal tax rate. Geeta also receives the 15 per cent pension rebate.

Geeta's pension is a complying income stream, and is therefore assessed against the pension RBL. If the ATO determines there is a component of Geeta's pension above the pension RBL, her 15 per cent pension rebate would be reduced.

Proposal

Geeta's pension payments would be tax free and would not be included in her tax return.

Example 5: Andrew is 65 years of age and retires with his superannuation in an untaxed scheme

Now

Andrew retires with a superannuation balance of $830,000. Andrew decides to take a lump sum payment of $200,000 and the remainder of his superannuation balance as a pension. Andrew's superannuation fund is an untaxed scheme.

Andrew's lump sum payment is an ETP, and his superannuation fund calculates the pre-July and post-June 1983 components of the lump sum based on Andrew's eligible service period. Andrew has a concessional component rolled over from a previous superannuation fund, and the fund also determines the amount of undeducted contributions.

Andrew needs to include 5 per cent of the concessional component and 5 per cent of the pre-July 1983 component in his assessable income on his tax return to be taxed at his marginal tax rate.

The post-June 1983 untaxed component will be taxed at 15 per cent up to the low-rate threshold ($129,751 for 2005-06) and at 30 per cent for any amount above the low-rate threshold, plus the Medicare Levy.

The annual deductible amount of Andrew's pension is calculated based on his undeducted contributions, life expectancy and could include his concessional component and pre-July 1983 component because of the previous rollover.

Andrew's pension income also needs to be included in his tax return. These payments are taxed at Andrew's marginal tax rate. Andrew will not be eligible for the 15 per cent pension rebate as his pension is paid from an untaxed source.

Andrew's lump sum payment and pension is assessed against the pension RBL as he has taken more than 50 per cent of his total benefit as a pension. These amounts are added to any superannuation benefits and employer termination payments that Andrew has already been paid. If the ATO determines there is an excessive component, Andrew will need to include this amount in his tax return to be taxed at 47 per cent, plus the Medicare Levy.

Proposal

Andrew's superannuation fund would calculate two components for the lump sum payment. The exempt component (which includes Andrew's pre-July 1983 component, concessional component and undeducted contributions) would be paid tax free to Andrew. As Andrew's lump sum payment would be less than $700,000, the taxable component would be taxed at 15 per cent.

Andrew's pension payments would continue to be included in his assessable income and be taxed at marginal rates. However, they would be eligible for a 10 per cent taxation offset.

GLOSSARY

References to superannuation funds also apply to Approved Deposit Funds (ADFs) and Retirement Savings Account (RSA) providers

For simplicity, this paper refers only to superannuation funds. It is intended that the proposals outlined in this paper apply equally to other types of superannuation entities such as ADFs and RSAs.

References to superannuation pensions also apply to superannuation annuities

For simplicity, this paper refers only to superannuation pensions. It is intended that the proposals outlined in this paper apply equally to superannuation annuities.

References to age pension

For simplicity, this paper refers only to age pensions. It is intended that the proposals outlined in this paper would apply equally to veterans, and related pensions.

Accumulation fund

A superannuation fund that provides retirement benefits based on accumulated contributions, and any investment earnings on those contributions, less taxes, administrative costs and other charges paid.

Allocated pension

Pensions where payments must be at least annual and where withdrawals during the year must be between the maximum and minimum limits specified in the *Superannuation Industry (Supervision) Regulations 1994*. Allocated pensions are assessed against the lump sum RBL as they are not complying pensions, but are eligible for other tax concessions, such as the pension rebate.

Complying pension

A pension is complying if it meets the relevant standards specified in the *Superannuation Industry (Supervision) Regulations 1994*. Complying pensions include lifetime pensions, life expectancy pensions and market-linked pensions (since 20 September 2004). Complying pensions are assessed against the pension RBL.

Defined benefit scheme

A superannuation scheme that provides a retirement benefit usually based on salary and/or a pre-determined formula for calculating that benefit.

Dependant

Includes a spouse (including opposite sex de facto), a child of the member (under 18 for tax purposes), a person who is in an interdependency relationship with the member and a person who is financially dependent on the member. An interdependency relationship exists between two people normally if:

- they have a close personal relationship;
- they live together;
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.

Eligible service period

This is used to calculate the pre-July 1983 and post-June 1983 components of an ETP. Where an ETP is made by an employer, the eligible service period is the whole of the period of employment to which the payment relates. Where the ETP is made by a superannuation fund, the eligible service period is effectively the combined periods of employment and fund membership to which the payment relates.

Eligible termination payment (ETP)

Lump sum payments from superannuation funds, lump sum payments made in consequence of a termination of employment and certain similar payments. These payments are subject to special taxation rules. The lump sum payment is divided into various components, each of which is subject to special tax treatment. The different components could include the following:

- Concessional component (5 per cent of the retained amount of the component is included in assessable income and taxed at marginal rates).
- Post-June 1994 invalidity component (exempt from tax).
- CGT exempt component (exempt from tax). The ETP may have this component if the member rolled-over the proceeds of certain business assets for his or her retirement. The exemption only applies where the net value of assets of the business does not exceed $5 million. Individuals are allowed to claim an exemption on capital gains amounts up to a lifetime limit of $500,000.
- Non-qualifying component (included in assessable income and taxed at marginal tax rates). This component is the earnings on any non-ETP money that was used to purchase an annuity and that annuity is now a commutation or residual capital payment. It must have been purchased before 12 January 1987 if purchased as a deferred annuity, or 9 December 1987 if purchased as an immediate annuity.

- Undeducted contributions component, which is the amount of any contributions paid by the taxpayer or any other person where no deduction was allowable in respect of those contributions (exempt from tax).

- Excessive component, which is the amount of the payment that exceeds the RBL (taxed at 38 per cent when paid from a taxed source or 47 per cent when paid from an untaxed source).

- Pre-July 1983 component, which is that amount of the payment that relates to pre-July 1983 employment or fund membership (5 per cent of the retained amount of the component is included in assessable income and taxed at marginal tax rates).

- Post-June 1983 component, which is that amount of the payment that relates to post-June 1983 employment or fund membership. When taken as a lump sum after age 55, this component is taxed at 0 per cent up to the low-rate threshold ($129,751 in 2005-06) and any amount over this threshold is taxed at 15 per cent up to the RBL. Amounts above the RBL are taxed as an excessive component at 38 per cent. If the amount is from an untaxed source, it is taxed at 15 per cent up to $129,751, at 30 per cent up to the lump sum RBL and 47 per cent above that limit.

Hybrid superannuation scheme

A superannuation scheme that provides a retirement benefit based partially on accumulated contributions and investment earnings on those contributions and partially on a salary and/or a pre-determined formula.

Low-rate ETP threshold

The amount of the post-June 1983 component of an ETP subject to low tax. Where the component is a taxed element, it is taxed at 0 per cent; where it is an untaxed element, it is taxed at 15 per cent. The threshold is currently $129,751 and is indexed.

Member contributions

These are personal contributions to a superannuation fund to obtain superannuation benefits for the member, or the member's dependants in the event of the member's death. They could be either undeducted personal contributions or deductible personal contributions.

Preservation age

The age at which superannuation benefits can be accessed once the individual is retired. It is currently age 55. In the 1997-98 Budget, the Government announced an increase in the preservation age from 55 to 60 on a phased basis between the years 2015 and 2025. This will mean that for someone born before 1 July 1960, the preservation age will remain at 55 years, while for someone born after 30 June 1964, the preservation age will rise to 60 by 2025.

RBL

The RBL system caps the amount of superannuation and similar benefits that an individual can receive on a concessionally taxed basis. For the 2005-06 financial year, the pension RBL is $1,297,886 and the lump sum RBL is $648,946. Whether the lump sum or pension RBL applies will depend on the type of pension chosen and whether, overall, 50 per cent or more of total benefits are taken as a particular type of pension known as 'complying pensions'.

The amount of the payment that exceeds the RBL, known as the excessive component, is taxed at 38 per cent when paid from a taxed source or 47 per cent when paid from an untaxed source, plus the Medicare levy.

Superannuation Holding Accounts Special Account

A reserve administered by the ATO whereby employers may make superannuation contributions for their employees in instances where the employer is unable to locate a superannuation fund account or RSA for the employee.

SG contributions

The prescribed minimum level of superannuation required under the *Superannuation Guarantee (Administration) Act 1992* that an employer must contribute for eligible employees.

Undeducted purchase price

The undeducted purchase price is used to calculate the portion of pension income which is exempt from tax. The undeducted purchase price typically represents amounts used to purchase a pension for which no tax deductions have been claimed, such as a member's own contributions from their after-tax income.