



## Superannuation ready reckoner: taxation and preservation rules for 2004–2005—revised February 2005

This brief, updated for the 2004–05 financial year, and now including additional material on co-contributions, self managed superannuation funds and the social security assessment of superannuation, is designed to provide readers with a ‘ready reckoner’—a simple, easy to use summary of superannuation taxation and preservation rules.

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## List of acronyms

ABN	Australian Business Number
ALP	Australian Labour Party
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
GST	Goods and Services Tax
SGA Act	<i>Superannuation Guarantee (Administration) Act 1992</i>

## Introduction

Superannuation law is extremely complex and individual circumstances can drastically alter its general application. This paper has been prepared as a briefing and reference tool only and is not intended for use in providing financial advice. This paper should not be used for determining the tax liability attached to superannuation in any particular case, especially in view of the many specific considerations that need to be addressed in a summary document of this kind. Nor should it be used to determine any person's social security entitlements, or any decision on the level of contributions to make to a superannuation fund or any decision on the choice of any superannuation fund. **The author disclaims any liability in relation to any financial decision taken which may be influenced by the content of this paper.**

This edition of the Superannuation Ready Reckoner differs from previous editions in that it includes additional material on superannuation co-contributions, self managed superannuation funds and the social security assessment of superannuation. The material on other matters is largely unchanged from the previous edition

Australia's retirement income system is based on the so called three pillars:

1. compulsory superannuation contributions under the superannuation guarantee regime for all employees
2. voluntary superannuation contributions, and
3. a means tested social security age pension.

This paper concentrates on the first two pillars, compulsory and voluntary superannuation contributions.

Superannuation is a tax-effective investment vehicle, but is known for its complexity and frequent change.<sup>1</sup> The complexity covers most areas of the superannuation system including prudential regulation, taxation and disclosure regulation. Frequent legislative changes contribute to the system's complexity. In the 2003–04 financial year, 60 Acts, regulations and other legislative instruments relating to superannuation were passed into law that introduced policy initiatives or amended existing acts and regulations in the areas of:

- income tax
- prudential supervision of superannuation funds and retirement savings accounts
- superannuation guarantee
- the superannuation contributions surcharge and termination payments surcharge Acts
- parliamentary superannuation, and

- the public sector and military superannuation schemes.<sup>2</sup>

Three substantial changes occurred in the superannuation system in June 2004. First, the Federal Government finally succeeded in getting the ‘choice of superannuation fund’ legislation through Parliament. Second, the Government removed the work test requirements from superannuation for those people aged between 18 and 65 years of age, which had the effect of opening up superannuation to those not in paid employment. Finally, the co-contributions legislation was passed, with the first payments being made after October 2004.

Further, the indexation of financial thresholds each financial year results in numerous changes of these threshold levels.<sup>3</sup>

This paper, updated for the 2004–05 financial year, and now including additional material on co-contributions, self managed superannuation funds and the social security assessment of superannuation, is designed to provide readers with a ‘ready reckoner’—a simple, easy to use summary of superannuation taxation and preservation rules, and covers the following topics:

- the taxation of superannuation contributions and benefits
- the level of superannuation contributions that employers must make
- taxation of superannuation fund earnings
- the rebates that apply to certain superannuation contributions and benefits
- the preservation rules that came into operation on 1 July 1999
- the application of the Goods and Services Tax (GST) to superannuation
- self managed superannuation funds
- a brief introduction to the interaction to superannuation and social security entitlements, and
- the proposed change to the taxation of superannuation that remains outstanding.

All figures in **bold** type are thresholds indexed in accordance with legislation governing the amounts that apply in a financial year for tax and other related purposes, and are only current for the 2004–05 financial year.<sup>4</sup> This brief will continue to be updated at the beginning of every financial year.

This brief does not address the roles of the various government agencies that regulate the superannuation industry. However, it should be noted that prudential legislation and regulations, administered by the Australian Prudential Regulation Authority (APRA), are directed at safeguarding the assets of superannuation fund members and investors. Disclosure legislation and regulations, administered by the Australian Securities and Investments

Commission (ASIC), are directed at ensuring that fund trustees provide relevant information to superannuation fund members and investors to enable them to make a fully informed investment decision. Taxation legislation and regulations, administered by the Australian Taxation Office (ATO), are directed at superannuation funds and their members to collect revenue for the Commonwealth of Australia.

The ATO also regulates self managed superannuation funds and registers all new superannuation funds (self managed and APRA-regulated superannuation funds) as part of the Australian Business Number (ABN) registration process.<sup>5</sup> For an APRA-regulated superannuation fund the ATO is required (once the ABN registration process has been completed) to pass the superannuation fund's registration and information contained in the notice of election under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and notice of establishment under the SIS Act.

The main focus of this paper is the taxation legislation and regulations that affect superannuation funds and their members.

## Taxation of superannuation contributions

This section explains how superannuation contributions are taxed, the maximum amount of tax-deductible contributions that an employer can make and the tax offsets that apply to certain superannuation contributions.<sup>6</sup> A superannuation contribution is a payment to a superannuation fund, which is generally concessional tax. A 'tax rebate' is a reduction in tax liability that has the same value to all taxpayers independent of the taxpayer's marginal tax rate.

### Age-based deduction limits

Employer contributions made to a complying superannuation fund or retirement savings account are fully tax deductible to the employer up to the age-based deduction limits.<sup>7</sup> 'Self-employed persons' (whose income from an employer is less than 10 per cent of their total income) get a full tax deduction on the first \$5000 of personal contributions plus 75 per cent of the remaining personal contribution up to the age-based deduction limits.<sup>8</sup> The deduction limits are:

<b>Age of employee (years)</b>	<b>Deduction limit 2004–05</b>
under 35	<b>\$13 934</b>
35 to 49	<b>\$38 702</b>
50 and over	<b>\$95 980</b>

Source: Australian Taxation Office: TD 2004/18

## Taxation of contributions

Employer and tax-deductible personal contributions are included in the income of complying superannuation funds and retirement saving accounts and are taxed at a rate of 15 per cent. Generally the personal contributions an employee may make to a complying superannuation fund out of his or her after-tax income are not eligible for a tax deduction and are not included in the income of complying superannuation funds or retirement saving accounts.

## Surcharge on contributions

Prior to 1 July 2003, all employer contributions, certain ‘golden handshakes’ and tax-deductible personal contributions made to superannuation funds for high-income earners were subject to a surcharge of up to 15 per cent.<sup>9</sup>

The maximum surcharge rate was reduced to 14.5 per cent for the 2003–04 year of income by the *Superannuation (Surcharge Rate Reduction) Amendment Act 2003*.<sup>10</sup> Amendments made by the *Superannuation Budget Measures Act 2004* will see the maximum surcharge rate reduced to 12.5 per cent for the 2004–05 year of income and 10 per cent for the 2005–06 year of income.<sup>11</sup>

For the 2004–05 year of income, the surcharge is currently phased in over the income levels of **\$99 710** to **\$121 075** (source: Australian Taxation Office SDC 2004/1).<sup>12</sup> The rate at which the surcharge increases if the income level is between these two amounts is worked out by a formula set out in subsection 5(1) of the *Superannuation Contributions Tax Imposition Act 1997*.

The surcharge may also be payable if a member does not quote his or her Tax File Number to his or her superannuation fund. For an account which existed prior to 7 May 1997 and received less than the surchargeable contributions threshold of **\$4273**, the surcharge will not be levied merely due to the non-quotation of a Tax File Number in relation to that account for that year.

## Government co-contribution for low income earners

The Government co-contribution for low income earners fulfils one of the Government’s 2001 election commitments and replaces the Low Income Superannuation Rebate.

From 1 July 2003, a person who is treated as an employee for superannuation guarantee purposes may be entitled to a Government co-contribution. In the 2004–05 year of income, an employee with total income less than \$28 000 who makes personal superannuation contributions is eligible for a \$1.50 contribution from the Government for every dollar of eligible personal contributions made to a complying superannuation fund.<sup>13</sup> The maximum amount of eligible personal contributions that the Government will match is \$1000. That is, the Government will contribute \$1500 if an employee with income less than \$28 000 makes \$1000 in personal superannuation contributions.

For an employee with a total income between \$28 000 and \$58 000, the maximum amount of the Government co-contribution is reduced by five cents for every dollar above \$28 000. There is no entitlement to the co-contribution once an employee's total income is \$58 000 or more. From the 2007–08 year of income, these thresholds will be indexed to increase in line with full-time adult average weekly ordinary time earnings. The following table sets out the levels of government co-contributions an employee may be paid, by total income and personal contributions made.

<b>Personal superannuation contribution(s) is</b>	<b>\$1000</b>	<b>\$800</b>	<b>\$500</b>	<b>\$200</b>
Total Income				
\$28 000 or less	\$1500	\$1200	\$750	\$300
\$30 000	\$1400	\$1200	\$750	\$300
\$36 000	\$1100	\$1100	\$750	\$300
\$40 000	\$900	\$900	\$750	\$300
\$46 000	\$600	\$600	\$600	\$300
\$50 000	\$400	\$400	\$400	\$300
\$56 000	\$100	\$100	\$100	\$100

Source: Australian Taxation Office Fact Sheet<sup>14</sup>

The lowest amount of co-contribution payable is \$20 per financial year. That is, if an employee contributes at little as \$1 in personal contributions he or she will receive a co-contribution payment into their superannuation fund of at least \$20 for the financial year.

The contributions are treated as an un-deducted contribution. This means they are not subject to contributions tax. However, the earnings of the co-contributions amounts are subject to tax (see below).

Early indications are that a significant number of employees have taken advantage of the co-contributions scheme.

### Low income spouse rebate

A contributing spouse is entitled to receive an 18 per cent rebate for contributions up to \$3000 per annum to the superannuation fund or retirement savings account of a spouse who has an assessable income plus reportable fringe benefits of \$10 800 or less per annum. The maximum rebate of \$540 phases out on a dollar-for-dollar basis, and is not available when the low income spouse's assessable income plus reportable fringe benefits is \$13 800 or more per annum.

### Non-deductible contributions

As part of its 2001 election commitment, the Government promised to introduce reforms to the superannuation system to allow contributions to superannuation accounts for children under the age of 18 and to allow recipients of the first child tax offset (Baby Bonus) to

contribute to their superannuation funds. The legislation that introduced these initiatives treats them as *undeducted contributions*, meaning that the contributor will not be able to claim a tax deduction for the contributions, they will not be entitled to any offset and the contributions will not be eligible for the Government co-contribution.

From 1 July 2004, the rules regarding who can make contributions to a superannuation fund were amended so that anyone under 65 years of age can now contribute to a superannuation fund (refer to the section below entitled '[Removing the work test](#)'). A consequence of this change is that, from 1 July 2004, the provisions for contributions for children and contributions by recipients of the Baby Bonus are no longer necessary. However, specific work tests have to be met before someone can claim a tax deduction for contributions made by or on behalf of a person less than 18 years of age.

#### Contributions for children

From 1 July 2002 to 30 June 2004, family and friends of a child under the age of 18 were allowed to make undeducted contributions to a superannuation fund on behalf of the child. The maximum amount that could have been contributed for a child over a three year period was \$3000 (this limit no longer applies).

#### Recipients of the Baby Bonus

From 1 July 2002 to 30 June 2004, superannuation fund members who were not gainfully employed but were eligible for the Baby Bonus were permitted to make contributions to their superannuation fund provided the contribution was within 12 months of the Commissioner of Taxation being notified that the member was entitled to the offset. The contribution was not limited to the amount of the first child tax offset.

## Regulation of superannuation contributions

The level of superannuation support that an employer is required to provide to employees is prescribed under federal and state industrial awards and the Commonwealth's superannuation guarantee scheme.

Under award superannuation, the parties (generally unions and employers) are bound by an industrial agreement (or award) to make superannuation contributions to a superannuation fund nominated in the agreement. The level of support is normally not greater than 3 per cent of ordinary time earnings or some other notional earnings base defined in the award and permitted by the *Superannuation Guarantee (Administration) Act 1992* (SGA Act).

The superannuation guarantee scheme requires all employers to provide a minimum level of superannuation support in each financial year for employees (with limited exceptions). The superannuation guarantee scheme operates in conjunction with award superannuation so that contributions made by an employer in conjunction with an industrial award may be counted

towards the employer's superannuation guarantee obligations using the notional earnings base in the award or ordinary time earnings.

However, from 1 July 2008, employers will not be able to use a notional earnings base to calculate the superannuation guarantee contributions. While they may still use the notional earnings base to satisfy award contributions, all superannuation guarantee contributions will have to be calculated on an employee's ordinary time earnings.

### Superannuation guarantee rate

Since the 2002–03 year of income, the superannuation guarantee rate has been 9 per cent of ordinary time earnings or an approved notional earnings base.

### Quarterly superannuation guarantee

From 1 July 2003, employers are required to make superannuation guarantee contributions on a quarterly basis.

### Maximum contribution base

Employers who do not make superannuation guarantee contributions are liable for the superannuation guarantee charge. The superannuation guarantee charge is made up of the employer's superannuation guarantee shortfall (the amount that the employee should have received in superannuation guarantee contributions), an interest (or penalty) component and an administration component (to recover costs incurred by the ATO). When calculating an individual employee's superannuation guarantee shortfall, the amount of an employee's salary or wages used to calculate their 'ordinary time earnings' in a contribution period is limited to the maximum contribution base, which is **\$32 180** (source: Australian Taxation Office SGD 2004/1), for each quarterly period.

### Choice of superannuation fund

The Coalition first announced the proposal to allow employees to choose the superannuation fund to which their superannuation guarantee contributions would be made during the 1996 election. Since then, the details concerning the operation and structure of choice of superannuation fund have been the subject of extensive public debate. The choice of superannuation fund legislation finally passed through Parliament and received Royal Assent (or formal approval) on 30 June 2004.

A history of the development of the choice of superannuation proposal can be found in the [Bills Digest](#) for the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002.

From 1 July 2005, employees must choose the complying superannuation into which they want to have their superannuation guarantee contributions paid. Where an employee does not

choose a superannuation fund, the employer may choose the complying superannuation fund, provided it is an ‘eligible choice fund’. An ‘eligible choice fund’ for an employer is:

- a complying superannuation fund
- a retirement savings account
- a fund presumed to be a complying superannuation scheme under section 24 of the SGA Act, or
- a fund presumed to be a complying superannuation fund under section 25 of the SGA Act.

However, the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* excludes various groups of employees from the coverage of the choice of superannuation fund legislation including:

- Commonwealth public sector employees
- employees covered by state awards, and
- those employees covered by a certified agreement or Australian Workplace Agreement that stipulates the superannuation fund(s) to which contributions are to be made on behalf of the employees.

Choice of superannuation fund will provide more competition for approximately half the people in the workforce who have superannuation.<sup>15</sup> However, partly due to the survey conducted jointly by the ASIC and the Australian Consumers’ Association into the financial planning industry in 2003 there are still concerns that there are insufficient controls in place to protect superannuation fund members who are permitted to choose a superannuation fund for their superannuation guarantee contributions from unethical practices similar to those seen in the United Kingdom in the 1990s.<sup>16</sup>

### Removing the work test

Prior to 1 July 2004, a superannuation fund could only accept unmandated (or non-compulsory) contributions if certain conditions were met.<sup>17</sup> These were:

- the person had been gainfully employed on at least a part-time basis for one week in the two year period prior to when the contribution was made<sup>18</sup>
- the person was no longer able to work because of ill health (physical or mental)
- the person was on authorised leave for no more than seven consecutive years to raise children
- the contribution was an eligible spouse contribution

- the contribution was to satisfy a payment split as part of a (matrimonial) property settlement
- the contribution was in respect of a child account, or
- the contribution was made in respect of a person entitled to the Baby Bonus.

The first three dot points above were commonly referred to as the ‘work test provisions’.

On 25 February 2004, the Treasurer released [\*A more flexible and adaptable retirement income system\*](#)<sup>19</sup> as part of the ‘Australia’s Demographic Challenges’ announcement.<sup>20</sup> Included in the policy announcement was the proposal to remove the work test for anyone under the age of 65. The policy announcement also included the introduction of a work test where a person wants to claim a tax deduction for the contributions made on behalf of a person less than 18 years of age.

Amendments made to the Superannuation Industry (Supervision) Regulations 2004, with effect from 1 July 2004, now allow anyone under 65 years of age to make contributions to a superannuation fund without needing to meet any work test requirements.

## Taxation of superannuation fund earnings

The investment earnings of a complying superannuation fund or retirement savings account are taxed at a rate of 15 per cent. The capital gains tax discount for superannuation funds is one third of the capital gains included in a superannuation fund’s assessable income. The tax that a superannuation fund pays on its assessable income (earnings and taxable contributions) can be reduced through the use of imputation credits and other deductions such as those related to property investment.<sup>21</sup> Funds which are made non-complying are taxed at a rate of 47 per cent on their entire assets, apart from undeducted contributions, and any income. Superannuation funds can be non-complying either through choice or through failing to meet the necessary standards and conditions required under prudential legislation to qualify for tax concessions.

## Taxation of superannuation benefits

This section describes the taxation arrangements that apply to superannuation benefits. A superannuation benefit is the amount of money in the superannuation fund or retirement savings account to which the fund member or retirement savings account holder is entitled. Most benefits are payable on termination of employment and will often be subject to preservation (see ‘Preservation rules’ below).

The taxation of superannuation benefits is complex due to changes made on 1 July 1983 and 1 July 1988 aimed at avoiding retrospectivity by applying new taxation treatment to only those portions of benefits attributed to service after 1 July 1983 and 1 July 1988.<sup>22</sup>

## Eligible termination payments

Eligible termination payments are lump sums usually paid on retirement or resignation from a job and include ‘golden handshakes’, payments from superannuation funds, approved deposit funds, and retirement savings accounts. Eligible termination payments are taxed differently from other income.

Eligible termination payments are comprised of several components (although not all eligible termination payments have every component). Each component of an eligible termination payment is taxed in a different manner and may be subject to various rebates.

The various components of an eligible termination payment and their respective taxation treatment are provided in the following table:

Eligible termination payment component	Maximum Tax Rate (add Medicare levy)
<b>Pre-July 1983 component</b> —the amount of an eligible termination payment that relates to superannuation benefits accrued with respect to employment before 1 July 1983.	5% of amount is taxed at marginal tax rates
<p><b>Post-June 1983 component</b>—refers to superannuation benefits accrued with respect to employment or fund membership after 30 June 1983. This component is the amount of the eligible termination payment reduced by the total amount of all the other eligible termination payment components. These benefits are taxed according to whether the superannuation fund’s earnings were taxable and the age of the benefit recipient, as follows.</p> <p><b>Person less than Preservation age (generally 55):</b></p> <ul style="list-style-type: none"> <li>• <b>Taxed element:</b> a post-June 1983 component is a taxed element if the fund is subject to 15% tax on investment earnings of the fund (i.e. most superannuation funds). 20%</li> <li>• <b>Untaxed element:</b> a post-June 1983 component is an untaxed element if the fund is not subject to 15% tax on investment earnings (e.g. some government superannuation funds and golden handshakes for employees). 30%</li> </ul> <p><b>Person over their preservation age:<sup>23</sup></b></p> <ul style="list-style-type: none"> <li>• <b>Taxed element:</b> <ul style="list-style-type: none"> <li>– from \$0 to <b>\$123 808</b> 0%</li> <li>– balance 15%</li> </ul> </li> <li>• <b>Untaxed element:</b> <ul style="list-style-type: none"> <li>– from \$0 to <b>\$123 808</b> 15%</li> <li>– balance 30%</li> </ul> </li> </ul>	
<b>Undeducted contributions</b> —member contributions (since 1 July 1983) not subject to a tax deduction (not included for reasonable benefit limits purposes—see below).	Exempt
<b>CGT exempt component</b> —an exemption from capital gains tax (on a total maximum capital gain of \$500 000) can be claimed on the sale of a small business where the proceeds are used for retirement.	Exempt
<b>Concessional component</b> —until 1 July 1994, this included any approved early retirement scheme payment, bona fide redundancy payment or invalidity payment. From 1 July 1994, eligible termination payments no longer have a concessional component, except where an eligible termination payment with a concessional component was rolled over (transferred to) a complying superannuation fund before 1 July 1994 and subsequently paid out by the fund.	5% of amount is taxed at marginal tax rates
<b>Post-June 1994 invalidity payments</b> —the recipient's disability must be verified.	Exempt
<b>Non-qualifying component</b> —that part of an eligible termination payment that represents investment income accruing between the time of purchasing an annuity (other than by a rollover) and the time of payment.	Full amount taxed at marginal tax rates
<p><b>Excessive component</b></p> <ul style="list-style-type: none"> <li>• Portion of the excessive component that reflects the taxed element of the post 30-June 1983 component. 38%</li> <li>• The remainder of the excessive component. 47%</li> </ul>	

Source: Chapter 18 CCH Master Superannuation guide 2004/05

## Reasonable benefit limits

The amount of concessional tax superannuation benefits a person is allowed to receive over his or her lifetime is limited by reasonable benefit limits. The table below shows the lump sum and pension reasonable benefit limits. The pension reasonable benefit limit is available provided that at least 50 per cent of the total benefit received by a person is taken in the form of a pension or annuity that satisfies the pension and annuity standards.

<b>Reasonable Benefit Limits</b>	<b>2004–05</b>
Lump sum	<b>\$619 223</b>
Pension	<b>\$1 238 440</b>

Source: Australian Taxation Office: TD 2004/18

## Bona fide redundancy payments

From 1 July 1994, a limit was set on redundancy and early retirement payments. Amounts within the limit are exempt from tax. For the 2004–05 year of income the limit is **\$6194** plus **\$3097** for each year of completed service (source: Australian Taxation Office TD 2004/18).

## Death benefits

All death benefits paid on or after 1 July 1994 are subject to pension reasonable benefit limits. Death benefit payments made directly to the dependants of a deceased member are exempt from tax up to the deceased person's pension reasonable benefit limit. When paid to a person other than a dependant, death benefit payments become eligible termination payments. The post-June 1983 death benefit eligible termination payment is taxed at 15 per cent if paid from a taxed source and 30 per cent if paid from an untaxed source up to the deceased person's pension reasonable benefit limit. Any amount above the deceased person's pension reasonable benefit limit is treated as an excessive component and is taxed at 38 per cent or 47 per cent depending on the source of the payment.

From 30 June 2004, the definition of 'dependant' was widened to include people living in an interdependent relationship.<sup>24</sup> An 'interdependent relationship' exists where the two people involved:

- have a close personal relationship
- 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.

## Pension and annuity rebate

Where a person receives an eligible termination payment and uses it to purchase an annuity or pension from a taxed superannuation fund and the person is 55 or more years of age, the person is entitled to a tax rebate, at 15 per cent, on the assessable part of the annuity or pension payment that is not in excess of the person's reasonable benefit limit.

## Departing Australia superannuation payments

From 1 July 2002, temporary residents who permanently depart Australia can gain access to their accumulated superannuation. To be eligible for a payment:

- the person must have entered Australia on an eligible temporary resident visa (New Zealand residents are excluded)
- the person's visa must have expired or been cancelled, and
- the person must have permanently departed Australia.

The payment of superannuation benefits that qualify as departing Australia superannuation payments are subject to special withholding tax rates to claw back the tax concessions the contributions received when originally paid into the superannuation. These are set out in the *Income Tax (Superannuation Payments Withholding Tax) Act 2002* and are as follows:

- undeducted contributions or post-June 1994 invalidity component – nil
- post-30 June 1983 untaxed component – 40 per cent, and
- the remainder of the payment – 30 per cent.

## Income tax rates

Individual income tax rates are relevant to calculating an individual's superannuation entitlement. For example, a fund member who receives an eligible termination payment that contains a non-qualifying component has taxation levied on that component at the member's marginal income tax rate. In addition, if a fund member has an eligible termination payment that contains a concessional component, 5 per cent of that component is taxed at the member's marginal income tax rate. The marginal income tax rates for the 2004–05 year of income are in the following table:

<b>Taxable income (\$)</b>	<b>Marginal income tax rate (%)</b>
up to 6000	0
6001–21 600	17
21 601–58 000	30
58 001–70 000	42
excess over 70 000	47

Source: Chapter 18 CCH Master Superannuation Guide 2004/05<sup>25</sup>

The marginal income tax rates set out above apply to Australian residents and do not include the Medicare levy, which is generally 1.5 per cent. A low-income rebate, worth a maximum of \$235 can affect the tax paid for lower income earners.

## Preservation rules

‘Preservation’ refers to the prudential regulatory requirement that certain superannuation benefits be maintained either in a superannuation or rollover fund or retirement savings account until permanent retirement or after the member reaches preservation age.<sup>26</sup> Benefits may be paid on a member’s death or invalidity prior to preservation age.

### New preservation rules from 1 July 1999

New preservation rules, administered by APRA and the ATO, took effect from 1 July 1999. Under the new regulations, all superannuation contributions (including member contributions) and superannuation fund investment earnings, from that date forward, will be preserved until the member’s preservation age. Pre-1 July 1999, non-preserved components of a member’s superannuation entitlement generally retain their non-preserved status.

Prior to 1 July 1999, some monies held in a member’s superannuation fund account were unpreserved benefits and could be accessed, subject to some restrictions, without having to wait until the member had reached the preservation age and retired from the workforce. An example is member contributions made from after-tax income prior to 1 July 1999 where the member is no longer working for the employer with whom they were employed when he or she made the member contributions.

From 1 July 2004, any employer eligible termination payment rolled over into a superannuation fund or approved deposit fund must be preserved until the member satisfies a condition of release that allows them access to their preserved benefits, such as retiring from the workforce once he or she have reached their preservation age.

## New preservation age from 1 July 1999

‘Preservation age’ is the age at which a fund member can gain access to benefits that have accumulated in a superannuation fund or retirement savings account, provided that the member has permanently retired from the workforce.

The Government announced in the 1997 Budget that the preservation age would be increased from 55 to 60 years on a phased-in basis. By 2025, the preservation age will be 60 years for anyone born after June 1964, with the preservation age being reduced by one year for each year that the person’s birthday is before 1 July 1964. This means that persons born before 1 July 1960 will continue to have a preservation age of 55. The following table summarises the phase-in schedule:

<b>For a person born</b>	<b>Preservation age (years)</b>
Before 1 July 1960	55
1 July 1960–30 June 1961	56
1 July 1961–30 June 1962	57
1 July 1962–30 June 1963	58
1 July 1963–30 June 1964	59
After 30 June 1964	60

Source: Reg 6.01(2) Superannuation Industry (Supervision) Regulations 1994

Under the new preservation rules, a person will continue to be allowed to have early access to preserved benefits where the benefits are taken in the form of a non-commutable lifetime pension or lifetime annuity on termination of gainful employment, subject to the governing rules of the fund or retirement savings account. Further, under measures announced by the Treasurer in February 2004 a person may have access to a non-commutable income stream at any point past their preservation age, without having to retire formally. This measure is designed to cater for more flexible working arrangements at the end of a person’s working life. Preserved superannuation benefits can be accessed on compassionate grounds and severe financial hardship.

## GST and superannuation

This section summarises how the GST is applied to superannuation funds.<sup>27</sup>

The GST is a broad-based, value-added tax of 10 per cent on most goods and services supplied in Australia. It is fully effective from 1 July 2000. (Some contracts entered into before 1 July 2000 are also affected by the GST.) The GST is payable on transactions where goods and/or services are supplied for consideration (payment). No business is GST-free; only certain transactions may be classified as such.

In all countries that have a GST-type tax, financial services are given special treatment. This is because of the difficulty in valuing the service provided when there are sums of capital and interest and other earnings in most financial transactions. It is just too hard and uncertain to unscramble the omelette when a fee for service and an interest charge may both be involved in a transaction. Accordingly, financial services are ‘input-taxed’.

Superannuation funds are ‘financial supplies’, meaning that the provision, acquisition, or disposal of an interest in or under a superannuation fund, scheme, approved deposit fund or retirement savings account or in or under an annuity or allocated pension, is a financial supply.<sup>28</sup> Accordingly, no GST is payable by superannuation funds in respect of contributed capital and related fees paid by members or employer sponsors as the consideration for the rights or interests of the members in the fund or scheme.

Most of the services provided by superannuation funds are free of GST; that is, they are ‘input taxed financial supplies’. This means that superannuation funds pay GST on many of their purchases (such as computers), do not levy GST on the supplies they make to their ultimate customers (that is, on benefits paid to fund members), and are input-taxed (that is, they are not able to obtain input credit for the GST levied on the goods or services they purchased).

Nonetheless, in some circumstances superannuation funds are eligible for reduced input tax credits. For example, superannuation funds are eligible for reduced refunds of the GST they paid for administration and legal services. In addition, superannuation funds also have to levy GST on their non-‘input tax financial supplies’. For example, superannuation funds are required to levy GST on the supply of premises to commercial property tenants. If a superannuation fund’s turnover (which excludes input-taxed supplies) exceeds \$50 000 per year, it must register with the ATO for GST purposes. The Government is also encouraging people who manage their own superannuation funds to apply for an ABN to assist with the administration of their fund. Possession of an ABN does not necessarily mean that a superannuation fund is registered for the GST.<sup>29</sup>

## Self managed superannuation funds

This section surmises the main features of a self managed superannuation fund (SMSF).

### General rules

A self managed superannuation fund is a fund that:

- has a trust deed that meets the requirements of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)
- has no more than four members
- all the members are trustees of that fund

- no member of the fund is an employee of another member of the fund, unless they are related, and
- no trustee of the fund receives any remuneration for their services as trustee.

Because all the members of a self managed superannuation fund are trustees, the fund is not subject to the full range of prudential regulation and supervision. However, trustees of self managed superannuation funds still have to meet a number of obligations:

- lodging an annual income tax return and superannuation fund annual return
- lodging Superannuation member contributions statements (MCS)
- reporting payments of member benefits
- appointing an approved auditor to complete the annual audit
- maintaining records for up to 10 years, and
- complying with investment restrictions.

Some of the key restrictions under the SIS Act applying to SMSFs include:

- meeting the sole purpose test
- formulate and enact an investment strategy
- not accessing member's money without meeting a specific condition of release
- not providing loans or financial assistance to members or relatives, and
- not borrowing money to invest.

Self managed superannuation funds are regulated by the ATO.

## Growth, assets and numbers

In the September quarter 2004, small superannuation funds (the overwhelming majority of which are self managed superannuation funds) held \$143 billion or some 22 percent of total superannuation assets of \$648.9 billion.<sup>30</sup>

There has been a steady increase in the number of self managed superannuation funds since the Tax Office became the regulator in November 1999, from 190 000 to just under 300 000 to the end of September 2004. The number of funds is currently growing at approximately 2500 funds a month. About 160 self managed superannuation funds are wound up per month.<sup>31</sup>

Self managed superannuation funds have the largest proportion of their assets invested in listed shares, but only a small proportion invested directly in international shares. Currently these funds have a much greater proportion of their assets invested in cash than do other superannuation funds. In the 2002 financial year collective SMSF assets were invested as follows:

<b>Asset class</b>	<b>% invested</b>	<b>Asset class</b>	<b>% invested</b>
Direct property	10	Unlisted shares	1
Listed shares	30	Public trusts	11
Other trusts	10	Loans	1
Cash/Term deposits	24	Other managed investments	7
Other	2		

Source: Australian Taxation Office<sup>32</sup>

At the end of the September quarter 2004 there were about 296 200 funds with about 563 000 members.<sup>33</sup>

## Payment of pensions

A self managed superannuation fund may pay an allocated pension or a term allocated pension (sometimes called a ‘market linked’ pension) to its members.

However, there are restrictions on the ability of a self managed superannuation fund to pay a defined benefit pension:

- if a self managed superannuation fund was paying a defined benefit pension before 12 May 2004, or a specific entitlement to such a pension for a particular member of the fund existed before that date, it can continue to pay that pension or commence to pay that pension after 12 May 2004
- if the self managed superannuation fund trust deed/governing rules allowed for the fund to pay a defined benefit pension before 12 May 2004 (but no specific entitlement to such a pension existed for a particular member), it may commence to pay such a pension before 30 June 2005, providing certain other conditions are also satisfied
- a self managed superannuation fund cannot alter its trust deed/governing rules to allow for the payment of a defined benefit pension on or after 12 May 2004, and
- no self managed superannuation fund established on or after 12 May 2004 may pay a defined benefit pension.

## Social security treatment of superannuation

If a person is eligible to receive a social security pension or benefit, how much they are paid is determined by the application of the income test and assets test. Briefly, a person is assessed under both the income and assets test. The test that produces the lower rate is then applied to determine the rate at which that person is paid.

### Assets test

Up to the Age Pension age, when a person becomes eligible for the Age Pension (65 years male, 60–65 years for a female depending on date of birth), superannuation in the accumulation stage is exempt from the assets test. After Age Pension age, superannuation is included in a person’s asset test assessment.

If the superannuation benefits are taken as an income stream, the particular income stream product purchased with those benefits may be subject to the assets test—depending on the type of product and the date on which was purchased. The following table gives a summary of the asset test treatment of various income stream products, either purchased with superannuation benefits, or arising from superannuation entitlements in public sector superannuation schemes.

<b>Type of Superannuation Income Stream</b>	<b>Social Security Assets Test Treatment</b>
Public Sector Defined Benefit Pension	100% Asset Test Exempt
Complying Pension/Annuity purchased before 20 September 2004, meeting all requirements in sections 9A or 9B Social Security Act 1991	100% Asset Test Exempt
Complying Pension/Annuity purchased after 20 September 2004, with proceeds of a commuted pre 20 September 2004 asset test exempt pension or annuity, meeting all requirements in sections 9A or 9B Social Security Act 1991	100% Asset Test Exempt
Complying Pension/Annuity purchased after on or after 20 September 2004 meeting all requirements in sections 9A or 9B Social Security Act 1991	50% Asset Test Exempt
Market Linked or Term Allocated Pension	50% Asset Test Exempt
Allocated Pension or Annuity (no matter when purchased)	Fully Asset Tested
Complying Pension/Annuity that does not meet requirements for Asset Test Exemption in Social Security Act 1991	Fully Asset Tested

Source: FaCS – Guide to Social Security Law<sup>34</sup>

## Income test

Superannuation in the accumulation stage is exempt from the income test until a person becomes eligible for the Age Pension. After Age Pension age, a person's superannuation balances are included in his or her financial assets for social security purposes. These financial assets are assessed as producing income using the relevant social security deeming interest rates.

The income produced by various income streams is assessed under the income test for social security purposes. Briefly, that portion of the income stream that is assessed as the return of a person's capital, over their average life expectancy, is not assessed as income for social security purposes.<sup>35</sup>

## Proposed changes

During the 2001 election campaign, the Government released a number of proposed reforms to superannuation.<sup>36</sup> The last major commitment to be legislated is the splitting of superannuation contributions between spouses. Legislation for this commitment was introduced into Parliament on 11 September 2003 and was awaiting debate in the Senate when the federal election was called in August 2004. Consequently, the legislation has now lapsed and will need to be reintroduced into Parliament if the splitting of contributions is to be implemented.

The Coalition has made all the necessary amendments to Acts and regulations to implement the policy proposals included in the Treasurer's announcement on 25 February 2004 [\*A more flexible and adaptable retirement income system\*](#).<sup>37</sup>

The Government's 2004 election policy on superannuation, [\*Super for All and Understanding Money\*](#), recommitted it to:

- the splitting of superannuation contributions between spouses
- the measures announced, and since implemented, by the Treasurer in February 2004, and
- other measures legislated by the Government over the last three years including:
  - choice of superannuation fund
  - Government co-contribution for low income earners, and
  - the continued reduction of the superannuation contributions surcharge below the levels already legislated.<sup>38</sup>

## Endnotes

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1. The value of the superannuation tax concessions to low income earners, that is, those subject to a marginal tax rate of either 17 per cent or 30 per cent, has been questioned by some experts. Refer to: David Knox, 'Is superannuation really taxed concessionally?' *Journal of the Securities Institute of Australia (JASSA)*, Spring 2003, pp. 28–30. When looking at the whole taxation impact on superannuation contributions and periods of low or negative earnings compared to other forms of investment, there is evidence that this proposition has some merit. However, these studies are often limited by the models used to generate the results and may not address all the possibilities or benefits available to taxpayers.
2. Including the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS), the Defence Forces Retirement and Death Benefits Scheme (DFRDB) and the Military Superannuation and Benefits Scheme (MSBS).
3. In the tax, superannuation and welfare systems, 'financial thresholds' are the levels of income at which benefits provided under those systems are phased out (reduced) or cease to be available to potential beneficiaries.
4. Indexed thresholds were obtained from the following sources:  
Commissioner of Taxation, *Superannuation Guarantee Determination*, SGD 2004/1  
Commissioner of Taxation, *Superannuation Contributions Determination*, SCD 2004/4, and  
Commissioner of Taxation, *Taxation Determination*, TD 2004/18.
5. 'Self managed superannuation funds' are superannuation funds with less than five members where, as a general rule, all the members of the fund are also the trustees of the fund.
6. 'Tax offsets' is the generic term used by the Australian Taxation Office to refer to tax offsets, tax rebates and tax credits.
7. A complying superannuation fund qualifies for concessional tax rates. It is regulated under the *Superannuation Industry (Supervision) Act 1993*. Retirement savings accounts are simple low-cost, low-risk superannuation products offered by life insurance companies, banks, building societies and credit unions. They are regulated under the *Retirement Savings Account Act 1997* and have the same tax treatment as superannuation.
8. Income for the purpose of determining age-based deduction limits includes reportable fringe benefits.  
  
The limit for self-employed persons was increased from \$3000 to \$5000 as part of amendments to the *Income Tax Assessment Act 1936* by the *Taxation Laws Amendment (Superannuation) Act (No. 2) 2002*, with effect from 1 July 2002. For self-employed people in the 2004–05 year of income, the contributions required to be able to claim as a deduction the full age-based limit are:  
  
age under 35 – \$16 912  
age 35 to 49 – \$49 936  
age 50 and over – \$126 307.
9. For the purpose of this paper, a 'high income earner' is a person whose adjusted taxable income (which includes the person's assessable income, eligible termination payments, surchargeable

contributions and reportable fringe benefits) is at least equal to the lower income amount (\$99 710 for the 2004–05 year of income) as defined in the *Surcharge Contributions Tax Impositions Act 1997*.

10. The *Superannuation (Surcharge Rate Reduction) Amendment Act 2003* received Royal Assent on 12 November 2003.

11. During the 2001 election campaign, the Government released its superannuation policy document, [\*A Better Superannuation System\*](#). In relation to the reduction of the superannuation surcharge, the Government stated:

The Coalition is keen to ensure that superannuation remains attractive and encourages all employees to save for their retirement. Commencing on 1 July 2002, a re-elected Coalition Government will reduce the surcharge rates by a tenth of their current level over each of the next three years (i.e. a maximum of 1.5 percentage points each year).

However, measures announced in the 2004–05 Budget proposed an acceleration of the reduction in the maximum surcharge rate. The proposal was to reduce the maximum surcharge to 12.5 per cent in 2004–05, 10 per cent in 2005–06 and 7.5 per cent in 2006–07 and subsequent years of income. Amendments moved in the Senate to the Superannuation Budget Measures Bill 2004 removed the decrease to 7.5 per cent in 2006–07. The *Superannuation Budget Measures Act 2004* received Royal Assent on 30 June 2004.

12. For the purposes of the superannuation contributions surcharge, income (defined as adjusted taxable income) includes the person's assessable income, eligible termination payments, surchargeable contributions and reportable fringe benefits. Adjustments are also made for ETOs included in taxable income.
13. 'Total income of a year of income' is defined in section 8 of the *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003* as being the person's assessable income for the year of income and his or her reportable fringe benefits for the year of income.
14. ATO Fact Sheet: Super Co-Contribution—How to give your super a helping hand – how does it work? See <http://www.ato.gov.au/super/content.asp?doc=/content/42616.htm&page=4&H4> (accessed 7 February 2005).
15. Barrie Dunstan, '[A super fraud masquerading as choice](#)', *Australian Financial Review*, 26 June 2004, p. 21.
16. In the 1990s UK authorities opened up the UK private pension in effect introducing its own form of choice of retirement income provider. The result was significant churning of members (moving members from one provider to another to gain commission fees for advisers even if the new provider provided a poor performing and inferior product). The industry faced a compensation bill of almost £12 billion. See Australian Securities and Investments Commission and the Australian Consumers' Association, '[Survey on the quality of financial planning advice](#)', *ASIC Research Report*, February 2003. Graeme Selleck, '[Choice of Superannuation Fund, are the Financial Planners Ready?](#)', *Research Note*, no. 1, Department of the Parliamentary Library, Canberra, 2003–04.
17. 'Mandated contributions' are contributions paid to a superannuation fund to meet an employer's obligation under an award or their superannuation guarantee obligation.

- 'Unmandated contributions' are all other contributions made by a member or on behalf of a member to a superannuation fund.
18. To be gainfully employed on a part-time basis, a person had to be employed for at least 10 hours in a week.
  19. This document can also be accessed from the Department of the Treasury website at: [http://demographics.treasury.gov.au/content/download/flexible\\_retirement\\_income\\_system/flexible\\_retirement\\_income\\_system.pdf](http://demographics.treasury.gov.au/content/download/flexible_retirement_income_system/flexible_retirement_income_system.pdf).
  20. The press release for *A more flexible and adaptable retirement income system* can also be accessed at: <http://parlinfoweb.aph.gov.au/piweb/repository1/media/pressrel/6mrb61.pdf>. The press release and policy document can be accessed at: [Australia's Demographic Challenges — Home](#).
  21. Imputation credits form part of the dividend imputation system. *The Australian Financial Review: Dictionary of Investment Terms* describes 'Imputation Credit' as:  
Taxation credits which are passed onto shareholders who have received franked dividends in relation to their shareholdings.
  22. For more information on the evolution of the taxation of superannuation, refer to Michael Reid, 'Supercalifragilisticexpianuation—A Plain English Guide to Australian Superannuation Arrangements', *Background Paper*, no. 23, Department of the Parliamentary Library, Canberra, 1994.
  23. The low rate eligible termination payment threshold (\$123 808 for the 2004–05 year of income) is a lifetime threshold for determining the maximum rate of tax applicable to the post-June 1983 component (regardless of whether the benefit is derived from a taxed or untaxed source) of all eligible termination payments received by a taxpayer at age 55 years or over.
  24. This includes people in a same-sex relationship where they meet the definition of interdependent relationship.
  25. See ATO Summary of individual tax rates at: <http://www.ato.gov.au/individuals/content.asp?doc=/content/12333.htm&mnu=5053&mfp=001> (accessed 4 February 2004).
  26. These prudential regulatory requirements are set out in the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Industry (Supervision) Regulations*.
  27. For more details, see the Association of Superannuation Funds of Australia and the GST Start-Up Office, *The Goods and Services Tax and the Superannuation Industry Workbook*, January 1999, website at: <http://www.superannuation.asn.au/gst/rpm.cfm?page=workbk>.
  28. This is set out in regulation 40–13 of A New Tax System (Goods and Services Tax) Regulations 1999.
  29. See The New Tax System Advisory Board media release, *Self Managed Super Funds Should Apply for an ABN Now*, 28 May 2000.
  30. APRA, Statistics, Superannuation Trends, 11 January 2005, p. 4, at: <http://www.apra.gov.au/Statistics/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=7806> (accessed 14 January 2005).

31. ATO, DIY Super – Its Your Money, But Not Yet, at:  
<http://www.ato.gov.au/super/content.asp?doc=/content/47067.htm&page=2&H2>  
(accessed 14 January 2005).
32. *ibid.*
33. APRA, Statistics, Superannuation Trends, 11 January 2005, p. 6. at:  
<http://www.apra.gov.au/Statistics/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=7806> (accessed 14 January 2005).
34. Department of Family & Community Services: Guide to Social Security Law, Part 4.9.2, at:  
<http://www.facs.gov.au/guide/ssguide/492.htm> (accessed 7 February 2005).
35. See Family and Community Services: Guide to Social Security Law – Part 4.9.2.30 – Income Test Assessment of Asset Test Exempt Income Streams, at:  
<http://www.facs.gov.au/guide/ssguide/49230.htm> (accessed on 7 February 2005) and FaCS – Guide to Social Security Law – Part 4.9.3.30 – Income Test Assessment of Asset Tested Income Streams at <http://www.facs.gov.au/guide/ssguide/49330.htm> (accessed 7 February 2005).
36. Liberal Party of Australia, *A Better Superannuation System*, November 2001.
37. This document can also be accessed from the Department of the Treasury website at:  
[http://demographics.treasury.gov.au/content/download/flexible\\_retirement\\_income\\_system/flexible\\_retirement\\_income\\_system.pdf](http://demographics.treasury.gov.au/content/download/flexible_retirement_income_system/flexible_retirement_income_system.pdf). The press release for *A more flexible and adaptable retirement income system* can be accessed at:  
<http://parlinfoweb.aph.gov.au/piweb/repository1/media/pressrel/6mrb61.pdf>. The press release and policy document can also be accessed at: [Australia's Demographic Challenges — Home](#).
38. Liberal Party of Australia and Nationals, *Super for All and Understanding Money*, October 2004.

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