SAVINGS:

CHOICE AND INCENTIVE

STATEMENT BY
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SAVINGS: CHOICE AND INCENTIVE

OVERVIEW

This Statement outlines the saving and retirement income policy measures announced in the 1997-98 Budget, including the new savings rebate.

These measures will encourage private saving and enhance Australia's retirement income system. Significantly, the measures ensure that encouragement to private saving is delivered fairly and allow individuals to choose the form most suited to their needs.

Australia must increase its national saving to reduce its reliance on borrowing from overseas. The principal plank of this Government's efforts to increase national saving is its commitment to a medium term fiscal strategy: maintaining fiscal underlying balance, on average, over the course of the economic cycle. The fiscal consolidation measures taken by the Government in the 1996-97 and 1997-98 Budgets provide a substantial boost to public sector and national saving.

There is also a clear need to increase private saving and household saving in particular, if we are to achieve a better balance between domestic saving and investment and allow the economy to grow faster. Importantly, with the ageing of our population, there is a need to ensure that Australians save for their own retirement through superannuation. Towards this end, the Government is providing additional tax incentives for members' personal superannuation contributions.

The Government recognises, however, that individuals also need to save for other life cycle needs, such as education, health care, housing and consumer durables. Recent studies have highlighted that a significant proportion of Australians have little or no savings beyond equity in their home and their superannuation savings. The Government's efforts to enhance the efficiency and competitiveness of the financial system will assist private saving, by increasing choice and reducing costs. The Government believes, however, it can and should do more to promote household saving.

Thus a major initiative of the 1997-98 Budget is the introduction of a broadly based savings rebate through the taxation system. The savings rebate will be available to people who make personal (undeducted) member superannuation contributions, and/or who earn net personal income from other savings and investments. It will be available in respect of superannuation contributions and/or income up to an annual cap of $3,000. The rebate will be phased in at a rate of 7.5 per cent from 1 July 1998, rising to 15 per cent from 1 July 1999, resulting in a maximum tax rebate of $225 with respect to the 1998-99 income year and $450 with respect to 1999-2000 and subsequent income years. The savings rebate will assist individuals to save or invest in the form that is most suited to their needs, but is designed to give most encouragement to saving in the form of superannuation.

The savings rebate replaces the former Government's 1995-96 Budget proposal to match compulsory superannuation contributions by employees. The origin of this proposal was in the 'LAW' tax cuts which were withdrawn after the 1993 election. The 1995-96 Budget superannuation measures which involved compulsory deductions from after tax income could not have been implemented as announced. They were highly

discriminatory as they provided no benefit to the retired or those otherwise ineligible to contribute to superannuation.

The Government's savings rebate will provide universal encouragement to private saving. It recognises the importance of enhancing superannuation savings, and provides encouragement for individuals who save for other life cycle needs. By applying the savings rebate to a very broad range of saving and investment alternatives, it avoids creating distortions in the financial sector.

The savings rebate provides incentives to household saving in a manner that is consistent with responsible budgeting and the Government's medium term fiscal strategy. The rebate is fully funded.

This Government is committed to a retirement income policy that provides encouragement for individuals to achieve a higher standard of living in retirement than would be possible from the Age Pension alone, but also ensures that all Australians have security and dignity in retirement. This will be achieved by:

- encouraging people who are able to save for their retirement to do so, particularly through superannuation;

- ensuring the provision of an adequate public safety net in the form of an Age Pension for Australians who are unable to support themselves in their retirement years;

- ensuring the system is predictable, but facilitates choice and is equitable; and

- ensuring the system is fiscally sustainable and delivers an increase in national saving.

The savings rebate is an important further enhancement of Australia's retirement income system. It demonstrates the Government's commitment to a retirement income system comprising compulsory and voluntary superannuation savings (assisted by tax concessions) along with other voluntary savings and the means tested Age Pension.

In meeting its objectives, the Government will maintain the single rate of Age Pension and other pensions at no less than 25 per cent of Male Total Average Weekly Earnings (MTAWE). The Government is legislating this commitment, with flow-ons to the married rate of all pensions and above minimum rate Family Payment. This is the first Government to commit the Budget in this way and is evidence of the high priority this Government places on ensuring the adequacy of pension payments.

Also consistent with meeting the above objectives, the Government believes there is considerable scope to enhance the operation of the retirement income system, so that it encourages people to save more for their retirement and to use those savings to improve their standard of living in retirement. This can be achieved by making the retirement income system more flexible, providing more choice, and ensuring that superannuation savings are directed towards their intended purpose, namely providing for retirement income. Enhancing the retirement income system along these lines will also enhance Australia's national saving performance.

The Government is therefore proposing further improvement to the retirement income system to provide people with:

- greater choice as to where their superannuation benefits are invested; and
- simpler and more equitable social security arrangements for superannuation benefits taken in retirement.

At the same time, the Government will improve the operation of the preservation rules and the arrangements for access to superannuation benefits prior to retirement in order to reduce the leakage of funds from the superannuation system. The result will be a significant increase in national savings, through greater accumulation of superannuation savings, and a higher level of income in retirement.

In the 1996-97 Budget, the Government announced that from 1 July 1997, people over age 65 and up to age 70 would be able to continue to contribute to a superannuation fund or Retirement Savings Account (RSA), provided they maintain a bona fide link with the paid workforce. In this Budget we have added to this initiative with the introduction of a tax exempt Deferred Pension Bonus to individuals who defer taking an Age Pension.

The Deferred Pension Bonus Plan announced by the Government, fulfils its election commitment and offers people of Age or Service Pension age a positive incentive to defer retirement. A financial bonus of 9.4 per cent of a person’s basic pension entitlement will accrue for each year of employment beyond Age or Service Pension age, up to a maximum of 5 years. At current pension rates, the maximum bonus, to be paid as a lump sum on pension take-up, would be $21,251 for a single person, and $35,450 for a couple, in receipt of the maximum rate of pension. Bonuses will begin to accrue from 1 July 1998.

SUMMARY OF 1997-98 BUDGET MEASURES

SAVINGS REBATE

A tax rebate will be available to individuals who make undeducted member superannuation contributions, and/or who earn net personal income from other savings and investments, up to an annual cap of $3,000. The rebate will be phased in at a rate of 7.5 per cent of the superannuation contributions and/or income from 1 July 1998 (a maximum rebate of $225), rising to 15 per cent (a maximum of $450 per annum) from 1 July 1999.

The savings rebate will replace the former Government's 1995-96 Budget proposal of compulsory after tax superannuation contributions and matching government payments. The savings rebate will provide cost effective and equitable assistance to household saving for life cycle needs in a manner which recognises the importance of individual choice. The savings rebate provides significant additional assistance for superannuation savings.

Further details of this measure are outlined in the body of the Statement and in Attachment A.

CHOICE OF FUND

From 1 July 1998, new employees will have greater choice as to the complying superannuation fund or RSA to which employer Superannuation Guarantee (SG) and award superannuation contributions are made. Employers will be required to give employees 28 days in which to make a choice from among five (or more) complying superannuation funds or RSAs nominated by the employer. Where the new employee does not nominate a fund or RSA, contributions will be made to the fund or RSA specified by the employer.

For existing employees, employers must provide a similar choice within two years of the date of effect of the legislation.

Legislative amendments will be made to override the specification of funds in Federal awards. Choice of fund requirements will not override workplace agreements and State award arrangements, and will only apply to public sector arrangements to the extent that the employer SG and award contributions are funded.

Combined with the introduction of RSAs, facilitating greater choice of fund for SG and award superannuation contributions will enhance competition within and between superannuation funds and RSA providers, leading to improved returns and placing downward pressure on fund administration charges. It will also give greater scope for employees to choose their superannuation arrangements having regard to their own circumstances and risk preferences.

Further details of this measure are contained in the body of the Statement and in Attachment A.

OPTING OUT OF SUPERANNUATION ARRANGEMENTS

To improve the flexibility of superannuation arrangements for low income employees, from 1 July 1998, people earning from $450 to $900 per month from an employer (or $1,800 over two months where the person is under 18 years of age) will be allowed, with the employer's agreement, to choose to receive wages or salary in lieu of employer SG contributions.

Further details of this measure are contained in the body of the Statement and in Attachment A.

PRESERVATION

From 1 July 1999 all future superannuation contributions (including member contributions) and earnings will be preserved until preservation age, except in limited circumstances. Benefits which are not preserved at 1 July 1999 will remain non-preserved. The new arrangements will overcome the administrative problems of the previously legislated changes to the preservation rules which were to take effect from 1 July 1998. They will also ensure that superannuation savings are directed towards their intended purpose, namely providing for retirement income.

Further details of this measure are outlined in the body of the Statement and in Attachment A.

EARLY RELEASE OF BENEFITS

With effect from 1 July 1997, arrangements for the early release of superannuation benefits will be tightened to enhance preservation:

- superannuation funds will be permitted to release benefits to a person who has left Australia permanently only after that person has reached preservation age;

- the $500 preservation threshold will be abolished;

- the current ad hoc assessment of claims for release of benefits on grounds of severe financial hardship will be replaced with a simple objective test of hardship to be administered by fund trustees based on evidence that a member has received specified Commonwealth income support payments for a continuous period of 12 months (or a cumulative period of 9 months for people aged 55 or over); and

- defined criteria for determining the release of benefits on compassionate grounds will be introduced.

Further details of these measures are contained in the body of the Statement and in Attachment A.

PRESERVATION AGE

The Government will proceed to legislate the phased increase in the preservation age from 55 to 60 by the year 2025. Consequently, as announced in 1992, the preservation age for someone born after 30 June 1964 will rise to 60 years.

Reducing the gap between the preservation age and the eligibility age for the Age Pension will reduce the opportunities for 'double dipping' and will encourage greater accumulation of superannuation savings.

Further details of this measure are contained in the body of the Statement and in Attachment A.

DEFERRED PENSION BONUS PLAN

The Deferred Pension Bonus Plan offers people of Age or Service Pension age a positive incentive to defer retirement. Under the plan a person who defers retirement and access to the Age or Service Pension will accrue a tax exempt bonus of 9.4 per cent of his or her basic pension entitlement for each year of employment beyond Age or Service Pension age, up to a maximum of 5 years, when the bonus reaches 47 per cent of entitlement for each of the deferral years. The starting date for bonus accrual will be 1 July 1998. The bonus will be paid as a lump sum on pension take-up. At current pension rates, the maximum bonus would be $21,251 for a single person, and $35,450 for a couple, in receipt of the maximum rate of pension.

Further details of this measure are contained in the body of the Statement and Attachment A.

IMPROVING THE SOCIAL SECURITY MEANS TEST AND SIS REGULATION TREATMENT OF RETIREMENT PRODUCTS.

From 1 July 1998, the Social Security means test treatment of income streams will be made simpler, more consistent and more equitable. Income streams will be classified and means tested on the basis of their characteristics.

Consistent with these changes, the Government also intends to amend the SIS Regulations to provide superannuants with greater choice as to which income stream products qualify as 'complying' pensions or annuities for purposes of gaining access to the higher superannuation pension reasonable benefit limits.

These changes will help to increase the level of competition in the provision of 'complying' retirement income stream products.

Further details of this measure are contained in the body of the Statement and Attachment A.

ACCESS TO SUPERANNUATION FOR HOUSING

A discussion paper is being released on the issue of allowing access to superannuation to facilitate home ownership. Interested parties are invited to make submissions by 30 June 1997.

Further details are contained in the body of the Statement.

1996-97 BUDGET MEASURES

Details of the 1996-97 Retirement Income measures and their current status are provided at Attachment B.

THE NEED FOR INCREASED NATIONAL SAVING AND AN EFFECTIVE RETIREMENT INCOME POLICY

The Government is committed to increasing national saving. Without an increase in national saving, increased investment will only come at the cost of a higher Current Account Deficit (CAD). The benefits of raising national saving — and the risks that continued high levels of the CAD pose — are set out in *Budget Paper No. 1* of the 1996-97 Budget Papers. Achieving a better balance between domestic saving and investment will relieve a constraint on faster economic growth and increase the standard of living for all Australians, including the growing proportion of the population in retirement.

The size of the present excess of national investment over national saving — represented by the CAD — reflects a significant decline in saving over the past 20 years, particularly in public saving. For this reason the Government's fiscal strategy has been focussed on raising public saving and thereby over time national saving. There has, however, also been a trend decline over many years in the private saving ratio.

PUBLIC SAVING

Public saving has improved from very low levels over the past few years, driven by stronger general government saving. In 1996-97, general government saving is estimated to have been equivalent to about ¾ per cent of GDP, up from its low point four years ago when the sector dissaved, equivalent to negative 2¾ per cent of GDP. General government saving is projected to further improve as the Government implements its fiscal consolidation strategy.

Movements in Commonwealth Government saving tend to dominate movements in general government saving and hence the underlying Commonwealth budget balance is the main driver of the movements in public saving as a whole. (The Fiscal Strategy Section of *Budget Statement No. 1* contains more details.)

The imperative for the Government to take action with respect to its own position can be traced back to the significant structural deterioration in net lending in the Commonwealth budget sector over the past two decades. This structural deterioration largely accounts for the growth in the excess of investment over saving over the same period.

The Government's medium term fiscal strategy is to achieve underlying budget balance on average over the course of the economic cycle. This is equivalent to ensuring that the Commonwealth budget sector saves enough, on average, to cover its investment needs and therefore is not calling on private saving. Pursuit of this strategy, over time, and in the absence of structural shifts in private saving or investment, should reduce the excess of national investment over national saving as manifested in high current account deficits.

In the 1996-97 Budget, the Government announced fiscal consolidation measures amounting to $3.9 billion in 1996-97 and $7.2 billion in 1997-98. Measures taken in the 1997-98 Budget build on the tightening undertaken in the 1996-97 Budget and together these should provide a substantial boost to public saving, and thereby increase national saving. The expected improvement in the underlying budget balance through the forward

estimates period is consistent with the achievement of the Government's medium term fiscal objective of budget balance over the cycle.

PRIVATE SAVING

Private saving comprises household and corporate saving. After reaching a peak in excess of 14 per cent of GDP in the mid-1970s, the gross household saving rate trended steadily downwards with some small temporary rises reflecting cyclical peaks in economic activity before flattening out over the past five years at around 7¾ per cent of GDP. Over the same period, the gross corporate saving rate has risen from around 4-5 per cent to a peak of 6¾ per cent of GDP in 1993-94, with a small fall since then.

Despite six years of recovery since the recession of 1990-91, gross private saving remains relatively low at around 15 per cent of GDP compared with an average 16 per cent in the 1960s and 18 per cent of GDP in the 1970s.

IMPLICATIONS OF THE AGEING POPULATION

The need to boost national saving is inherently linked with the need for effective retirement income policy.

Australia, like most other economically advanced countries, is facing a steady ageing of its population. The Australian Bureau of Statistics has estimated that between 1994 and 2051 the proportion of Australians aged 65 years and over will increase from 11.9 per cent to about 23 per cent of the population. This projected demographic change highlights the need to develop a retirement income policy that is fiscally sustainable. It implies the increasing need for Australians to make adequate provision for their own retirement. The primary way in which people can provide for an income in retirement is by saving through their working lives.

Currently around 81 per cent of Australians of Age Pension age draw on the Age or Service Pension, with some two-thirds of pensioners being paid the full rate pension. While new recipients are more likely to be part-rate pensioners, the cost to Government of providing Age and Service Pensions is forecast to grow from around $15 billion in 1995-96 to around $18 billion in 1999-2000 as the retirement age population increases. The Retirement Incomes Modelling Task Force has projected that expenditure on Age and Service Pensions will rise from 3.2 per cent of GDP in 1994-95 to 4.7 per cent in 2050 taking into account the reduction in pension outlays resulting from the superannuation savings undertaken under the compulsory SG arrangements. Without the SG, pension outlays would increase by a further 0.3 per cent of GDP by 2050.

The SG arrangements, combined with the tax concessions granted for SG and voluntary superannuation contributions, can be viewed in part as a move from an unfunded Age Pension to a partly Government funded, partly privately funded, retirement income scheme, which nonetheless maintains the Age Pension as an adequate safety net.

The superannuation arrangements are also important in contributing towards increasing Australia's national saving over the longer term. Analysis by the Retirement Incomes Modelling Task Force indicates that the current and proposed superannuation arrangements, including the measures announced in the 1996-97 and 1997-98 Budgets

and the legislated prescribed schedule of SG contribution rates, are estimated to have a positive impact on national savings of 1.5 per cent of GDP in 2001-2002 rising to 3.6 per cent of GDP in 2019-2020.

RETIREMENT INCOME POLICY OBJECTIVES

This Government is committed to a retirement income policy that provides encouragement for individuals to achieve a higher standard of living in retirement than would be possible from the Age Pension alone, but also ensures that all Australians have security and dignity in retirement. This will be achieved by:

- encouraging people who are able to save for their retirement to do so, particularly through superannuation;
- ensuring the provision of an adequate public safety net in the form of an Age Pension for Australians who are unable to support themselves in their retirement years;
- ensuring the system is predictable, but facilitates choice and is equitable; and
- ensuring the system is fiscally sustainable and delivers an increase in national saving.

The Government believes these objectives can be met by the current three pillared retirement income system comprising:

- voluntary superannuation and other private savings;
- compulsory superannuation savings through the SG contributions; and
- a means tested Age Pension and associated social security arrangements.

As noted above, by funding future retirement income, superannuation contributions supported by taxation concessions are the key component in containing the future budgetary cost of Age Pension payments in the face of our ageing population.

THE 1995-96 BUDGET SUPERANNUATION MEASURES

In its 1995-96 Budget, the previous Government sought to increase the rate of private and public funding of retirement income through the introduction of a phased 3 per cent 'compulsory' employee superannuation contribution which would be matched by government payments. The payments were to be in place of the 'LAW' tax cuts which were initially enacted in 1992.

It was proposed to make employees' after tax contributions compulsory by inserting appropriate provisions in enterprise agreements and awards. The Government reserved the option to legislate for compulsory member contributions if the co-contribution measure did not achieve the anticipated level of employee participation.

The 1995-96 proposed measures also involved a series of restraints in terms of which superannuation funds could receive the contributions. Members' contributions matched by government contributions were to be preserved, an arrangement which would be extremely difficult for funds to administer.

Since the 'compulsory' employee contributions of 3 per cent were to be made out of after tax income, the 1995 measures would have resulted in a significant reduction in the income available to low income earners to meet their current living requirements.

The proposal for matching contributions only applied to those eligible to contribute to superannuation. Those retired from the workforce were not eligible, nor were others outside the paid workforce, for example those engaged in child rearing.

The proposed savings incentive was in this sense highly discriminatory. In addition the government contributions were available for only one kind of saving, superannuation, and had the potential to be distortionary as people reduced other forms of saving or engaged in substitution.

The significant ongoing cost of the 1995-96 proposals were not compatible with the Government's commitment to achieve Budget balance over the economic cycle.

THE SAVINGS REBATE

A major initiative of the 1997-98 Budget is the introduction of a broadly based savings rebate. It will assist household saving in a manner which recognises the importance of individual choice.

The savings rebate will be available to resident individual taxpayers and will apply to member (undeducted) superannuation contributions, or net income receipts from savings and investment, or a combination of both, up to an annual cap of $3,000. The savings rebate will take effect from 1 July 1998 at a transitional rate of 7.5 per cent of the superannuation contributions and/or income; increasing to 15 per cent from 1 July 1999. The maximum rebate will therefore be $225 with respect to the 1998-99 income year and $450 with respect to the 1999-2000 and subsequent income years.

The savings rebate will be relatively simple to administer and will utilise the present taxation arrangements. Further details on the savings rebate are provided in Attachment A.

All taxpaying individuals who have some savings or investments or make undeducted superannuation contributions will benefit from the savings rebate, which consistent with other taxation rebates will not be refundable. Small business operators who have built up their savings in their business will also benefit from the savings rebate when they draw a return from their business, other than in the form of salary and wages.

Because the savings rebate is a flat rate reduction against the marginal tax rate it delivers the largest proportionate benefit to low income earners. For example, an individual that otherwise faces the lowest marginal tax rate of 20 per cent (excluding the Medicare levy) and has $3,000 of eligible savings would pay only 5 per cent on the capital income derived after the full savings rebate is taken into account, whereas an individual on the 47 per cent marginal tax rate (excluding the Medicare levy), with the same level of savings, would pay net tax of 32 per cent on the income derived. The application of the $3,000 cap also contributes to the progressivity of the measure. A further worked example of the progressivity of the savings rebate is provided in Attachment A.

The savings rebate is also fiscally responsible. The cost to the Government will be $350 million in 1998-99 rising to $2,040 million in 2000-2001. As such the rebate achieves an appropriate balance between providing an incentive for saving and investment and the Government's commitment to achieving an underlying budgetary balance over the course of the economic cycle.

The savings rebate fulfils the Government's pre-election undertaking to introduce a tax rebate on interest earned by low to middle income earners from savings in approved financial instruments, including bank, building society and credit union accounts. The savings rebate will provide a more efficient outcome for financial markets in that assistance will not be limited to particular forms of savings.

THE SAVINGS REBATE AND RETIREMENT INCOME POLICY

The Government will proceed with the scheduled increase in the SG contributions from the current 6 per cent of qualifying employee earnings to 9 per cent by the year

2002-2003. These SG contributions and voluntary contributions made by, and on behalf of, employees and the self-employed are enhanced by substantial tax concessions.

While the savings rebate accommodates individuals' preferences and savings for life cycle needs, it also provides a further, significant incentive for saving in the form of superannuation and as such makes a major contribution to the Government's retirement income policy framework.

- The savings rebate will apply to undeducted member superannuation contributions, and will complement the range of taxation concessions already in place for superannuation savings. For instance, the first $1,000 of personal superannuation contributions made by low to middle income earners (ie individuals earning up to $31,000) will qualify for both the savings rebate and the existing 10 per cent rebate.

- The savings rebate for superannuation savings will be calculated with respect to the amount contributed, rather than the income earned on the savings. For example, once the measure is fully implemented, a person could obtain a rebate of $450 by making a $3,000 superannuation contribution, but to receive an equivalent rebate from net unearned income, the person would require savings or investments of $60,000 (assuming a return of 5 per cent per annum).

- The savings rebate will provide assistance at both the contribution and end benefit stages of superannuation savings. Initially, undeducted member superannuation contributions will attract the savings rebate in the financial year in which the contributions are made. In retirement, pensions and annuities flowing from an individual's superannuation benefits will attract the savings rebate in each financial year in which such income is received. Alternatively, if superannuation benefits were received in the form of a lump sum, and saved or invested, the subsequent net income receipts from those investments would qualify for the savings rebate.

EQUITY AND CHOICE

Promoting equity and individual choice are driving features underlying this Government's approach to retirement income policy.

CHOICE OF SUPERANNUATION FUND

A major initiative towards promoting choice and accommodating individual preferences is the decision to provide employees with greater choice as to which fund will receive the compulsory SG and award contributions made on their behalf by their employers.

From 1 July 1998, employers will be required to give new employees 28 days in which to make a choice from among five (or more) complying superannuation funds or RSAs nominated by the employer. The five (or more) choices offered must include at least one RSA and at least one public offer fund. The employer must also include, subject to their existence, an industry fund (or funds), an RSA provided by the institution receiving the employee's pay, or an in-house superannuation fund. Where the employee does not nominate a fund or RSA within the required time, contributions will be made to the fund or RSA chosen by the employer.

For existing employees, employers must provide a similar choice within two years of the date of effect of the legislation.

Legislative amendments will be made to override the specification of funds in Federal awards. However, for Constitutional reasons the choice of fund legislation will not apply to employees working under State awards. Further, choice of fund provisions will not override workplace agreements and will only apply to public sector arrangements to the extent that employer SG and award contributions are funded.

States will be asked, however, to consider putting in place complementary legislation to achieve choice of fund for employees working under State awards where they have not already done so.

Combined with the introduction of RSAs, facilitating greater choice of funds for SG and award superannuation contributions will enhance competition between superannuation funds and RSA providers, leading to improved returns and placing downward pressure on fund administration charges. It will also give greater scope for employees to choose their superannuation arrangements having regard to their own circumstances and risk preferences.

Further details can be found in Attachment A.

OPTING OUT OF THE SUPERANNUATION ARRANGEMENTS

To improve the flexibility of superannuation arrangements for low income employees, from 1 July 1998, people earning from $450 to $900 per month (or $1,800 over two months where the employee is under 18 years of age) from their employer, will be allowed to opt out of the SG system, and receive wages and salary in lieu of SG contributions, with their employer's agreement.

Employees will only be able to opt out to the extent that SG contributions exceed relevant award obligations.

Further details of this measure can be found in Attachment A. It replaces the opting out measure announced in the 1996-97 Budget, which along with a number of other measures, was designed to make superannuation arrangements more equitable and offer more choice in light of the changing structure of the workforce.

INTERACTION BETWEEN SUPERANNUATION AND THE AGE PENSION

The existing retirement income system poses a risk that superannuation benefits, which have accumulated with the benefit of generous tax concessions, may be dissipated before an individual reaches Age Pension age. Principal contributing factors are the provisions for early release of benefits; inconsistencies in preservation arrangements, which are also partly unworkable; and the preservation age which is set some ten years earlier than Age Pension age.

Too rapid dissipation of superannuation benefits in retirement would also serve to undermine the integrity of the retirement income system. For that reason, Australia's current system contains a number of incentives to encourage retirees to invest their superannuation savings in lifetime income stream products. These include:

- the reasonable benefit limit, above which benefits taken as a lump sum are taxed at the highest marginal tax rate, is doubled (currently to $869,440) where at least half of a superannuation benefit is taken as a 'complying' pension or annuity;

- superannuation pensions (except allocated pensions) are exempt from the Age Pension assets test if paid from a complying superannuation fund; and

- tax payable on superannuation benefits taken as an income stream is deferred until such time as the income is actually received. The initial capital used to acquire the income stream is not taxed at the point of retirement and earnings on assets underpinning immediate pensions and annuities are exempt from tax in the hands of the pension or annuity provider. This is in contrast to lump sum benefits which are taxed at the point of retirement (where they exceed the tax free threshold).

It is difficult to determine, however, how effective these incentives are in practice.

The tax advantages of income stream products may be offset by less favourable treatment under the social security means test arrangements. For example, full allowance for the capital value underlying an income stream is not given under the social security income test. This means that the income test applying to income stream products can be less generous than that afforded other financial investments under the extended deeming arrangements. In particular, this potentially discriminates against the taking of superannuation pensions and annuities in favour of the investment of lump sum superannuation benefits in retirement.

Moreover, effectively identical income stream products receive different treatment under the social security assets test. Superannuation pensions are not subject to the assets test, but equivalent lifetime annuities are. This gives rise to confusion and increased compliance costs for retirees.

PRESERVATION

'Preservation' refers to the requirement that superannuation benefits be maintained in a superannuation or rollover fund until retirement on or after the 'preservation age', (currently age 55) is reached. At present not all superannuation benefits are required to

be preserved and there are complex arrangements as to which superannuation contributions are preserved and which are not. The result is not only excessive administrative costs, but a significant leakage from superannuation funds before genuine retirement. Consequently there has for some time been a pressing need to reform the preservation arrangements.

The former Government amended the preservation rules in 1994 with the aim of moving to a system where all superannuation contributions, other than a person's own post-tax (undeducted) contributions, would be preserved, without reducing a person's access to existing unpreserved benefits. However, the date of effect of these new rules has been twice deferred because the arrangements for determining an individual's unpreserved benefits are complex and in themselves pose significant administrative problems.

The Government believes that superannuation savings should be directed to their intended purpose; namely to provide for retirement income. Towards this end, superannuation receives substantial tax concessions. For these reasons and in order to simplify the complex preservation arrangements, the Government has decided to preserve all superannuation contributions and earnings from 1 July 1999.

- Even where superannuation savings are made from an individual's post-tax income, the 15 per cent concessional rate of tax on fund earnings provides an advantage to superannuation savings over other forms of saving.

  — For example, if a person on a marginal tax rate of 48.5 per cent made undeducted member superannuation contributions of $5,000 in each of ten years, he or she would accumulate a balance in the superannuation fund of $67,672, assuming an earnings rate of 7 per cent and tax paid on earnings of 15 per cent. If that same person were to make similar non-superannuation savings on which the earnings were taxed at the marginal tax rate, the after-tax accumulated balance would be $59,987.

- This advantage will be increased by the savings rebate which applies to personal (undeducted) superannuation contributions up to a maximum $3,000 per annum, but only to earnings up to that maximum on other savings.

From 1 July 1999, all future superannuation contributions (including member contributions) and earnings will be preserved until preservation age, except in limited circumstances. Transitional arrangements will provide that the greater of a member's undeducted contributions and the member's resignation/retrenchment benefits as at 1 July 1999, as well as the amount as at 1 July 1999 of other unpreserved benefits which can currently be accessed at any time, will not be preserved.

The new arrangements will overcome the administrative problems of the previously legislated changes to preservation rules which were to have taken effect from 1 July 1998. Individuals will continue to be allowed to obtain early access to preserved benefits where the benefits are taken as a non-commutable life pension or lifetime annuity on termination of gainful employment, subject to the terms of superannuation trust deeds.

The Government will be consulting the superannuation industry on the implementation of these new preservation arrangements.

EARLY RELEASE OF BENEFITS

Early release of superannuation benefits is currently allowed in certain circumstances, including: retirement due to permanent incapacity; permanent departure from Australia; where a person ceases employment with a preserved benefit in a fund of $500 or less; in cases of severe financial hardship; and on compassionate grounds. The administration of some of these conditions involves considerable compliance and administration costs for members, fund trustees and Commonwealth Government agencies, as well as being open to abuse.

In order to address the shortcomings of the current system, the Government will amend the arrangements for early release of superannuation benefits, with effect from 1 July 1997, so that:

- superannuation funds may release benefits to a person who has left Australia permanently only after that person has reached the preservation age;

- the $500 preservation threshold is abolished;

- the current ad hoc assessment of claims for release of benefits on grounds of severe financial hardship is replaced with an objective test of hardship to be administered by fund trustees based on evidence that the member has received specified Commonwealth income support payments for a continuous period of 12 months (or a cumulative period of 9 months for people aged 55 or over); and

- defined criteria for determining the release of benefits on compassionate grounds are introduced.

Release of benefits to members who meet these tests will remain subject to the governing rules of their superannuation fund.

Improving the preservation rules and tightening arrangements for the early release of benefits will significantly reduce the existing leakage of funds from the superannuation system before genuine retirement. This will increase national saving through greater accumulation of superannuation savings, leading to reduced pension outlays as individuals achieve higher levels of income in retirement.

These measures will have a medium term fiscal cost, due to reduced tax receipts from lower withdrawals from superannuation. The cost of the changes is estimated to be $9.6 million in 1997-98, $10.2 million in 1998-99, $45.8 million in 1999-2000, and $116.4 million in 2000-2001. However, they are estimated to add an additional 0.9 per cent of GDP to national saving by 2019-2020.

The Government will consult closely with the superannuation industry and other interested parties in implementing these new measures.

PRESERVATION AGE

In 1992 the then Government announced it would phase-in an increase to the preservation age to age 60 by 2025. This was confirmed by the then Government in 1995.

As announced prior to the election, the Government will proceed with this phased increase in the preservation age from 55 to 60. This will affect people born after 30 June 1960 so that by 2025 the preservation age will be 60 for anyone at or under that age. That is, for someone born before 1 July 1960 the preservation age will remain at 55 years; for someone born after 30 June 1964 the preservation age will rise to 60. The Government will legislate for these changes as soon as practicable.

Reducing the gap between the preservation age and the eligibility age for the Age Pension will reduce the opportunities for 'double dipping' and will encourage greater accumulation of superannuation savings.

Individuals affected by the higher preservation age will continue to be allowed to obtain early access to preserved benefits where the benefits are taken as a non-commutable life pension or lifetime annuity on termination of gainful employment, subject to the terms of superannuation trust deeds.

Details of these three preservation measures are provided in Attachment A.

IMPROVING THE ADEQUACY OF INCOME SUPPORT

The Government has continued to demonstrate its commitment to maintaining an adequate Age Pension for those who need it by introducing legislation for maintaining the single rate of Age Pension and other pensions at no less than 25 per cent of MTAWE with flow-ons to the married rate of all pensions and above minimum rate Family Payment. The date of commencement for the legislation will be 20 September 1997.

This builds on the 1996-97 Budget measure to include provision for meeting the 25 per cent of MTAWE benchmark in the forward estimates, and gives further effect to the Government's commitment to pensioners by ensuring that they share in increasing community living standards as measured by movements in wages.

While the minimum of 25 per cent of MTAWE benchmark has been a longstanding policy commitment adopted by previous governments, this is the first time a government has explicitly committed itself to implementing the benchmark through legislation. This provides further evidence of the high priority this Government places on ensuring the adequacy of pension payments.

IMPROVING INCENTIVES FOR SELF PROVISION: DEFERRED PENSION BONUS PLAN

The Deferred Pension Bonus Plan offers people of Age or Service Pension age a positive incentive to defer retirement. Under the plan a person who defers Age or Service Pension take-up while continuing to work for at least 25 hours per week will accrue a bonus of 9.4 per cent of his or her basic pension entitlement. The bonus will accrue for each year of employment beyond Age or Service Pension age, up to a maximum of 5 years, when the bonus reaches 47 per cent of that entitlement for each year of deferral. The starting date for bonus accrual will be 1 July 1998. The bonus will be paid as a tax exempt lump sum on pension take-up. At current pension rates, the maximum bonus would be $21,251 for a single person, and $35,450 for a couple, in receipt of the maximum rate of pension.

Further details of this measure are provided at Attachment A.

Encouraging self-provision has been a strong, ongoing focus in expanding the role of the Social Security portfolio from that of primarily a payment agency to an information and education agency as well. There has been an increased emphasis on customer service to the retired through innovative approaches to customer service, such as the opening of specialised Retirement Service Centres, a seminar program and the production of a number of information booklets.

IMPROVING THE SOCIAL SECURITY MEANS TEST AND SIS REGULATION TREATMENT OF RETIREMENT PRODUCTS

From 1 July 1998, the Social Security means test treatment of income streams will be made simpler, more consistent and more equitable. Income streams will be classified and means tested on the basis of their characteristics. Those products where ownership of the asset is signed away in return for an income stream for life or life expectancy (or 15 years where life expectancy is greater) will be exempt under the assets test. All other income streams will be assets tested using a simpler and fairer test that accurately reflects the actual asset value.

Under the income test, those income streams with a term over five years will receive a deduction based on their purchase price. Income streams with a term of five years or less will be deemed at standard deeming rates in recognition of their similarity to other short term financial investments.

Consistent with these changes, the Government also intends to amend the SIS Regulations to provide superannuants with greater choice as to which income stream products qualify as ‘complying’ pensions or annuities for purposes of gaining access to the higher superannuation pension reasonable benefit limits.

These changes will help to increase the level of competition in the provision of complying retirement income stream products. Individuals who have products purchased before this Budget will be able to request an exemption from the new rules when they have a contract that cannot be broken or where significant penalties would apply for changing the current contract.

Further details of these measures are provided at Attachment A.

ACCESS TO SUPERANNUATION FOR HOUSING

Prior to the election, the Government undertook to examine the full implications of implementing a scheme to allow people direct access to their accumulated superannuation benefits to assist them in purchasing a home. The Government undertook to assess the impact of such a scheme on national savings, and to consult extensively with the superannuation, welfare and housing sectors as part of that examination. Superannuation has recently been used indirectly to assist the purchase of a home with some superannuation funds investing in securitised home loans and participating in schemes to provide housing loans to fund members.

In keeping with its pre-election commitment, a discussion paper is being released on the issues surrounding the adoption of such a scheme. The paper notes that such a scheme would have adverse consequences for national savings and retirement incomes. It calls on interested parties to make submissions on these issues to the Government by 30 June 1997.

Copies of the discussion paper may be obtained by telephoning the Treasury on 1800 020 008, or by accessing Treasury's home page on the Internet, http://www.treasury.gov.au.

IMPROVED SERVICE DELIVERY

Retirement Service Centres

The Government is committed to the provision of tailored services to the ageing population. As part of this commitment, the Department of Social Security, in conjunction with the Australian Taxation Office and the Department of Veterans' Affairs, has been trialing six Retirement Service Centres, where customers are able to get information from all three agencies at one location. The aim of these centres is to inform people more comprehensively of the range of options open to them in retirement, encourage a more pro-active approach to retirement planning in the wider community and reduce confusion about the Age and Service Pensions and taxation arrangements. The operation of these centres has been extended by another 12 months.

Publications

In order to disseminate information regarding a number of 1996-97 Budget initiatives, the Department of Social Security has established an active information strategy. The strategy also aims to support the objectives of the retirement income system and to respond to demographic and social trends such as workforce participation, developments in the financial services industry and so on.

Successful information products launched so far include *Age Pension — All you need to know*, a magazine style publication for people claiming the Age Pension, and *Investing Money — Your Choices*, a joint publication from DSS and the National Information Centre on Retirement Investment.

A third information product, *Moving House — Your Choices* has been developed and will be distributed in June 1997. It will assist pensioners who are considering moving house and perhaps realising capital at the same time as better meeting their lifestyle in retirement.

Commonwealth Services Delivery Agency

The Commonwealth Services Delivery Agency (CSDA), announced in the 1996-97 Budget, will be formally established in July this year. The CSDA will have a key focus on increasing efficiency and effectiveness in the provision of Commonwealth services.

ATTACHMENT A

DETAILS OF MEASURES ANNOUNCED IN THE 1997-98 BUDGET TO IMPROVE THE RETIREMENT INCOME SYSTEM

SAVINGS REBATE

The savings rebate will be available to resident individual taxpayers (but not other taxpayers and entities such as companies and trusts) and will apply to superannuation contributions made by employees or the self-employed from post-tax income, ie undeducted member superannuation contributions, and/or net personal income from savings and investment, up to an annual cap of $3,000.

The savings rebate will take effect from 1 July 1998 at a transitional rate of 7.5 per cent; increasing to 15 per cent from 1 July 1999. The maximum rebate will therefore be $225 with respect to the 1998-99 income year and $450 with respect to the 1999-2000 and subsequent income years. Therefore, the savings rebate will first apply to undeducted member superannuation contributions made in, and net unearned income received in, the 1998-99 income year.

Superannuation contributions made by employers or by self employed individuals, for which a tax deduction has been claimed, will not qualify for the savings rebate. Neither will the rebate apply to contributions made on behalf of a spouse, such as those that could qualify for the low income spouse rebate announced in the 1996-97 Budget. Nor could a person claim the savings rebate when his or her spouse has claimed the spouse rebate on those same contributions.

For low to middle income earners, the first $1,000 of personal superannuation contributions will attract both the savings rebate and the existing 10 per cent tax rebate that is available to individuals earning up to $31,000 in respect of personal superannuation contributions of up to $1,000.

Other net income from savings and investments (ie 'net unearned income' which will be unearned income less allowable deductions relating to that income) will also attract the savings rebate. This will include such items as interest receipts, dividend income (grossed-up by imputation credits), net rental income, net capital gains, privately funded pensions and annuities (including Commonwealth and State Government employee pensions), assessable bonuses from life insurance companies and friendly societies, partnership income, trust income and attributed foreign income.

Allowing the savings rebate to be available to earnings from a wide range of savings and investments has significant attractions from the point of view of equity, efficiency and simplicity.

Net business income received by an individual, such as income, other than salary or wages, derived from operating as a sole trader or a partnership will also qualify for the savings rebate. This recognises that an individual may use savings to build up a business, and that the self-employed may build up the capital value of their business as a means of saving for their retirement, rather than making superannuation contributions. This is

consistent with the philosophy of the 1996-97 Budget measure to exempt from tax up to $500,000 of capital gains made on the sale of a small business where the proceeds are used for retirement.

The savings rebate will not apply to net salary and wages (including Government payments made through the social security system, such as Age Pension and unemployment payments).

Individual taxpayers will not be means tested to receive the benefit of the savings rebate, though the flat rate reduction against marginal tax rates and the application of a $3,000 cap impose a measure of progressivity.

As the savings rebate is being delivered through the tax system and will be applied against a taxpayer's tax liability, it will not be refundable. This is consistent with other taxation rebates, including the low income rebate, the pensioner rebate and the franking rebate. It also reduces the complexity of the measure and the costs of compliance.

For the sake of simplicity, net unearned income will be calculated directly by the Australian Taxation Office from an individual's tax return. Taxpayers will need to provide additional information on their undeducted member superannuation contributions if they wish to claim the savings rebate on those contributions. Appropriate methodology will be developed which will avoid the taxpayer having to sum each component of net income derived from savings and investments.

Arrangements will be made so that provisional tax payments can be adjusted to reflect eligibility for the savings rebate. PAYE taxpayers can also elect to have their tax instalment deductions adjusted to gain the benefit of the savings rebate prior to the assessment of their tax return.

Example*: Richard and Judy have very different incomes, but both will receive the maximum savings rebate with respect to their savings in 1999-2000.

Richard's taxable income is $20,000 per annum and he has a marginal tax rate of 20 per cent. Judy has a taxable income of $60,000 and a marginal tax rate of 47 per cent. Richard and Judy each have a diversified portfolio of investments, including shares, life insurance bonds, and units in a property trust. They also receive a small amount of interest from a savings account.

Richard's net income receipts from his savings and investments total $3,000 per annum on which he would have paid tax of $600. For Richard, the savings rebate of $450 will reduce the tax on his savings and investment income to $150. This represents a tax rate of 5 per cent on this income.

Judy's net income receipts from her portfolio of savings and investments total $9,000 per annum on which she would have paid tax of $4,230. The savings rebate of $450 will reduce the tax paid on that income to $3,780. This represents a tax rate of 32 per cent on $3,000 of her net income receipts.

* Example is exclusive of Medicare levy.

CHOICE OF FUND

Legislation will be introduced, with effect from 1 July 1998, to provide employees with greater choice as to which superannuation fund or RSA will receive compulsory employer superannuation contributions made on their behalf.

Employers will be required to offer new employees a choice of five (or more) complying superannuation funds or RSAs to which such contributions could be paid. The five (or more) choices offered must include at least one RSA and at least one public offer fund. The employer must also include, subject to their existence, a relevant industry fund (or funds), an RSA provided by the institution receiving the employee's pay, and an in-house superannuation fund. Employers will be required to give employees 28 days in which to make their choice. Where the employee does not nominate a fund or RSA within the required time, contributions will be made to the fund or RSA nominated by the employer.

Employers will be required to contact existing employees in similar terms within two years of the date of effect of the legislation.

The employer will also need to provide a 'key features statement' prepared by each of the chosen superannuation funds or RSA providers. The employer must also supply any relevant application forms.

The employer will be bound by the decision of the employee, and will be liable to pay the Superannuation Guarantee Charge for non-compliance. Employers will be exempt from this penalty in cases where an employee does not nominate a fund within 28 days, or the employee's choice cannot be implemented. This will include circumstances where the fund nominated by the employee ceases to be a complying superannuation fund, or otherwise refuses or is unable to accept contributions.

Appropriate mechanisms will be developed to ensure that employers and employees can be certain that an election is correctly made, received by employers and acted upon. It will also be expected that employers will advise employees of all the consequences of their decision, such as the implications of an election to leave a defined benefit scheme.

Legislative amendments will be made to override the specification of funds in Federal awards. However, for Constitutional reasons, the choice of fund legislation will not apply to employees working under State industrial awards. In this regard, the Commonwealth Government will ask the States to consider putting in place complementary legislation to achieve choice of fund for employees working under State awards, where they have not already done so.

Furthermore, choice of fund legislation will not override workplace agreements as to do so would be inconsistent with the intention of the industrial relations legislative framework.

The choice of fund legislation will not apply to public sector arrangements to the extent that employer SG and award contributions are unfunded. This is because of the fiscal consequences associated with being required to fund the benefits of members transferring from partially or totally unfunded superannuation schemes.

The legislation will apply to defined benefit schemes. For these schemes, employers do not make contributions for any particular employee but contribute an amount recommended by the fund's actuary as being necessary to fund the liability to provide benefits under the scheme as a whole. It is possible that employees who exercise their choice to leave a defined benefit fund may receive reduced contributions. For example, they may only receive the SG minimum employer contributions, rather than contributions at a rate consistent with the defined benefit scheme they have left. In such circumstances employees will need to be informed by their employers of the full consequences of their choice.

In order to contain the costs which would be imposed on employers if employees frequently nominated a different superannuation fund or RSA, employers will not be required to act on an employee's changed nomination of fund within twelve months of acting on a previous nomination. At any time, employers would also only be obliged to contribute to one fund or RSA for any individual employee. Employers will be able to contribute to more than one fund or RSA for an employee, or accept a new choice more than once per year, if they wish to do so.

OPTING OUT OF SUPERANNUATION ARRANGEMENTS

In the 1996-97 Budget, the Government stated its intention to allow employees earning $450 to $900 per month from an employer the opportunity to receive wages or salary in lieu of SG contributions. The Government has now decided the mechanism for opting out.

The proposal will apply from 1 July 1998 to 'eligible employees' receiving monthly salaries of $450 to $900 provided they can obtain their employer's agreement to opt out. Moreover, in response to the Small Business Deregulation Task Force, the Government recently announced that the proposed $900 per month threshold will be replaced by a threshold of $1,800 over a period of two months for employees under the age of 18.

Employees will be able to negotiate with their employer to opt out of SG arrangements on commencement of employment or once annually thereafter. Employees will be able to opt back into superannuation arrangements at any time.

Opting out will not override the effect of industrial awards. Employees will only be able to opt out of SG arrangements to the extent that an employer's SG liability exceeds the relevant award obligations. For example, if the employer had an obligation under an award to pay 3 per cent of a employee's salary in the form of an employer superannuation contribution and the SG contribution rate was 7 per cent then the employee could only opt out to the extent of 4 per cent of salary.

An employer will not be able to force employees or groups of employees to opt out. Rather, any decision to opt out must be initiated by the employee.

To help employees decide whether to opt out or not, this Budget provides extra funding to the Australian Taxation Office to ensure that an education package is prepared and available to employers and employees.

The introduction of opting out has been delayed until 1 July 1998 to allow time for the Australian Taxation Office, superannuation funds and employers to prepare the necessary documentation and alter systems.

PRESERVATION

The former Government amended the preservation rules such that all superannuation contributions, other than a member's own 'undeducted contributions' (ie contributions for which tax deductions have not been received) would be preserved, without reducing a member's access to existing unpreserved benefits. However, the date of effect of these new rules has been twice deferred because the arrangements are complex and pose significant administrative problems.

The Government has decided to improve and simplify the preservation rules by requiring that, from 1 July 1999, all contributions made by or on behalf of members will be preserved on entry to a superannuation fund. All earnings in the fund after that date will also be preserved. Transitional arrangements will provide that the greater of a member's undeducted contributions and the restricted non-preserved benefits payable if the member had resigned or been retrenched on 1 July 1999 (or on the fund's 'changeover day' in 1999, if this is not 1 July) will be the member's restricted non-preserved benefits. The member's unrestricted non-preserved benefits as at 1 July 1999 (or at 'changeover day' if applicable) will also be allowed to be maintained as unrestricted non-preserved benefits. This amount will not be indexed. This approach to determining non-preserved benefits will overcome administrative problems associated with the previously legislated amendments to the preservation requirements which were due to take effect from 1 July 1998.

These changes will ensure that superannuation savings are maintained in the superannuation system until retirement on or after preservation age, currently 55. This will significantly boost national saving, enhance retirement income and reduce future Budget outlays on the Age Pension.

Individuals will continue to be allowed to obtain early access to preserved benefits where the benefits are taken as a non-commutable life pension or lifetime annuity on termination of gainful employment, subject to the terms of superannuation trust deeds.

EARLY RELEASE OF BENEFITS

The Government will also reform the current arrangements for early release of superannuation benefits with effect from 1 July 1997. These changes will improve the administration of the system by the Insurance and Superannuation Commission and fund trustees, with assistance from the Department of Social Security. These measures will also address some abuses of the current arrangements.

The changes are as follows:

- superannuation funds will be able to release benefits to a person who has left Australia permanently only after that person has reached preservation age. This is broadly consistent with overseas practice;

- the $500 preservation threshold will be abolished. This threshold is now less relevant given the introduction of 'member protection rules' (which prevent benefits of less than $1,000 from being reduced by administrative fees and charges). Small amounts can now generally be transferred or diverted to eligible rollover funds;

- the current ad hoc assessment of claims for release of benefits on grounds of severe financial hardship will be replaced with a simple objective test of hardship to be administered by fund trustees which is based on the following criteria;

  — people under age 55 who have been in receipt of a specified Commonwealth income payment for 12 months will be considered to meet the test; and

  — people over age 55 who have been in receipt of specified Commonwealth income payment for a cumulative period of 9 months or more after reaching age 55 will be considered to meet the test.

This measure will result in less 'red tape' for applicants and be more equitable because release of benefits will be targeted at those who meet objective tests of financial need under broader social policy parameters.

- Defined criteria to clarify the circumstances covered by the condition for release of benefits on compassionate grounds will be introduced. This will provide a more objective test for the release of benefits on compassionate grounds.

Release of benefits to members who meet the objective tests of severe financial hardship or compassionate grounds will still be subject to the governing rules of the funds. The current arrangements for allowing early release of benefits on the grounds of permanent incapacity will remain unchanged.

The changes outlined above to preservation and early release of benefits will also apply to superannuation savings held in RSAs.

PRESERVATION AGE

The Government has decided to proceed with a phased increase in the preservation age from 55 to 60 years. By 2025 the preservation age will be 60 for anyone born after 30 June 1964. For someone born before 1 July 1960, the preservation age will remain at 55 years. The phase-in schedule will be as follows:

People born	Preservation age
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

This increase is consistent with the Government's pre-election commitment to maintain the timetable announced by the former Government for increasing the preservation age. Legislating for the phased increase in the preservation age will provide greater certainty as to who will be affected by the changes.

Individuals will continue to be allowed to obtain early access to preserved benefits where the benefits are taken as a non-commutable life pension or lifetime annuity on termination of gainful employment, subject to the terms of superannuation trust deeds.

DEFERRED PENSION BONUS SCHEME

As a consequence of rising life expectancies, an Australian man reaching Age Pension age can now expect to live another 15 plus years, whilst a woman reaching Age Pension age can look forward to another 22 more years of life. At Age Pension age an increasing number of Australians are still capable of putting their accumulated skills and experience to productive use in the workforce, even if they might wish to reduce their working hours in a gradual transition to retirement.

The Deferred Pension Bonus Plan delivers a Government election commitment. It offers people reaching Age Pension age a positive incentive to defer retirement. Under the plan a person who defers Age Pension take-up whilst continuing to work a minimum of 25 hours per week, will accrue a cumulative tax exempt bonus entitlement of 9.4 per cent of his or her basic pension entitlement for each full year of employment past pension qualifying age.

The bonus has been set at a level to provide revenue neutral programme outlays over the medium term, with small savings in the early years. Overall, the scheme should raise the proportion of older people in the workforce and increase the level of individual retirement savings. This is especially important for women, given their commonly interrupted work histories and the scheduled rises in female pension age. The Plan is consistent with the Government's policy intent in raising the maximum age at which contributions can be paid into a superannuation fund from 65 to 70.

Commencement date for the Plan will be 1 July 1998, the starting date for bonus accrual. The earliest a bonus could be paid is 1 July 1999. For ease of administration and to provide people with extra assistance at a time of adjustment, the tax exempt bonus will be paid as a lump sum on pension take-up. The payment is targeted to those in need of income support in retirement and the largest bonus will be payable to full rate pensioners.

At current pension rates, the maximum bonus would be $21,251 for a single person, and $35,450 for a couple, in receipt of the maximum rate of pension.

Example: Mary qualifies for Age Pension on 28 July 1998. She defers Age Pension take-up and continues to work until 27 July 2003, thereby accruing a 5 year bonus entitlement. She is assessed as being eligible for full rate pension of $347.80 per fortnight and her bonus is calculated as follows:

47% x ($9,042.80) x 5 = $21,250.58. That is, bonus payment equals: (number of years of deferral x 9.4%) x (annual basic pension) x (number of years of deferral).

IMPROVING THE SOCIAL SECURITY MEANS TEST AND SIS REGULATION TREATMENT OF RETIREMENT PRODUCTS

The Government has also announced improvements to the social security means test treatment of retirement income streams to make them more equitable and to provide simple and consistent treatment for similar retirement income stream products.

This measure is the result of the review of the means test treatment of income streams which was undertaken in response to the problems that were identified in the *Final Report of the Strategic Review of the Pensions' Income and Assets Tests (1994).*

Under the revised arrangements, from 1 July 1998, the Departments of Social Security and Veterans' Affairs will exempt from the assets test an income stream product which meets the following broad set of characteristics. The income stream must:

- be guaranteed for life, or life expectancy for those products commencing at or after Age or Service Pension age, (ie the term at the date of commencement must be life expectancy based on the Australian Government life tables, but where life expectancy is greater than 15 years, a term of at least 15 years will satisfy the criteria for asset test exemption);

- provide that benefit payments be made at least annually and that they be fixed within a given year;

- not be commutable to a lump sum except on terms consistent with those currently set out for existing 'complying' pensions and annuities in the SIS Regulations;

- have no residual capital value; and

- have limited reversionary benefit provisions consistent with the current SIS Regulations for 'complying' pensions and annuities.

In keeping with these arrangements, the Government will also amend the SIS Regulations so that income streams meeting the above characteristics will be classified as 'complying' pensions or annuities for purposes of qualifying for the higher superannuation pension reasonable benefit limits.

In addition to streamlining and making more equitable the social security treatment of income stream products, and creating greater consistency between the social security and SIS Regulations, these changes will help to increase the level of competition in the provision of 'complying' retirement income stream products. In this way retirees should be offered a wider choice of 'complying' income stream products and downward pressure should be placed on the costs of purchasing these products. In cases where contracts for income stream products cannot be broken or where there would be a significant penalty for changing the current contract, individuals may request an exemption.

ATTACHMENT B

DETAILS OF MEASURES ANNOUNCED IN THE 1996-97 BUDGET

SUPERANNUATION SURCHARGE

In the 1996-97 Budget, the Government announced a range of measures to make superannuation arrangements fairer and more flexible. An important element of making the superannuation system more equitable was the introduction of a surcharge on all employer contributions and tax deductible member superannuation contributions made for or by higher income earners.

The 15 per cent surcharge phases in over the income levels of $70,000 to $85,000 and effectively increases by 1 per cent for each additional $1,000 of income from $70,000. Income for surcharge purposes is defined to include taxable income and employer and tax deductible member superannuation contributions.

The superannuation surcharge legislation was introduced into the Parliament on 13 February 1997.

CONTRIBUTIONS AFTER AGE 65

In the 1996-97 Budget, the Government announced that, from 1 July 1997, individuals will be allowed to contribute to a regulated superannuation fund up to age 70 provided they maintain a bona fide link with the paid workforce.

The Government decided that the measure would take effect from 1 July 1997, in order to allow time for superannuation funds to make necessary changes to their trust deeds and for the required legislative amendments to be made. The legislation, introduced into the Parliament on 26 March 1997, will be supplemented by amendments to the contribution standards in the SIS Regulations.

This measure will remove a number of inconsistencies between the treatment of superannuation contributions by different groups of individuals under age 70. In particular, the increased age limit will replace the existing transitional arrangements which were inequitable in that individuals born on or before 1 July 1930 could contribute to superannuation until age 70, whereas people born after this date could generally only contribute until age 65.

The measure will also help those who have had poor access to superannuation by increasing the age at which individuals are generally allowed to make superannuation contributions. In particular, the measure will benefit women who leave the workforce to care for children and others whose workforce experience has been characterised by breaks, by providing a longer period in which to accumulate an adequate retirement income.

RETIREMENT SAVINGS ACCOUNTS

The Retirement Savings Accounts Bill 1997 (RSA Bill) and related Bills, and the Retirement Savings Accounts Regulations (RSA Regulations) give effect to the Government's 1996-97 Budget decision to allow banks, building societies, credit unions and life insurance companies to provide superannuation without a trust structure in the form of RSAs. These Bills were introduced to the Parliament on 4 December 1996.

RSAs will be required to be 'capital guaranteed'. This means, in effect, that the balance of the RSA including accumulated earnings or interest cannot be reduced by negative investment returns or downward adjustments to the value of investments underlying the policy.

RSAs will be fully portable. They will be owned and controlled by the RSA holder, and will be subject to the retirement income standards applying to other superannuation products, including preservation, contributions eligibility and disclosure rules. Disclosure rules for RSAs contained in the Regulations will be simplified in recognition of their capital guaranteed nature.

Regulation of RSAs will consist of prudential supervision for institutional soundness of the RSA provider and functional supervision for compliance with retirement income and other superannuation standards.

Prudential supervision will be carried out under existing regulatory frameworks by the Reserve Bank of Australia in the case of banks, the Australian Financial Institutions Commission and State Supervisory Authorities in the case of building societies and credit unions, and the Insurance and Superannuation Commission (ISC) in respect of life insurance companies.

Functional supervision of RSAs and RSA providers will be undertaken by the ISC. This will involve, inter alia, ISC approval of RSA institutions, a system of annual reporting and on-going compliance monitoring and the capacity for an institution's approval to be suspended or revoked in the event of flagrant and systematic breaches of the operating standards. There will be close consultation between the ISC and the relevant prudential supervisor in carrying out this functional supervision role.

The statutory-based Superannuation Complaints Tribunal will deal with consumer complaints about RSAs which cannot be resolved by an RSA provider's internal complaints handling mechanisms.

SPOUSE REBATE

In the 1996-97 Budget, the Government announced its intention to allow a contributing spouse to receive an 18 per cent income tax rebate for contributions up to $3,000 per annum to the superannuation fund or RSA of a non-income earning spouse or working spouse with an income below $10,800 per annum. The maximum rebateable limit will be shaded out at the rate of one dollar for each dollar of spouse income in excess of $10,800. This means that the rebate will fully shade out where the spouse's income exceeds $13,800.

This measure will take effect from 1 July 1997, with the rebate payable on assessment from 1 July 1998.

This measure is aimed at making superannuation more flexible, reflecting people's actual social and work experiences. In the past, many people, particularly low income women, have not had access to their own superannuation plans. This measure is designed to address this problem.

The legislation was introduced into Parliament on 26 March 1997.

ABOLITION OF THE SUPERANNUATION STANDARD CONTRIBUTION LIMIT

In the 1996-97 Budget the standard contribution limit for an employer with ten or more employees was abolished from 20 August 1996. Consequently, a deduction will not be allowed for that part of an employer's superannuation contribution that is over the age based limit for a particular employee for the 1996-97 or subsequent income years.

The legislation for this measure is in Taxation Laws Amendment Bill (No 2) 1997 which was introduced into the Parliament on 13 February 1997.

LOW INCOME AGED PERSONS REBATE

The 1996-97 Budget, also included provision for a tax rebate for lower income aged people. The tax rebate is available to people at or above Age Pension age (currently 60 years and 6 months for women and 65 for men) who are considered to be residents for Age Pension purposes (ie individuals who have been resident in Australia for at least ten years) and who have taxable income below the pensioner rebate cut-out threshold.

As a transitional measure, the rebate for 1996-97 is at a level equivalent to half the pensioner rebate for a given level of taxable income. For 1997-98 and subsequent income years, the rebate will be equivalent to the pensioner rebate for a given level of taxable income.

The legislation providing for this measure is set out in Taxation Laws Amendment Bill (No 3) 1997 which was introduced into the Parliament on 26 March 1997.

CAPITAL GAINS TAX EXEMPTION ON THE SALE OF A SMALL BUSINESS FOR RETIREMENT

The Government also announced, in the 1996-97 Budget, its intention to exempt from tax up to $500,000 of capital gains made on the sale of a small business where the proceeds are used for retirement.

In the Prime Minister's 24 March 1997 Statement, *More Time For Business*, this measure was extended to allow eligible people, who operate their small businesses through a private company or trust structure, to claim the CGT exemption. This will remove the potential for the measure to discriminate against small business people who operate their businesses through such structures.

Legislation to implement this measure was introduced into Parliament on 26 March 1997 in Taxation Laws Amendment Bill (No 3) 1997.