

**Submission
of the
Australian & International Pilots Association
to the
Productivity Commission
on the
Superannuation Surcharge Tax Legislation**

The Australian and International Pilots Association (AIPA) requests a review of the existing surcharge tax legislation on the basis that the legislation has unintended and inequitable consequences for fund members of defined benefit superannuation schemes who are subject to the surcharge tax.

Existing legislation unintentionally confers a benefit on business at the expense of the members of those funds. Currently, if a fund chooses to implement a surcharge debit offset account to administer the superannuation surcharge tax, an inequity can arise because of the difference between the interest rates applied to a member's benefit and the rates applied to the member's surcharge tax liability. This inequity results because the surcharge tax is in effect borrowed by the super fund, from the super fund, in order to pay the Federal Government tax. The capital and interest on the loan is charged to an account in the member's name and compounds whilst a member remains in the fund. The compounded amount is *then subtracted* from the final benefit upon the member's retirement from the fund.

Actuarial advice

AIPA has obtained actuarial advice regarding the decision of trustees of some fully funded defined benefit *superannuation funds* to use the credited earnings rate as the lending rate to be applied to surcharge offset accounts. This advice- confirms that the decision to use the credited earnings rate results in significant reductions in a member's final superannuation benefit. For a member having around 30 years' membership in the fund, a three percent gap between the credited earnings rate and salary inflation rate, results in a reduction of around 13% of the final benefit. Given the inequities that arise from decisions to set up surcharge tax offset accounts as a mechanism for collecting and paying the surcharge tax and having regard to the fact that there is no express provision in the legislation dealing with collection of the surcharge tax, the mechanism adopted by some fund managers appears to be an unintended consequence of the legislation which needs to be addressed.

Applying credited earnings rate to surcharge offset accounts is always detrimental. Despite the absence of express legislative authority, surcharge offset accounts are used by some corporate schemes as a result of discretion given to trustees by the cut deeds of their respective funds. In such cases, actuarial opinion varies widely as to the correct rate of interest to be applied. Advice obtained by AIPA consistently confirm that the use. of the credited earnings rate of interest will be detrimental in the long run to fund members, irrespective of members' years of service, when compared to either the actuarially assumed salary inflation rate or the 10 year long term bond rate that is used for public sector unfunded defined benefit schemes.

The legislation is silent on utilisation of surcharge debit accounts for fully funded defined benefit funds. Advice we have received from Senator Rod Kemp states there is "no *need for* the trustees to adopt the practice of establishing debt accounts for affected members". Additional advice AIPA has received confirms that specific authority for trustees to set up surcharge debt accounts applies only to unfunded defined benefit providers (see *Superannuation Contributions Tax (Assessment and Collection) Act 1997* (Surcharge Act), section 16). There is no express provision in the legislation for fully funded defined benefit funds to utilise surcharge debit accounts as a mechanism for collecting and paying the surcharge tax. The *Surcharge Collection Act*, section 15, is silent on this aspect.

ATO opinion

Although Regulation 13.16 of the *Superannuation Indus" (Supervision) Regulations 1993* (SIS Regulations) does permit "tees to make a claim on future benefits and to be reimbursed for amounts paid under the Surcharge Act, AIPA has received verbal advice that this provision appears to have been intended only for unfunded public sector schemes. Regulation 5.02B of the SIS Regulation appears to confirm the opinion of the Commissioner of Taxation that trustees should debit the existing accumulated benefits of fund members to accommodate the surcharge tax. This is not equitably possible with defined benefit schemes under existing legislation.

AIPA believes that this legislation has inequitable consequences for fully funded defined benefit members. It is clear that the Federal Government intended that funds should recoup the tax from the members' accounts. However, because of the many different types of funds covered by the Surcharge Act, the decision by some "tees to use surcharge debit accounts for fully funded schemes, when that method is only expressly authorised for unfunded schemes, has resulted in widespread, significant inequity for fully funded defined benefit members. The inequity becomes even more exaggerated when inappropriate interest rates are used.

The risk of investment loss is passed on to individual fund members. The effect of a trustee's decision to employ surcharge &bit accounts, is to burden the member with any loss of investment return to the fund. This inequity does not occur because of the surcharge tax, but results from the fundamental incompatibility when accumulated offset accounts are used within defined benefit schemes. It ultimately serves to improve the benefit of any contributions holiday that the principal company may receive. The use of surcharge offset accounts could be construed as a technical means of passing on the investment loss to individual fund members. Surely, this can not have been the intent of the legislators.

Possible solutions

AIPA requests that the current surcharge tax legislation be reviewed with a view to removing the potential for its manipulation in a way that might lead to inequity and which operates to confer a benefit upon business.

AIPA suggests the following solutions.

1. The adoption of a prescribed rate of interest to be used by corporate fund trustees who choose, currently without express legislative authority, to utilise surcharge debit accounts *for* collecting and paying the surcharge tax. It would be reasonable for the salary inflation rate of interest to be used as that is the interest rate used by fund actuaries when calculating the contributions to a fund required by a principal company. The alternative rate to be prescribed is the long term (10 year) bond rate which is used for public sector surcharge debit accounts.
2. There is no fundamental reason why surcharge payments cannot be expressed as a reduction in the affected members benefit multiple. This would ensure that the defined benefit nature of the fund is maintained. Prescribing this method would produce an equitable result for both business and the member.

Conclusion

AIPA would like to ~ all members of the Productivity Commission for the opportunity to make known AIPA's concerns, and trusts that the issues raised will be given due consideration towards resolving a clearly inequitable outcome of current legislation and practice.

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