

LEGISLATIVE REFERENCES AND ASSUMPTIONS FOR RIMHYPO

(AS AT 20 SEPTEMBER 2000)

JULIE TINNION

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Legislative References and Assumptions for RIMHYPO (as at 20 September 2000)

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LEGISLATIVE REFERENCES AND ASSUMPTIONS FOR RIMHYPO

INTRODUCTION

RIMHYPO is an individual hypothetical model of the interaction of superannuation accumulations with the tax and social security systems over the lifetimes of hypothetical *individuals and couples*. It models the accumulation of superannuation benefits, the drawdown of the associated retirement benefits and income streams and all the associated tax and social security interactions for individuals and couples over their lifetimes. The model takes account of characteristics such as salary level, work force participation, gender, marital status, home ownership and choices as to benefit type and drawdown patterns.

RIMHYPO also includes non concessional (counterfactual) scenarios which assume that there is no concessional treatment of superannuation. In these scenarios, superannuation fund earnings are fully assessable for taxation purposes and contributions come from after tax income. (For social security purposes deeming treatment is applied to both concessional and non concessional scenarios.)

The model was originally developed by the then Retirement Income Modelling Task Force, a joint project of the Treasury, Department of Finance and the Department of Social Security. Now operating wholly within the Treasury, the Retirement and Income Modelling Unit (RIM), continues to develop the model reflecting recent policy and legislative changes.

This paper is largely a revision of an earlier paper¹ that outlined those provisions of the taxation, social security and superannuation law relevant to our modelling and how RIMHYPO has accommodated those provisions. The paper updates existing RIMHYPO documentation and should be read in conjunction with:

- ‘RIMHYPO – A User’s Guide’ (RIM Task Force 1995); and
- ‘RIMHYPO – An Outline of the Code’, Colin Brown and Anne McDiarmid, RIM Technical Paper, 2/1995.

Although every care has been taken in the compilation of this document, it should not be used as a legal interpretation of the relevant legislation. Wherever possible, the paper includes reference to the relevant provisions of the law so readers may look up those provisions.

The paper covers three main areas, namely superannuation, social security payments, and income tax arrangements. The first section on superannuation covers contributions, preservation arrangements, and taxation of contributions and fund earnings.

¹Brown, Colin and McDiarmid, Anne, *Legislative References and Assumptions for RIMHYPO (as at February 1995)* RIM Task Force, February 1995. Technical Paper No. 95/1.

SUPERANNUATION

Contributions

Superannuation Guarantee Charge (SGC)

The Superannuation Guarantee Charge (SGC) first applied in 1992-93. The rates are set out in sections 20 & 21 of the *Superannuation Guarantee (Administration) Act 1992* (SGAA). Prior to 1996-97, employers with a payroll of less than \$1 million in the base year (1991-92 or the first year in which the employer operated for the whole of the year) were subject to a lower compulsory contribution rate. Rates are as follows:

Table: Superannuation Guarantee rates

| Time Period | Charge Percentage % | |
|--------------------------|--|--|
| | <i>Where employer's base year payroll was \$1million or less</i> | <i>Where employer's base year payroll was above \$1million</i> |
| 1/7/92 – 31/12/92 | 3 | 4 |
| 1/1/93 – 30/6/94 | 3 | 5 |
| 1994/95 | 4 | 5 |
| 1995/96 | 5 | 6 |
| 1996/97 and 1997/98 | 6 | 6 |
| 1998/99 and 1999/00 | 7 | 7 |
| 2000/01 and 2001/02 | 8 | 8 |
| 2002/03 and subsequently | 9 | 9 |

The model code also allows for the possibility of the introduction of a compulsory member co-contribution under the SGC through an interface parameter that can be varied by users (Superannuation parameters screens.) The default is set to zero as a co-contribution was announced, but not legislated, by the Keating Government in 1995.

Scope of the SGC

Prior to July 1997, contributions were not required for people who had turned 65, or who were paid less than \$450 per month, or who were part-time workers aged less than 18.

(Ref. sections 27 & 28 SGAA)

Since July 1997, SG contributions have not been required for people who have turned age 70, or who are paid less than \$450 per month, or who are part-time workers aged less than 18.

(Ref. sections 27 & 28 SGAA)

'Part-time work' is defined as employment for not more than 30 hours per week.

(Ref. section 6(1) SGAA)

Salary Base for SGC Contributions

Sections 13 and 14 of the *SGAA* provide that, generally speaking, the salary specified by a superannuation fund or scheme as the base for calculating contributions is acceptable for use in offsetting the SGC charge. The RIMHYPO model ignores most non-standard award earnings bases used by employers for the purposes of calculating contributions. One exception, incorporated into the RIMHYPO model, is the provision that if the salary specified under the rules of the fund or scheme is greater than the 'maximum contribution base', then the maximum contribution base applies for SG purposes.

This 'maximum contribution base' is used in calculating the employer's existing or 'voluntary' contribution rate and the superannuation guarantee shortfall, if actual earnings or the salary for superannuation purposes are greater than the base as calculated under section 15(1) of the *SGAA*.

(Ref. sections 6(1), 13((3), 14(4), 18(3) & 19(3) *SGAA*)

The maximum contributions base was \$40,000 for each 6 month period in 1992-93. For each three month period in 1993-94 it was \$20,000 multiplied by the indexation factor. For later years it is the maximum contribution base for a period in the immediately preceding year times the indexation factor. All amounts are rounded to the nearest \$10. (Ref. section 15 *SGAA*)

Table: Quarterly Maximum Contributions Bases

| Year | Maximum Contributions Base |
|---------|----------------------------|
| 1992/93 | \$20,000 |
| 1993/94 | \$20,160 |
| 1994/95 | \$20,780 |
| 1995/96 | \$21,720 |
| 1996/97 | \$22,590 |
| 1997/98 | \$23,630 |
| 1998/99 | \$24,480 |
| 1999/00 | \$25,240 |
| 2000/01 | \$26,300 |

For purposes of RIMHYPO the maximum contribution base is annualised.

The indexation factor is the greater of 1 or:

$$\frac{\text{AWOTE for March quarter of the previous year}}{\text{AWOTE for the March quarter of the year immediately preceding that year.}}$$

AWOTE is full time adult average weekly ordinary time earnings. The factor is rounded to the nearest third decimal place, rounding up if the value of the fourth decimal place is greater than 4. (Ref. section 9 *SGAA*)

'Year' means a financial year. (Ref. section 6(1) *SGAA*)

RIMHYPO uses *annual* changes in AWOTE, based on year average AWOTE estimates, to index SGC variables rather than the movements over the year to the March quarter as

set out in the legislation. (RIMHYPO modelling is done on a full year basis only.) In practice, over time, the impact of this difference will be negligible.

Adjusting the SGC rate

The SGC is a charge that is levied on an employer. The charge is reduced by amounts paid by the employer (in respect of the employee) to a complying superannuation fund or Retirement Savings Account (RSA) as defined by the *Superannuation Industry (Supervision) Act 1993 (SIS Act)*. (Ref. sections 13,14 & 23 SGAA) The reduction is based on the amount of the contribution expressed as a percentage of salary for SGC purposes. There is no charge if the amount contributed is greater than or equal to the salary times the SGC percentage. Thus, even if the percentage contributed is less than the SGC percentage, there may be no charge if the salary is higher than the maximum contribution base.

For purposes of this model, it is assumed that where the employer did not pay contributions prior to the SGC legislation, or paid contributions at a rate less than the SGC rate, new or additional contributions are 'SGC contributions'. Employers are also assumed to pay superannuation up to at least the SGC rate rather than pay the charge.

The model does not directly accommodate the possibility of defined benefit or unfunded superannuation arrangements. Rather it assumes that all SG contributions in respect of hypothetical employees are made annually by employers into defined contribution superannuation funds. RSAs are also not explicitly recognised. Users should treat RSAs as defined contribution arrangements for the purposes of the model.

Treatment of superannuation contributions differs depending on the member's age. The three groups are under 65s, those aged from 65-70 and those aged over 70.

Acceptance of Contributions to Superannuation Funds for those aged under 65

Generally speaking, a fund may accept superannuation contributions that are made for members who are under age 65 only if:

- (a) The contributions are mandated employer contributions (made under SG legislation, required under industrial awards or certified agreements or paid from the SHAR). (Ref. sub-regulations 5.01(1)(2) and sub-regulation 7.04(1)(a) *Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations)*); or
- (b) the contributions are not mandated employer contributions (such contributions include voluntary employer or employee contributions and those made by the self employed) **and**:
 - (i) the member has at any time in the two years immediately preceding the date of acceptance engaged in full-time or part-time employment; or
 - (ii) ceased full-time or part-time gainful employment because of ill health; or
 - (iii) is on authorised leave from his or her employer for the purposes of raising children, has a right to resume employment, and where the period

of leave is not more than 7 years. (Ref. sub-regulation 7.04(1)(b) *SIS Regulations*); or

(Note: Contributions are only disallowed after two continuous years without any form of full time or part time employment. For purposes of this model we assume that employers do not continue to make mandated or award contributions after employment has ceased, although the model allows for members to continue to contribute during this time. This model also ignores the possibility of periods of authorised leave of greater than two years, as this arrangement is only available to a very limited number of employees.)

- (c) The contributions are eligible spouse contributions** (from 1 July 1997). (Ref. sub-regulation 7.04(1)(c) *SIS Regulations*)

**Currently, the model does not explicitly allow for such contributions. Under some circumstances users can provide for spouse contributions by including a rate for member contributions for low income spouses in the personal parameters – life events section of the interface. This can only be done where the spouse has some income as amounts are shown as percentages of AWOTE in this section. Because the spouse may not have other income, it would be preferable to be able to include a dollar amount of contributions in the interface, rather than expressing contributions as a percentage of income. The model also does not at present incorporate provision for the tax rebate of up to \$540 that may be available for contributors to a complying superannuation fund on behalf of a low income spouse. (Ref. sections 159T to 159TC of the *Income Tax Assessment Act 1936 (ITAA 1936)*) The rebate is 18 per cent of up to \$3000 of contributions. This is one aspect where further model development would be desirable.

Superannuation Contributions by Persons aged 65 and over

Prior to 1 July 1997, superannuation funds could not accept contributions for members who had reached age 65 unless they were mandated superannuation contributions.

From 1 July 1997 regulated superannuation funds may accept contributions for members who have reached age 65 but not age 70 only if contributions are mandated superannuation contributions (Ref. sub-regulation 7.04(1B)(a) *SIS Regulations*) or the member is gainfully employed on a part-time (between 10 and 30 hours per week) or full-time basis. This means that members cannot make contributions on their own behalf unless they are gainfully employed. Individuals cannot make contributions on behalf of spouses aged 65 and over. (Ref. sub-regulation 7.04(1B)(b) and 1.03(1) *SIS Regulations*)

Mandated contributions include SG contributions, SG shortfall contributions or superannuation contributions required under occupational awards.

Acceptance of Contributions to Superannuation Funds for those aged over 70

Under the SGAA, salary and wages paid to an employee aged 70 or over are not to be taken into account for SGC purposes. A regulated superannuation fund may accept contributions that are made for members who have reached age 70 only where they are mandated superannuation contributions. Taken together, the legislation can probably be interpreted to mean that only award superannuation contributions are mandated for those

aged 70 or over. This is regardless of number of hours worked. Individuals cannot make contributions on their own behalf or on behalf of a spouse after age 70. (Ref. sub-regulation 7.04(1C) *SIS Regulations*)

The model accommodates some of these arrangements through changes to the default parameter set for RIMHYPO. The model code also allows a person who continues to work past age 70 to accrue earnings in a fund while they continue to work full time (at least 30 hours per week) even though (non mandated) member contributions cease at age 70. This condition is tested by reference to the 'hours worked' parameter for the person's age, passed into the model from the Parameters/Personal/Life events screen. The model does not currently allow mandated contributions past age 70 even though these are allowed (if required by industrial awards) under the SIS legislation.

Preservation

Preservation in the superannuation system effectively requires that certain benefits must remain in the superannuation system until retirement of a member on or after preservation age or satisfaction of several other (limited) conditions of release. This is discussed in more detail below.

Definitions

- **'indexed'** in relation to a benefit means indexation in the same manner as prescribed by section 159SG of the *Income Tax Assessment Act 1936*. That is, the amount is multiplied by the greater of:
 - one; or
 - $$\frac{\text{AWOTE for the March quarter of the previous financial year}}{\text{AWOTE for the March quarter of the financial year immediately preceding that year.}}$$

Note: RIMHYPO uses annual changes in AWOTE based on year average AWOTE estimates to index SGC variables rather than the movements over the year to the March quarter as set out in the legislation. This is necessary as the model does not contain quarterly or six monthly data – only year averages.

- AWOTE is full time adult average weekly ordinary time earnings for the middle month of the quarter. The factor is rounded to the nearest third decimal place, rounding up if the value of the fourth decimal place is greater than 4. (Ref. sub regulation 6.01(2) *SIS Regulations*/section 159SG *ITAA 1936*)
- **'part-time'** is defined as being gainfully employed for at least 10 hours but less than 30 hours each week. (Ref. sub regulation 1.03(1) *SIS Regulations*)
- **'gainfully employed'** is defined as 'employed or self employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment'. (Ref. sub regulation 1.03(1) *SIS Regulations*)
- **'retirement'** of a person is taken to occur if:
 - (a) in the case of a person who has reached a preservation age less than 60:

- (i) there is an end to an arrangement under which a member was gainfully employed; and
 - (ii) the trustee is reasonably satisfied that the person intends never to again become gainfully employed either on a full or part time basis;
- (b) in the case of a person who has attained age 60 - a particular employment arrangement ends on or after the member attained age 60.
- (Ref. sub regulation 6.01(7) *SIS Regulations*)

Reflecting labour market developments, RIMHYPO allows users to model late retirement and people who continue to work into their retirement. The model does not require retirement to be complete withdrawal from the workforce. Rather, it defines retirement as the time at which individuals convert their superannuation savings into retirement investments (or dissipate those savings) and cease to make further superannuation savings. It does this by allowing individuals being modelled to continue to work past age 65 and shows the salary generated as a component financing 'retirement expenditure'. The user decides when retirement will be taken to have occurred.

Preservation Rules

Modelling of general preservation rules is now based on provisions of the *SIS Regulations* applying from the commencement date of recent amendments to the regulations (1 July 1999). In short, all contributions to superannuation funds made from 1 July 1999 and all earnings of the fund applicable to the period from 1 July 1999 must be preserved until retirement on or after preservation age except under very limited circumstances. These exceptions are elaborated in the section on Payment of Benefits beginning on page 10.

Effective from 30 June 1998, Preservation Age means:

- (a) for a person born before 1 July 1960 – 55 years; or
- (b) for a person born during the year 1 July 1960 to 30 June 1961 – 56 years; or
- (c) for a person born during the year 1 July 1961 to 30 June 1962 – 57 years; or
- (d) for a person born during the year 1 July 1962 to 30 June 1963 – 58 years; or
- (e) for a person born during the year 1 July 1963 to 30 June 1964 – 59 years; or
- (f) for a person born after 30 June 1964 – 60 years.

(Ref. sub regulation 6.01(2) *SIS regulations*)

The increase in the preservation age has been incorporated into the default RIMHYPO parameter sets. While the preservation age is increased by six months in each year of the shade in period under the legislation, RIMHYPO only operates in full years. Accordingly, the new parameters increase preservation age by a year every two years from 2015, this being the closest approximation to the required result possible using an annualised model.

Before 1 July 1999

Legislated preservation arrangements applying before the start date of the model (1 July 1992) are not specifically modelled, though users may impute initial balances reflecting the effect of such events should they wish to do so.

Although different regulations apply for superannuation funds and approved deposit funds, the rules are essentially compatible and for modelling purposes we use those specifically applying to superannuation funds. All superannuation funds are assumed to be complying (with the SIS legislation).

The preservation standards applying up to 1 July 1999 are extremely complex. Two concepts are important in the legislation (Ref. regulation 6.01(2) *SIS Regulations*):

(a) "commencement day" which meant the later of the first day of the 1994-95 year of income of the fund; or the day on which the trustee or trustees make an election under section 19 of the SIS Act; and

(b) "changeover day" which refers to the day that was fixed for the class of members of the fund in which the member is included. This can be any day chosen by the fund between 1 January 1996 and 1 July 1998. Not all funds chose a changeover day.

Part 6 of the *SIS Regulations* also defined three categories of benefit - preserved, restricted non-preserved, and unrestricted non-preserved.

Preserved benefits are essentially the total benefit less the sum of restricted non-preserved and unrestricted non-preserved benefits (see below). (Ref. regulation 6.02 *SIS Regulations*)

Restricted non-preserved benefits are effectively the greatest of:

- (1) the indexed amount of restricted non-preserved benefit that would have been payable to the member on resignation at changeover day, or
- (2) the indexed amount of restricted non-preserved benefit that would have been payable to the member on retrenchment at changeover day, or
- (3) the person's restricted non-preserved contributions (defined in SIS regulation 2 as undeducted contributions other than those required to be preserved in satisfaction of the *ITAA*, the old *Operational Superannuation Standards (OSS)* laws, or *Superannuation Industry (Supervision) (Transitional Provisions) Regulations* - this excludes the deducted contributions of the self-employed). (Ref. regulation 6.07 *SIS Regulations*)

The restricted non-preserved benefits referred to in (1) and (2) are defined by SIS regulation 6.07 as total benefit less preserved and unrestricted non-preserved benefits. In most cases there will be no unrestricted non-preserved benefits (see definition below). The preserved benefits are as defined in SIS regulation 6.02. This refers to the *OSS* laws as modified by Schedule 2 of the *SIS Regulations* and operates as if sections of the *Occupational Superannuation Standards Act 1987* had not been repealed by the *Occupational Superannuation Standards Amendment Act 1993*.

Preserved benefits under the *OSS* laws were therefore defined by regulations 9-12 of the *OSS Regulations* and with reference to the vesting standards defined in *OSS* regulation 8. The following are preserved:

- benefits from employer contributions not in excess of the SGC requirement and made on or after 1 July 1994;
- benefits from member contributions which were made during a period before 1 July 1994 when the member did not have employer support (ignoring any different provisions prior to July 1992);
- benefits from member contributions that are not undeducted contributions and were made on or after 1 July 1994;
- benefits from employer contributions made under an industrial award; and
- any new or improved benefits arising from an arrangement or agreement made after 22 December 1986 for a private sector fund, or 1 July 1990 for a public sector fund.

However, where the total preserved benefit would be less than \$500 (\$200 from 1 July 1997), the benefit is not preserved. (Ref. regulation 12 *OSS* and schedule 1 *SIS Regulations*)

It is not practical to model the detail of the preservation provisions applying from 1992 to 1999. Accordingly RIMHYPO assumes that employer financed benefits up to the SG amount are preserved benefits, except where the total preserved amount would be less than \$500 (\$200 from 1 July 1997). (Employer contributions in excess of SG are not preserved in the period prior to 1 July 1999.) Member financed benefits from contributions that are **not** undeducted are also preserved.

The effect of this is that the restricted non-preserved benefit payable on resignation or retrenchment is limited to (in RIMHYPO equal to) undeducted contributions plus earnings, *less* any amount that has become an unrestricted non-preserved benefit (see below). At the point where this amount, indexed, is less than the member's total undeducted contributions without earnings, the latter becomes the person's restricted non-preserved benefit.

Unrestricted non-preserved benefits are defined as benefits that were preserved or restricted non-preserved benefits but ceased to be such because the member satisfied a condition of release for which there was no cashing restriction (see Payment of Benefits below). For our purposes, this will only involve amounts under \$200 (\$500 before 1 July 1997) and restricted non-preserved benefits that become unrestricted when the person resigns or is retrenched. Earnings on these amounts are also unrestricted non-preserved amounts. (Ref. regulations 6.10, 6.11 and 6.12 *SIS Regulations*)

From 1 July 1999

All contributions to superannuation funds made after 1 July 1999 are preserved until retirement on or after preservation age except under very limited circumstances. (See

Payments of Benefits below.) This means that all new employer contributions, and all new member contributions (whether deducted or undeducted), and earnings on all contributions will be preserved from 1 July 1999.

Preserved benefits are defined as the total benefit less the sum of restricted non-preserved and unrestricted non-preserved benefits (see below). (Ref. regulation 6.03 *SIS Regulations*) The amounts of restricted non-preserved and unrestricted non-preserved benefits (for those members below preservation age) will be fixed (grandfathered) as from 1 July 1999. This amount will not be indexed.

Where the total preserved benefit would be less than \$200, the benefit is not preserved. (Ref. schedule 1 *SIS Regulations*)

Restricted non-preserved benefits are defined as the greatest of:

- (1) the amount of restricted non-preserved benefit that would have been payable to the member on resignation at 1 July 1999; or
- (2) the amount of restricted non-preserved benefit that would have been payable to the member on retrenchment at 1 July 1999; or
- (3) the person's restricted non-preserved contributions (defined in SIS sub regulation 6.01(2) as the amount of undeducted contributions other than those required to be preserved in satisfaction of the *ITAA*, or *Superannuation Industry (Supervision) (Transitional Provisions) Regulations*, in the fund as at 1 July 1999. Note that this definition means that the deducted contributions of the self-employed are all preserved.

(Ref. regulation 6.08 *SIS Regulations*)

Unrestricted non-preserved benefits are defined as benefits that were preserved or restricted non-preserved benefits but ceased to be such because the member satisfied a condition of release for which there was no cashing restriction (see Payment of Benefits below). From 1 July 1999, this will only involve amounts under \$200 and the amount of existing restricted non-preserved benefits that become unrestricted when the person resigns or is retrenched. (Ref. regulations 6.10, 6.11 and 6.12 *SIS Regulations*)

RIMHYPO assumes that all benefits less the member's restricted non-preserved and unrestricted non-preserved amounts (in excess of \$200) will be preserved from 1 July 1999.

Payment Of Benefits

Unrestricted non-preserved benefits can be taken, in whole or in part, at any time. (Ref. sub regulation 6.20 *SIS Regulations*)

The circumstances under which preserved and restricted non-preserved benefits can be paid are defined in Schedule 1 of the SIS regulations. There are no cashing restrictions on these benefits when the person:

- retires on or after preservation age (see definition of retirement page 6);

- dies;
- becomes permanently incapacitated;
- attains the age of 65;
- left Australia permanently before 1 July 1998;
- has preserved benefits less than \$200 on or after 1 July 1997 (\$500 before that date) and employment with relevant employer is terminated; or
- the person has reached the preservation age plus 39 weeks and has received Commonwealth income support payments for a cumulative period of 39 weeks after the person reached the person's preservation age, provided he or she was not gainfully employed on a full time or part time basis.

(Ref. sub regulation 6.01(5) *SIS Regulations*)

When relevant employment ceases before preservation age, and the preserved amount is \$200 or more, there is no restriction on the cashing of restricted non-preserved benefits. However, in such cases, any preserved amount can only be taken as a non-commutable life pension or annuity if the fund allows this.

The rules in cases of financial hardship differ from the above for those less than preservation age. In these cases, in each 12 month period a single lump sum of between \$1,000 and \$10,000 may be paid, provided the person is receiving Commonwealth income support and has done so for a continuous period of 26 weeks and the person is unable to meet reasonable and immediate family living expenses. Where the amount of the person's preserved benefits and restricted non-preserved benefits is less than \$1,000 a lesser sum may be taken.

Payment of preserved and restricted non-preserved benefits, in the form of an income stream, may also be made in respect of temporary incapacity, although RIMHYPO does not model this. The model will permit preserved benefits to be taken before retirement either at or after age 55 only in cases of death or permanent disability. In other circumstances benefits that may be cashed out will be deducted from the relevant category and either be added to unrestricted non-preserved benefits or subtracted from the fund.

A single lump sum may also be taken under certain circumstances on compassionate grounds. This possibility is not separately allowed for in RIMHYPO – but could be modelled in the same way as ad hoc dissipation discussed below (of which it is really just a special form).

Ad Hoc Dissipation

From time to time proposals are suggested which allow for dissipation of superannuation benefits before retirement for purposes such as housing purchase or other life cycle purposes. As the legislation does not currently allow for the dissipation of superannuation for such purposes, RIMHYPO default parameters assume no such dissipation. Nevertheless the parameters can be varied to allow for the analysis of such

proposals. Various parameters can be used, for example, to vary the indexation rate for indexing the real value of dollar amounts dissipated, provide for an indexation base year and the maximum proportion of superannuation benefits dissipated, and determine whether the dissipated amount is treated as an ETP or not for taxation purposes. Users should refer to the Ad Hoc Dissipation Screen under Personal Parameters to model such proposals.

Taxation of Contributions and Fund Earnings

All superannuation funds and Approved Deposit Funds are assumed to be complying funds for the purposes of the model. This is important because different tax rates would apply to non-complying superannuation arrangements.

The income of complying superannuation funds is subject to taxation under section 278 of the *ITAA 1936*. The income of complying Approved Deposit Funds is subject to taxation under section 289 of the *ITAA 1936*.

The nominal tax rate for superannuation funds and approved deposit funds is 15 per cent in respect of 'standard' income (which includes certain superannuation contributions and all earnings less allowable deductions). (The 47 per cent rate for 'special' income is ignored in RIMHYPO.)

(Ref. sections 26(1) and 27(1) *Income Tax Rates Act 1986*)

Contributions in respect of which the member or the employer is entitled to a deduction, and contributions by a tax exempt entity are included in the taxable income of the fund. (Ref. sections 82AAC, 274(1), 281 *ITAA 1936*) Undeducted contributions made by or on behalf of members are not included in the taxable income of the fund.

Note: although taxable contributions are taxed in the same way as other fund income, RIMHYPO uses different parameters with the same default value for tax on contributions and tax on earnings. This allows policy analysis assuming different tax rates for these types of income to be undertaken, and reflects how many funds actually operate their businesses.

Premiums paid by a fund to cover death and disability insurance are deductible. Where the fund self insures for these risks, a deduction can be claimed for an amount equal to a reasonable premium. (Ref. section 279 *ITAA 1936*) RIMHYPO deducts tax from contributions at the fund's nominal rate after contributions have been reduced by deductible amounts. (This includes amounts for death and disability insurance and fees, which are assumed to be deductible expenses).

The effective tax rate on earnings of the fund is assumed to be reduced by the use of imputation credits, capital gains etc. The user can specify this effective tax rate. The effective tax payable on earnings by most funds is less than the legislated 15 per cent. Generally a rate of 7 per cent is used.

A person who is self-employed or substantially self-employed (ie where the income from employment other than self-employment does not exceed 10 per cent of the person's assessable income) can claim a deduction from their taxable income for their own superannuation contributions. A deduction of \$3000 (not indexed) plus 75 per

cent of contributions (if any) that exceed that amount is allowed. (The legislation specifies that the deduction is limited by the age based contributions limits, and cannot exceed taxable income for the year).

(Ref. sections 82AAS & 82AAT *ITAA 1936*)

An employee who receives employer superannuation support is not eligible for a tax deduction for personal superannuation contributions. (Ref. section 82AAS of the *ITAA 1936*) Such employees can claim a rebate of tax for their own superannuation contributions if the total of assessable income and reportable fringe benefits is less than \$31,000 for the income year. The amount of the rebate is the lesser of 10 per cent of:

- (1) their eligible contributions; or
- (2) \$1000 reduced by 25 cents for each \$1 of assessable income in excess of \$27,000.

These amounts are not indexed. (Ref. section 159SZ *ITAA 1936*)

The amount of contributions for which no tax deductions are allowed or have been allowed are counted as undeducted contributions. Contributions must have been made in order to obtain superannuation benefits.

(Ref. section 27A(1) *ITAA 1936*)

Employers are entitled to a deduction for contributions made in respect of employees. (Ref. section 82AAC *ITAA 1936*) From 1 July 1994, the limits on deductible contributions have been set out in sub-sections 82AAC(2) (2A)-(2G) of the *ITAA 1936*. As the limits are well above SG requirements, and would in practice affect relatively few people, they are not modelled in RIMHYPO.

Surcharge on Superannuation Contributions

The surcharge on superannuation contributions of higher income earners was introduced in the 1996-97 Budget to commence from 20 August 1996. It is imposed by the *Superannuation Contributions Tax Imposition Act 1997*. As RIMHYPO only operates in full years, the surcharge has been modelled to apply for the whole of the 1996-97 financial year and thereafter.

The surcharge is assessed and collected under the *Superannuation Contributions (Assessment and Collection) Act 1997 (SCT (A&C) Act)*. The surcharge (of up to 15 per cent) applies on tax deductible member and all employer superannuation contributions made by or on behalf of members whose adjusted taxable incomes are in excess of the surcharge threshold (\$70,000 in the first year). (Ref. section 9(1) *SCT (A&C) Act*) Adjusted taxable income is defined (Ref. part 7 section 43 *SCT (A&C) Act*) to include:

- the member's taxable income (including inter alia reportable fringe benefits for employees and eligible termination payments) for that financial year;
 - less any amounts that are ETPs from a superannuation fund or that are lump sum leave payments tied to redundancy, early retirement or invalidity;

- plus the member's surchargeable contributions for that year. Surchargeable contributions include tax deductible member and all employer superannuation contributions, specified roll over amounts that are ETPs under subsection 27A(1) of the *ITAA 1936*, and any allocated surplus amounts in relation to a member for that financial year. (Ref. section 8 *SCT (A&C) Act*) Note: RIMHYPO assumes all contributions and earnings are allocated as they accrue.

In the first year, the surcharge shaded in over a range of individual total incomes from \$70,000 (low threshold) to \$85,000 (high threshold) at the rate of 1 per cent per \$1,000 (denominator amount) of taxable income in this range.

The thresholds and denominator amounts are indexed to movements in AWOTE. (Ref. sections 9(2), 9(3), and 9(4) *SCT (A&C) Act*) By default the thresholds in RIMHYPO are indexed annually to movements in AWOTE with indexation commencing from July 1997.

The thresholds are shown below:

| Surcharge on Superannuation Contributions Thresholds | | | |
|---|-----------------|-----------------|-------------|
| Year | Lower Threshold | Upper Threshold | Denominator |
| 20/8/96-30/6/97 | \$70,000 | \$85,000 | \$1,000 |
| 1997/98 | \$73,221 | \$88,909 | \$1,046 |
| 1998/99 | \$75,856 | \$92,111 | \$1,084 |
| 1999/2000 | \$78,208 | \$94,965 | \$1,118 |
| 2000/2001 | \$81,493 | \$98,955 | \$1,165 |

The surcharge is assessed by the Australian Taxation Office using information provided by funds and members' tax file numbers. The surcharge liability generally falls on the superannuation provider that holds the surchargeable contributions. (Ref. section 10 *SCT (A&C) Act*)

As RIMHYPO does not provide for defined benefit schemes and unfunded superannuation arrangements, the specific application of the surcharge to such schemes is disregarded. RIMHYPO also disregards details such as the payment of advance instalments which, in any case, the Government has announced will no longer be collected. (Ref. sections 11 and 12 *SCT (A&C) Act*) Further, RIMHYPO currently does not reflect the changes that include fringe benefits such as motor vehicles in adjusted taxable income for surcharge calculation purposes.

SOCIAL SECURITY PAYMENTS

Legislative Definitions

Asset-test exempt income streams are defined in sections 9A and 9B of the *SSA*. Section 9A lists the requirements for a **lifetime asset-test exempt income stream** as follows:

- (1) must arise under a contract, or governing rules that meet the requirements of subsection (2) which specifies:

- (2) (a) payments under the income stream are to be made at least annually throughout the life of the person and, if there is a reversionary beneficiary:
- (i) throughout the reversionary beneficiary's life; or
 - (ii) if the reversionary beneficiary is a child of the person or of a former reversionary beneficiary under the income stream – at least until he or she turns 16; or
 - (iii) if the child is a full time student who has turned 16 at least until the end of his or her full time studies or until he or she turns 25, whichever occurs sooner; and
- (b) the total amount of the payments that may be made under the income stream in the first year after the commencement day of the income stream (not taking commuted amounts into account); and
- (c) that the total amount of the payments that may be made under the income stream in each year (not taking commuted payments into account) is constant (indexation of up to five per cent of the previous year's total is allowed) or if inflation is running above 4 per cent then indexation may be done using the following formula:
- $$100 \times \frac{(\text{Recent index number} - \text{Base index number})}{\text{Base Index Number}} + 1$$
- (d) if the income stream is purchased - that the first payment under the income stream relates to the period commencing on the day on which the income stream is purchased; and
- (e) if the income stream is not purchased - that the first payment under the income stream relates to the period commencing on the day on which the income stream is acquired; and
- (f) if the income stream is not a defined benefit income stream - then the amount paid as the purchase price for the income stream is wholly converted into income; and
- (g) that the income stream has no residual capital value; and
- (h) that the income stream cannot be commuted except:
- (i) if the commutation is made within 6 months after the commencement day of the income stream; or
 - (ii) if the commutation is made to the benefit of a reversionary beneficiary or of the person's estate, on the death of the person within 10 years after the commencement day of the income stream; or
 - (iii) if the payment resulting from the commutation is transferred directly to the purchase of another income stream arising under a contract, or governing rules, that meet the requirements of the subsection or subsection 9B(2); or

- (iv) to the extent necessary to cover any superannuation contributions surcharge that the person is liable to pay in his or her capacity as purchaser of the income stream; and
- (i) that the income stream:
 - (i) can be transferred only on the death of the person; and
 - (ii) can then only be transferred to a reversionary beneficiary; and
- (j) that neither the capital value of the income stream, nor the income from it, can be used as security for a borrowing; and
- (k) that, if the income stream reverts, it must not have a reversionary component greater than the benefit that was payable immediately before the reversion; and
- (l) that, if the income stream is commuted, the commuted amount must not be greater than the benefit that was payable immediately before the commutation.

In RIMHYPO, the proportion of superannuation benefit to be placed in such products should be noted in the rollover annuity /superannuation pension part of the Personal Parameters – Retirement screen in the interface. Such **life time asset-test exempt income streams** are specifically modelled by putting PEN in the benefit type section under the annuity characteristics part of the screen. Users would also need to ensure that the term is put at 99 to indicate life time.

The rules for *Asset-test exempt income streams with a life expectancy or 15 year minimum term* are contained in subsection 9B of the SSA and are broadly the same as those outlined above except for 2(a). The significant difference is that in the case of **life expectancy or 15 year minimum term income streams** the person needs to be above age pension age on entry for the income stream to be asset test exempt. The RIMHYPO code now reflects this. The proportion of superannuation benefit to be placed in such products should be noted in the rollover annuities/superannuation pension part of the Personal Parameters - Retirement screen in the interface. These specific products are modelled by putting ANN in the benefit type section under annuity characteristics. It is also important to put either 99 if life expectancy or the actual term (15 years or greater) if specified in the term section under annuity characteristics.

Users should note that it is assumed that all the superannuation benefit taken as **an asset-test exempt income stream** must be either a life time income stream, or a life-expectancy or 15 year minimum term income stream. The model does not allow for a combination of the two types of asset-test exempt income streams.

Asset-tested income stream (long term) is defined in sub section 9(1) to mean an income stream that:

- (a) is not an asset-test exempt income stream; and
- (b) has, on its commencement day:
 - (i) a term of more than 5 years; or

- (ii) if the person who has acquired the income stream has a life expectancy of 5 years or less – a term equal to or greater than the person's life expectancy.

Examples of **long term asset-tested income streams** could include those where payments are variable from year to year within a range, where there is a residual capital value or where amounts can be commuted. In the past these products were often known as allocated pensions. Accordingly, the proportion of superannuation benefit to be placed in such products should be noted in the allocated pension part of the Personal Parameters - Retirement screen in the interface.

Asset-tested income streams (short term) are not specifically allowed for in the RIMHYPO model. They are defined in sub section 9(1) to mean an income stream that is not either:

- (a) an asset-test exempt income stream; or
- (b) an asset-tested income stream (long term).

Income

Income for social security purposes is defined in section 8(1) of the *Social Security Act 1991 (SSA)* as 'an income amount earned, derived or received for the person's own use or benefit; or a periodical payment or benefit by way of gift or allowance'. This definition, broadly speaking, conforms to the ordinary meaning of the word. Certain amounts are excluded from income as defined in subsections 8(4), 8(5) (home equity conversion amounts) 8(7A) and 8(8) of *SSA*. Excluded amounts under 8(7A) include any return on an investment in a superannuation fund, approved deposit fund or deferred annuity that is made prior to the person reaching age pension age or commencing to receive a pension or annuity from the fund. There have been a number of changes to legislation relating to pensions and annuities over recent years. In particular, significant changes to definitions occurred as at 20 September 1998.

Pensions and Annuities prior to 20 September 1998

Prior to 20 September 1998, once the person had reached age pension age or commenced to receive a pension or annuity, the payments became assessable as income under *SSA* section 1098 (annuities) and *SSA* section 1099 (superannuation pensions). The amount assessed was the amount payable less the 'deductible amount'. The 'deductible amount' was defined in section 9(1) of the *SSA* as:

- The amount that would have been the 'deductible amount' under section 27H(2) of the *ITAA 1936* if the definition of 'non assessable purchase price' in the *SSA* had had the same meaning as 'undeducted purchase price' (UPP) in the *ITAA 1936*.

For the purposes of the definition of UPP in the *ITAA 1936*, *purchase price* of a pension or annuity meant the sum of any contributions made or amounts paid to acquire the pension or annuity, and excludes fund earnings. (Ref. section 27A(1) *ITAA 1936*)

- Section 9(1) defined the 'non-assessable purchase price' for *superannuation pensions and non-rollover annuities* as being equal to the definition of

'undeducted purchase price' (UPP) in section 27A(1) of the *ITAA 1936* as it was *prior to 1 July 1994*. In summary, that section defined UPP as:

- That part of the *purchase price* of the pension or annuity paid before July 1983 that did not comprise deductible or rebatable contributions; *plus*
 - That part of the *purchase price* paid after June 1983 that was not a deductible contribution, reduced by any taxed or untaxed elements of the post June 1983 component of any eligible termination payment rolled over to purchase the pension or annuity; *less*
 - The residual capital value of the annuity (if any).
- Section 9(1) defined the 'non-assessable purchase price' for a *rollover immediate annuity* as being the UPP as defined above plus an amount equal to the tax threshold amount for the post June 1983 component of an eligible termination payment (ie the 'upper limit' under section 159SG of the *ITAA 1936*) *or* the actual purchase price, whichever is the lesser.
 - Section 9(1) defined the 'non-assessable purchase price' for an annuity purchased with ordinary monies (ie not by rollover of an eligible termination payment) as the purchase price of the annuity *less* any residual capital value.
 - The 'deductible amount' for a superannuation pension or annuity was equal to the UPP divided by the number of years the pension or annuity is expected to be payable. The expected payment period generally equaled the term of the pension or annuity, where that term is a fixed number of years, or a period equal to the life expectancy of the longer lived potential recipient.

This definition of UPP was more restrictive for superannuation pensions and deferred annuities than for rollover annuities, reflecting two factors:

- First, the effect of the *former ITAA 1936* definition was to exclude from the UPP virtually any part of the pre-83 component of the accrued fund, except for that which may have initially been included as part of a lump sum rolled over into the fund. Where a person rolled over a lump sum into a pension or deferred annuity, the value of the pre-July 83 component was frozen as at the rollover date. Because most superannuation contributions prior to July 1983 were entitled to some tax concessions, very few pre 83 contributions to a superannuation pension were likely to be included in the UPP. This did not affect rollover immediate annuities which were purchased with payments commencing from the purchase date. This means that their UPP included *all* of the pre-July 1983 component of the rolled over lump sum as at the purchase date.

From 1 July 1994, the *ITAA 1936* definition of UPP for superannuation pensions and rollover annuities was limited to the post June 1983 undeducted contributions. However, the *SSA* retained the pre-July 1994 definition of UPP for calculating the deductible amount for social security purposes. This meant that the *SSA* continued to treat superannuation pensions and rollover immediate annuities differently.

- Second, the 'non-assessable purchase price' of a rollover immediate annuity also included, on a once off basis for each person, an extra amount equal to the ETP low rate threshold (\$90,474 for 1997-98). This was the case irrespective of whether the person had already used that threshold up for taxation purposes.

Allocated pensions

Allocated pensions and annuities were defined by sub-section 9(8) of the SSA (as amended by the *Social Security Legislation Amendment Bill (No2) 1994*) to include only those purchased on or after 1 July 1992. These were treated the same as other pensions and annuities under the income test.

Asset-Test Exempt and Asset-Tested Short and Long Term Income Streams (From 20 September 1998)

From 20 September 1998, the SSA provides for the concept of asset-test exempt and asset-tested income streams rather than pensions and annuities and allocated pensions as outlined under the definitions section beginning on page 14.

Once the person has reached age pension age or commences to receive a pension or annuity, the payments can be treated as either an asset-test exempt income stream or as an asset-tested short or long term income stream, depending on their characteristics. Income from asset-test exempt income streams is dealt with under sections 1098-1099A of the SSA and from asset-tested income streams under sections 1099B to 1099D of the SSA.

Income from Asset Test Exempt Income Streams

Where an asset-test exempt income stream is not a defined benefit income stream, the amount that the person is taken to receive from the income stream is worked out as follows (Ref. section 1099 of the SSA):

$$\text{Annual Payment} - \frac{\text{Purchase Price}}{\text{Relevant Number}}$$

where relevant number is defined according to the term of the income stream. (Ref. sub section 9(1) of the SSA) If the income stream is payable for a fixed number of years that would be the relevant number. If the income stream is payable for the life of a person and no longer the relevant number would be his or her life expectancy. Finally, if the income stream is jointly owned by a person and his or her partner, and is payable for the lifetime of the person or the partner or is payable during the lifetime of a person and then for the lifetime of a reversionary beneficiary, the relevant number is the number of years of the longer of the relevant life expectancies.

If the asset-test exempt income stream is a defined benefit income stream the amount that the person is taken to receive from the income stream each year is worked out as follows (Ref. section 1099A of the SSA):

$$\text{Annual Payment} - \text{Deductible Amount}$$

RIMHYPO does not specifically model defined benefit products.

Where a non asset-test exempt income stream is also not a defined benefit income stream, the amount that the person is taken to receive from the income stream is worked out as follows (Ref. section 1099C of the SSA):

$$\text{Annual Payment} - \frac{(\text{Purchase Price-Residual capital value})}{\text{Relevant Number}}$$

where relevant number is defined according to the term of the income stream as outlined above. (Ref. sub section 9(1) of the SSA)

If the non asset-test exempt income stream is a defined benefit income stream the amount that the person is taken to receive from the income stream each year is worked out as follows (Ref. section 1099D of the SSA):

$$\text{Annual Payment} - \text{Deductible Amount}$$

As already noted RIMHYPO does not specifically model such products.

Interest income

RIMHYPO assesses as income the interest earned on savings accounts and fixed interest investments. For share investments both the dividends and capital growth are assessed as income. RIMHYPO does not model the details of provisions applying to managed investments, shares, deprivation of income, deemed income etc. It is assumed that subjects behave with a reasonable degree of knowledge and self interest in choosing investments and achieve overall a reasonable rate of return at or above the 'deeming rate'. As at 1 July 2000, deeming rates were 3.5 per cent for amounts up to \$31,600 for a single person, 3.5 per cent for the first \$26,300 of total financial investments held by each member of an allowee couple, 3.5 per cent for the first \$52,600 of total financial investments held by a pensioner couple and 5.5 per cent for balances above these thresholds. Users can set the rate of return lower than this, but it is not advised as results are likely to be misleading.

In practice, (and in the RIMHYPO model) for social security purposes, benefit payments are determined taking deemed income into account, that is, benefit is not increased (or decreased) if a person achieves a lower (or higher) return than would be deemed on their financial assets. (For taxation purposes, actual income received is used.)

Capital gains

Sub-section 9(1) of the SSA defines an 'accruing return investment' as an arrangement with a fixed or quantifiable rate of return or a rate or return that may reasonably be approximated, the value of which from time to time is unlikely to decrease as a result of market changes. The return on such investments is included in the income test definition of income under sections 1074A to 1074G of the SSA.

RIMHYPO includes the return on investments in the income test definition of income, including the value of capital gains on assets in each period.

Asset definitions

'Asset' for Social Security purposes is defined in section 11(1) of the SSA as 'property (including property outside Australia)'. Exempt assets are described in subsections 1118(1) (a) to (t) and section 1118A. The exempt assets of relevance for RIMHYPO include:

- the person's principal home;
- (prior to March 1995) the value of any superannuation pension;
- (between March 1995 and 20 September 1998) the value of any superannuation pension that is not an allocated pension;
- (from 20 September 1998) the value of any asset-test exempt income stream of the person; and
- the value of any investment in a superannuation fund, approved deposit fund or deferred annuity until the person reaches age pension age or commences to receive a pension or annuity from the fund.

(Note: Because of the relative unimportance of allocated pensions before March 1995, RIMHYPO does not treat allocated pensions taken between 1992 and March 1995 differently from those taken after March 1995.)

The 1996-97 Budget announced that, from September 1997, the means test exemption of assets held in superannuation and rollover funds by pensioners and allowees under age pension age would be removed for people aged between 55 and age pension age, once such people have been on income support for nine months.

This policy is incorporated in RIMHYPO. However, because RIMHYPO is a model based on annual flows, the number of months on benefit is rounded to the nearest whole year in order to test period on benefit. The current 9 month test is therefore rounded to one year, the person would have to be on benefit for a full year in the model before superannuation benefits commenced to be counted for the DSS means tests. *(Note: if the test was a three month test, RIMHYPO would assess superannuation assets for the DSS benefits means tests immediately a person commenced to receive benefits after the threshold age.)*

The model code treats the period of time a person is on benefit after the threshold age as cumulative. This means that once a person's benefits commence to be counted for the DSS means tests, they continue to be counted from that time on unless the number of months on benefit threshold is increased in the interface.

In RIMHYPO, non concessional scenarios assume that there is no concessional treatment of superannuation. Therefore the fund balance is assessable at all times.

For all non superannuation investments, RIMHYPO uses the balance at the end of the previous year for assets test purposes. Deprivation is not modelled. An asset is deprived where a person has disposed of the asset but it is still included in the person's assets test assessment. (Ref. subsection 9 (4) SSA)

Pensions and annuities

Prior to 20 September 1998, the SSA excluded the value of a superannuation pension (that was not an allocated pension) from assets counted towards the assets test. (Ref. section 1118(1)(d) SSA) Since 20 September 1998, SSA has excluded the value of any asset-test exempt income stream from the same test. (Ref. section 1118(1)(d) SSA)

Section 1119 of SSA provided for some annuities to be disregarded under the assets test, but not an annuity purchased or becoming presently payable after 15 August 1989. The value of an assessable annuity is worked out by multiplying the purchase price (*less* any residual capital value²) by the 'adjustment factor'. The adjustment factor is the number of years payable minus the number of years elapsed plus one, divided by the number of years payable. That is, the value assessed is the expected balance at the end of the year of assessment. The 'plus one' adjustment assumes the recipient receives one year's payment immediately at the time the annuity commences to be payable, whether that is the case or not.

As already indicated, since 20 September 1998, the SSA has divided income streams into asset-test exempt and non-asset test exempt long and short term. Where the income streams are not asset-test exempt, section 1119 of SSA has been amended to provide a method of calculating the value of the income stream for the purposes of the assets test, as follows:

- (a) if the person receives payments from the income stream 2 or more times a year—in relation to each 6 month period of the income stream's term; and
- (b) if the person receives a payment from the income stream only once a year—in relation to each 12 month period of the income stream's term.

If the income stream has an account balance, the value of the income stream, for the purposes of the assets test, is the value of the account balance at the beginning of the six month or 12 month period (as the case requires).

If the income stream does not have an account balance, the value of the income stream is for the purposes of the assets test worked out as follows:

$$\text{Purchase Price} - \frac{(\text{Purchase Price} - \text{Residual Capital Value})}{\text{Relevant Number}} \times \text{Term Elapsed}$$

where:

purchase price means the sum of the payments made to purchase the income stream (including amounts paid by way of employer and employee contributions) less any commuted amounts.

relevant number means:

- (a) if the income stream is payable for a fixed number of years—that number; or

²RIMHYPO does not model residual capital value.

- (b) if the income stream is payable during the lifetime of a person and no longer—the number of years of the person’s life expectancy; or
- (c) if the income stream:
 - (i) is jointly owned by a person and his or her partner and is payable for the lifetime of the person or the partner; or
 - (ii) is payable during the lifetime of a person and then for the lifetime of a reversionary beneficiary;

the number of years of the longer of the relevant life expectancies.

residual capital value has the meaning given in section 27A(1) of the *ITAA 1936* namely 'the capital amount payable on the termination of the annuity or superannuation pension, as the case may be'.

term elapsed is the number of years of the term that have elapsed since the commencement day of the income stream, rounded down to the nearest half year (if payments are made twice or more per year) or whole year (payments paid annually), whichever is relevant.

Allocated pensions and allocated annuities

Prior to 20 September 1998, the *SSA* referred to concepts of allocated pensions and allocated annuities. Between 1992 and 1994 it treated those allocated pensions and allocated annuities purchased prior to 1 July 1992 in the same manner as superannuation pensions (assets test exempt) and annuities (assets tested on a depletion basis) respectively. However, Social Security Legislation Amendment Bill (No2) 1994, passed by Parliament in July 1994, amended the *SSA* to include a separate assets test treatment for allocated pensions and allocated annuities. From 1 July 1994, for allocated pensions and allocated annuities purchased on or after 1 July 1992, the *SSA* counted the current account balance as an asset for the assets test.

As already outlined above, since 20 September 1998, the legislation has excluded the value of any asset-test exempt income stream from the assets test. Allocated pensions and annuities are not asset-test exempt income streams as they do not comply with all the necessary features of such products as defined in the relevant legislation.
(Ref. section 1118(1)(d) *SSA*)

Because RIMHYPO starts from 1 July 1992, it only models the treatment of allocated pensions and allocated annuities applying after that time.

Superannuation pensions, rollover annuities, allocated pensions and allocated annuities that commence to be payable in the model from 1 July 1998 will receive a social security UPP exclusion based on the full purchase price of the pension or annuity and rollover annuities will no longer have an amount equal to the eligible termination payment tax free threshold included in their social security UPP exclusion. These changes are hard coded in the RIMHYPO code, which also includes provision for the

earlier social security means test treatments of income streams. (RIMHYPO modelling is done on a full-year basis – changes cannot be implemented for only part of a year.)

Payments

Labour Market Allowances

RIMHYPO assumes that where the person is not employed full time they will have a *prima facie* eligibility for some type of benefit or allowance: eg, Newstart, Partner Allowance and Parenting Payment. This is the case except where they have retired and therefore fail the activity test applying to some payment types.

Another reason why the model may not make payments to individuals not gainfully employed on a full or part time basis, is where a person has reached the preservation age (currently age 55 but rising to age 60 as outlined earlier in the paper) plus 39 weeks and has received Commonwealth income support payments for a cumulative period of 39 weeks after the person reached the person's preservation age. Under these circumstances the accumulated superannuation is included as an asset for assets test purposes. Due to the sudden death nature of the assets test cut offs for labour market allowances, individuals with sufficiently large accumulated superannuation benefits will not be eligible for social security payments. The sudden death assets test is discussed further below.

Jobsearch Allowance was subsumed by Newstart Allowance from 20 September 1996. Nonetheless, the amount paid under both Jobsearch and Newstart allowances was the same. AUSTUDY, which is not paid by Centrelink, is not modelled. Imputation of Centrelink benefit in lieu gives a rough approximation. As children have no explicit existence in the model, parenting payments (single) and payments in respect of dependent children are also not modelled.

The income test thresholds for allowances are not indexed in the base parameter set and historically are increased very infrequently. RIMHYPO allows the user to select an indexation rate, including zero, for these thresholds.

Taper Income Test

Currently (under the recent tax reform), the first \$62 (previously \$60) per week of income does not reduce benefit. Income between \$62 and \$142 (previously \$140) per week reduces benefit by 50 cents in the dollar, with a 70 per cent withdrawal rate thereafter. The 70 per cent withdrawal rate has applied from 1 July 1996. Before that time the withdrawal rate for income of over \$140 per week was dollar for dollar.

These thresholds and withdrawal rates apply to single persons and to each member of a couple, so that each member of a couple will have a separate entitlement. The income of a spouse will only affect a person's allowance after the spouse's entitlement has been exhausted. In this case, the entitlement of the lower earner is first reduced by 70 cents for each dollar of the spouse's income over the basic allowance cutout before any personal income test is applied. Where one partner receives a pension and the other an allowance each will be assessed according to their own income test based on an even split of combined income.

Sudden Death Assets Test

The assets test for labour market allowances (and also now parenting payment single) is 'sudden death'; that is, assets in excess of the limits preclude any payment. For couples, combined assets are assessed regardless of whether both partners are in receipt of an allowance. The limits for 20 September 2000 – 31 December 2000 are:

| Assets Test Limits for Labour Market Allowances | |
|--|----------------------|
| Single homeowner | \$133,250 |
| Single non homeowner | \$228,750 |
| Partnered homeowner | \$189,500 (combined) |
| Partnered non homeowner | \$285,000 (combined) |

(Ref. sections 529, 611, 680 SSA)

Under section 1191 of SSA these limits are indexed on 1 July each year. The indexation factor is the CPI for the year to the preceding December quarter. The amount is rounded to the nearest \$250.

Basic rates of allowance for various ages and circumstances are set out in section 1068 - B1 of SSA and are expressed as fortnightly amounts. These rates are indexed under section 1191 of SSA.

- The under 21 rate is indexed each January (by the CPI for the most recent June quarter divided by that for the highest preceding June quarter). The amount is rounded to the nearest 10 cents.
- Other allowance rates are indexed each 20 March (by the CPI for the preceding December quarter divided by the CPI for the highest preceding June quarter), and each 20 September by the CPI for the most recent June divided by the CPI for the highest preceding December quarter. The amount is rounded to the nearest 10 cents.

Up until November 1997, Newstart allowance rates for couples and those over 60 were equal to pension rates, which are also indexed by the CPI according to the legislation. However, Government policy and legislation now links age pension rates to MTAW. Ad hoc adjustments previously resulted in *de facto* AWE indexation. RIMHYPO allows the user to choose the indexation factor. Most labour market benefits are currently below those for age and disability pensions.

Youth Allowance Basic rates per fortnight from 20 September 2000 – 31 December 2000 are:

| Basic Youth Allowance Rates | |
|-------------------------------------|----------|
| Single aged 16-17 at home | \$153.90 |
| Single aged 18 or more, at home | \$185.00 |
| Single aged 16 plus, away from home | \$281.10 |
| Partnered, no children | \$281.10 |
| Partnered, with children | \$308.70 |
| Single, with children | \$368.30 |

(Ref. Centrelink – A Guide to Commonwealth Government Payments)

Newstart Allowance Basic rates per fortnight from 20 September 2000 – 31 December 2000 are:

| Newstart Allowance Basic Payment Rates | |
|---|---------------|
| Single aged 21-59, no children | \$350.80 |
| Single aged 60 or over* | \$379.30 |
| Single aged 21-59, with children | \$379.30 |
| Partnered** | \$316.40 each |

(Ref. Centrelink – A Guide to Commonwealth Government Payments)

*Although the higher rate is payable to those 60 or over who have been in receipt of a payment for at least 9 months, RIMHYPO ignores this second condition. This group is also entitled to pharmaceutical allowance. The mature age allowance, payable under pension conditions is not modelled as it was a temporary measure with no new claims to be lodged after 30 June 1996.

**RIMHYPO also ignores lower payments for partners aged less than 21 and without children.

Pensions

RIMHYPO models age and disability support pensions. Coding adjustments would be necessary to model carer's payment.

- Persons retiring on disability grounds are assumed to be eligible for disability support pension.
- The age pension age is defined in section 43(1)(a) of SSA. Legislation was passed in 1994 to phase in an increase in the female age pension age to age 65 over the period to 2013. For women born before 1 July 1935 the age pension age remains at 60. For those born after 1 January 1949 the age pension age will be 65.
- Income and asset testing for pensions is based on section 1064 of SSA. The income test and the assets test are separately applied to the person's maximum payment rate. The amount paid is the lesser of the income test rate and the assets test rate.
- There have been no new grants of wife pension since 1 July 1995. Accordingly we have not included it in RIMHYPO. Wives of pensioners who do not themselves qualify for a pension will be means tested for social security allowances.

Under section 1064-A2 of SSA the income and assets of a couple are treated as shared on a 50/50 basis. Couples will also be treated as sharing expenses such as rent on a 50/50 basis.

Age Pension Taper Income Tests

The amount of reduction of age pension (this also applies to disability support pensions) under the income test is calculated under section 1064-E of SSA. Up to 30 June 2000, the reduction was half (40 per cent from 1 July 2000) the person's income in excess of

the threshold. In calculating the reduction for a couple, the combined threshold is halved and the income of each partner is assumed to be half the combined income.

As at 20 September 2000, the income test thresholds are \$106 per fortnight for singles and \$188 combined per fortnight for couples. An additional \$24.60 of income is allowed per child. The thresholds are indexed each 1 July by the CPI for the preceding March quarter divided by the CPI for the next most recent preceding March quarter. The annual threshold amounts are rounded to the nearest \$52 per annum. Income over these amounts reduces the rate of pension payable by 40 cents in the dollar (single) and 20 cents in the dollar each (couple). Prior to 1 July 2000, these thresholds were previously 50 cents in the dollar (single) and 25 cents in the dollar each (couple).

The threshold changes were announced in the New Taxation System arrangements. Changes to thresholds can be input into the model using the Social Security – Pensions screen of the RIMHYPO model interface.

Age Pension Taper Assets Test

The amount of reduction under the assets test is calculated under section 1064-G of SSA. The assets test *thresholds* for pensions are the same as the assets *limits* for allowances.

From 20 September 2000 – 31 December 2000 these limits are:

| Assets Test Limits for Age and Disability Support Pensions | | |
|---|----------------------|----------------------|
| | For Full Payment | For Part Payment |
| Single homeowner | \$133,250 | \$266,500 |
| Single non homeowner | \$228,750 | \$362,000 |
| Partnered homeowner | \$189,500 (combined) | \$411,000 (combined) |
| Partnered non homeowner | \$285,000 (combined) | \$506,500 (combined) |

(Ref. section 1064-G3 SSA)

Under section 1191 of SSA these thresholds are indexed on 1 July each year. The indexation factor is the CPI for the year to the preceding December quarter. The amount is rounded to the nearest \$250.

In calculating the reduction for a couple, the combined threshold is halved and the asset value for each partner is assumed to be half the combined assets. The amount of reduction under the assets test is \$78 per annum (\$3 per fortnight) for each \$1000 of assets over the threshold. Any part of the assets excess that is not a multiple of \$250 is disregarded.

Basic rates of pension are set out in section 1064 - B1 of SSA. Under section 1191 of SSA the annual rates are indexed each 20 March by the CPI for the preceding December quarter divided by the CPI for the highest preceding June quarter, and each 20 September by the CPI for the most recent June divided by the CPI for the highest preceding December quarter. The amount is rounded to the nearest \$2.60 per annum. Since 19 September 1997, if 25 per cent of the annualised Male Total Average Weekly Earnings figure exceeds the indexed amount for the single rate of pension, then this rate will be increased by a 'top up amount' equal to the excess. This amount is rounded up if necessary to the next highest multiple of \$2.60. The married rate is increased by an

amount equal to 83 per cent of the 'top up', also rounded to the next highest multiple of \$2.60 if not divisible by that number. (Ref. section 1195(2) SSA)

A special provisional supplement amount of 4 per cent was added to the basic rate of pension to compensate for CPI effects arising from the introduction of the Goods and Services Tax from 1 July 2000, part of the New Taxation System arrangements. The pension supplement amounts are indexed 6 monthly but only in line with CPI changes as outlined above. (Ref. section 1064-BA2 SSA) Basic rates of pension from 20 September 2000 – 31 December 2000 are as follows:

| Basic Rates of Age Pension per fortnight | |
|---|----------|
| Single | \$394.10 |
| Partnered (each) | \$328.90 |

(Ref. Centrelink – A Guide To Commonwealth Government Payments)

Indexation

The indexation factors for social security payments vary as does their periodicity. Some, such as the benefits income test thresholds, are not indexed at all. RIMHYPO generally allows the user to specify the indexation factor (including zero) but will not permit indexation more frequent than annual.

Rent Assistance

Rent assistance is payable to pensioners and allowees who do not own a home and who pay private rent. Conditions of eligibility and rates are contained in sections 1064-D and 1068-F of the SSA. RIMHYPO ignores the effect of the 'rent threshold' whereby the amount of rent assistance paid depends on the amount of rent paid. It also ignores the different payment arrangements for families with children. It is assumed that all couples are living together and that anyone who does not own a home pays private rent.

Rent assistance rates are generally expressed as annual amounts for pensioners and fortnightly rates for allowees. However, in practice the amounts are identical. Under section 1191(1) of SSA, rates are indexed twice annually. Indexation on 20 March is by the CPI for the preceding December quarter divided by the CPI for the highest preceding June quarter, and on 20 September is by the CPI for the most recent June divided by the CPI for the highest preceding December quarter. The amount is rounded to the nearest \$5.20 per annum.

Where both partners of a couple are in receipt of a pension or both are in receipt of an allowance, each receives a separate entitlement of rent assistance. (Ref. sections 1064-D5, 1068 F15 SSA) Where only one partner receives a pension or allowance the combined amount is payable to that partner. (Ref. sections 1064-D5 and 1068-F15 SSA) Where one partner is a pensioner and the other an allowee the combined amount is payable to the pensioner and no rent assistance is payable to the allowee. (Ref. sections 1064-D5 and 1068-F1(e) SSA)

Maximum rates per fortnight from 20 September 2000 – 31 December 2000 are \$86.40 for singles and \$40.60 for each partner of a couple or \$81.20 combined.

Pharmaceutical allowance

Pharmaceutical Allowance is payable to sickness allowees, long term allowees aged 60 or over, certain other allowees who are incapacitated for work, and to pensioners. In RIMHYPO it is only paid to pensioners and allowees aged 60 or over. Conditions of eligibility and rates are contained in sections 1064-C and 1068-D of the SSA.

Under sections 1191(1) and 1206A of the SSA, fortnightly rates are indexed each 1 January by the CPI for the preceding September quarter divided by the CPI for the highest preceding September quarter. The amount is rounded down to the nearest 10 cents per fortnight.

Generally each member of a couple receives a separate entitlement of pharmaceutical assistance at half the single rate. (Ref. sections 1064-C8, 1068-D10 SSA)

Rates per fortnight as at March 2000 are \$5.60 for singles or couple combined (or \$2.80 if only one of a couple is a pensioner). These rates change very infrequently.

Order of Withdrawal of Payments

Section 1207(1) of the SSA describes the order in which reductions under the income and assets tests are applied to components of pension and benefit payments for income tax purposes. The reduction is applied first to the basic rate, then to the rent assistance and lastly to the pharmaceutical allowance.

Note: Disability support pension, rent assistance and pharmaceutical allowance are not assessable income for taxation purposes.

Deferred Pension Bonus Scheme

RIMHYPO incorporates the announcement in the 1997-98 Budget to introduce an incentive to defer retirement. The incentive is a deferred pension bonus scheme which provides a bonus payment to those who delay receipt of the age pension for up to 5 years and continue in employment for at least 960 hours of gainful employment per year (an average of 20 hours per week for 48 weeks per year).

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 the entitlement for each of the deferral years. Thus, the bonus payable is the annual rate of pension at the time of payment times the bonus percentage (9.4 per cent), times the number of years of deferral (up to a limit of 5) *squared*.

The starting date for bonus accrual was 1 July 1998. The default values in the model reflect the phasing in of the bonus which is only payable in respect of deferral accrued after 1 July 1998 (by the end of 1998-99 a maximum of one year's deferral will be recognised, by the end of 1999-00 two years etc). The default also assumes that the person invests 100 per cent of the bonus in interest bearing securities.

For single people, RIMHYPO models the age pension bonus solely on the person's own behaviour. For couples, RIMHYPO allows a person to qualify for the age pension bonus on the basis of both their own behaviour and the behaviour of their spouse. The code allows an age pension bonus to be paid to the spouse of a person who continues to work past age pension age and who satisfies the work test for the bonus. RIMHYPO administers the work test by comparing the average hours worked in the deferral period (set from the hours worked parameter in the Personal parameters/Life Events Table with the work test in the Age Pension Bonus parameters screen). The bonus paid to the spouse is based on the lesser of the number of years the person working defers receipt of the age pension and the number of years the spouse defers. This allows single income couples to receive an age pension bonus based on their joint pension entitlements on the basis of the workforce participation of the working partner.

RIMHYPO allows for the possibility that people may continue to work during retirement to either have a transition into retirement or supplement investment income in retirement through part-time work or by establishing a retirement business. This is possible even where the person being modelled does not utilise the age pension bonus. Salary paid after a person has retired does not accrue further superannuation benefits but counts towards the age pension income tests and as income in retirement in reports. The salary paid to someone who works in retirement or who defers an age pension is set by reference to the salary level and hours worked parameters set in the Personal Parameters Life events screen of RIMHYPO.

The bonus is paid as a non-taxable lump sum on pension take up based on the pension payable to the person at that time.

INCOME TAX

Superannuation contributions and earnings

The taxation of superannuation contributions and earnings is covered in the section on Superannuation, Taxation of Contributions and Fund Earnings (see page 12).

Individuals, Assessable Income and Taxable Income

Section 4-15 of *ITAA 1997* refers to taxable income as assessable income less allowable deductions. Section 6-5 of *ITAA 1997* states that assessable income includes 'the ordinary income you derived directly or indirectly from all sources, whether in or out of Australia, during the income year'. Assessable income can also include statutory income amounts (the various types of statutory income are summarised in section 10-5 of *ITAA 1997*). Certain income may be exempt income where it is neither ordinary nor statutory. (Ref. section 6-15 *ITAA 1997*)

For the purposes of the model all income is assumed to be assessable except for specifically exempted social security income (Ref. division 52 of the *ITAA 1997*) and certain superannuation amounts as outlined in the Superannuation and Retirement Benefits taxation section (see page 35).

Disability support pension is exempt (Ref. item 6.1 of table in section 52-10 *ITAA 1997*) when paid to a person under age pension age. RIMHYPO imputes this payment only to people under age pension age. Section 52-15 of *ITAA 1997* lists an amount paid

as pension or benefit because the person pays rent as a 'supplementary amount' in items 1 and 2. Supplementary amounts are exempt under item 2.1 for age pensioners, and under items 19.1 and 23.1 for certain allowees. (Ref. section 52-10 *ITAA 1997*) Pharmaceutical allowance is also exempt under items 1 and 2. (Ref. section 52-15 *ITAA 1997*)

Under the non concessional scenarios the grossed up earnings of funds are included in the person's assessable income as if they were ordinary investments. The fund fees are deductible under section 8-1 of *ITAA 1997* as outgoings incurred in gaining assessable income. Superannuation contributions are also taxed as ordinary income in the non concessional counterfactual to the RIMHYPO model.

Tax Scales

Income tax scales are set out in Schedule 7 of the Income Tax Rates Act 1986. The scales have been amended several times since 1992. RIMHYPO uses the actual tax scales applying for 1992-93 to 2000-01 (those currently known). The scales have been updated to include the tax parameters applying under the Government's New Tax System. Any new parameters are input using the Personal Taxation screen of the user interface. For years after 2000-01 the scales can be indexed, with the rate and periodicity of indexation being chosen by the user.

Medicare Levy

Medicare levy is payable under section 251S of the *ITAA 1936*. Under section 251R(7) of *ITAA 1936*, the levy payable is not included in the meaning of 'tax' for purposes of rebates applying under Division 17 of Part 3 of that act. That is, rebates of tax cannot be applied to reduce a Medicare liability.

The levy is imposed under section 5 of the Medicare Levy Act 1986 (*MLA*). The rate is specified in section 6(1) of *MLA* as 1.5 per cent, applicable since 1 July 1997. A rate of 1.7 per cent applied for the 1996/97 financial year, 1.4 per cent from 1 July 1993 – 30 June 1996 and a rate of 1.25 per cent immediately prior to 1 July 1993.

MLA section 7(1) exempts from the levy persons with taxable income for 1999/2000 of less than \$13,550. Section 7(2) of *MLA* prescribes a shade in of 20 per cent for incomes between \$13,550 and \$14,648. Legislative amendments are made, from time to time, to vary these amounts.

Reductions and exemptions for couples and families are prescribed by section 8 of *MLA*. The family income threshold is defined in section 8(5) of *MLA* at \$22,865 (for 1999/2000) plus \$2,100 for each dependent child or student. (These amounts are also varied from time to time.) If the taxable income of a couple or sole parent is below this threshold no levy is payable. As noted earlier RIMHYPO does not model sole parents.

Where the couple's income is above the levy threshold a 'reduction amount' may be calculated under section 8(2) of *MLA*. This is equal to 1.5 per cent of the family income threshold less 18.5 per cent of the excess above the threshold. Where only one spouse would have a levy liability, this amount is subtracted from that liability under section 8(2) of *MLA*. Where both have a normal liability, the reduction amount is shared

between them in the same proportions as their respective shares of the couple's taxable income. (Ref. section 8(3) *MLA*)

Prior to 1994-95 the Medicare levy thresholds were set each year to correspond to the maximum taxable income of a pensioner eligible for pensioner health benefits under the now abolished income test. In the 1993-94 Budget, the Government restated its policy of exempting persons who would have been entitled to free medical care prior to the introduction of Medicare. As there were 27 rather than 26 pension paydays in 1993-94 there was no need to increase the thresholds in 1994-95 to meet this commitment. Users can set their own threshold indexation using the Taxation interface.

RIMHYPO does not model the Private Health Insurance Incentive Rebate nor the surcharge for those high income earners without private health insurance.

Savings Rebate

The 1997-98 Budget introduced a new savings rebate which provided for a maximum 15 per cent rebate for member superannuation contributions and/or for earnings on personal income from other investments and savings, up to an annual cap of \$3,000. The rebate was to be phased in commencing from 1 July 1998, with a 7.5 per cent rebate in 1998-99 (and a maximum rebate of \$225) rising to 15 per cent (a maximum rebate of \$450) from 1 July 1999.

These changes were incorporated into RIMHYPO through an additional taxation parameter screen (Capital Income Rebate) that included the rebate parameters. These were included in a generic fashion to allow users to model a range of possible rebate settings such as income tests etc.

With the announcement of the New Taxation System arrangements the savings rebate was abolished from 1 July 1999. Users should apply a rebate rate of zero from 1999 and thereafter to effectively remove the rebate from 1 July 1999.

Pensioner and Beneficiary Rebates

Under section 160AAA of the *ITAA 1936* recipients of certain Social Security pensions and allowances are entitled to a rebate of tax. The rebatable benefits and pensions include Age Pension and Newstart and Sickness Allowances.

The amount of the rebate is calculated in accordance with Part 8 of the Income Tax Regulations (*ITR*). Regulation 151 of *ITR* prescribes the method of calculating the pensioner rebate. The maximum rebate is the amount of tax that would be payable at the lowest marginal rate on the excess over the first tax threshold of the relevant annual taxable pension amount plus the pensioner income test free area. This is rounded up to the nearest whole dollar. (Ref. sub regulation 151(3) *ITR*) The rebate is reduced by 12.5 cents for each \$1 of taxable income in excess of the pensioner's rebate threshold. (Ref. sub regulation 151(1) *ITR*) The rebate threshold is calculated using the formula:

$$\text{Tax Free Threshold} + \frac{\text{Tax Payer's Rebate amount}}{\text{Lowest Marginal Tax Rate}}$$

This amount is rounded up to the nearest whole dollar. (Ref. sub regulation 151(2) *ITR*) Under sub regulation 151(6) of *ITR*, where one partner of a pensioner couple is entitled to a rebate greater than their ordinary tax liability, the excess rebate is added to that of the other partner. This increased rebate is used to calculate the rebate threshold of the higher income partner under sub regulation 151(2) of *ITR*.

The Government's announced New Tax System arrangements increased the amount of the maximum rebate by \$250 for single pensioners and \$175 for each member of a couple. This can be varied using the Taxation Parameters – Other Rebates Screen of the RIMHYPO interface.

Under regulation 152 of *ITR*, the beneficiary rebate is calculated using the following formula:

$$\text{Lowest Marginal Tax Rate} \times (\text{Taxpayer's Benefit Amount} - \text{Tax-Free Threshold})$$

Where the amount of benefit received in an income year is in excess of the second tax threshold (\$20,000), the beneficiary rebate is calculated as follows:

$$\begin{aligned} &\text{Lowest Marginal Tax Rate} \times (\text{Taxpayer's Benefit Amount} - \text{Tax-Free Threshold}) \\ &+ 0.13 \times (\text{Taxpayer's Benefit Amount} - \$20,000) \end{aligned}$$

In practice there are no rebatable benefits in excess of the \$20,000 threshold at present.

Prior to 1 July 1996, the beneficiary rebate was calculated in a similar manner to the pensioner rebate, with the maximum rebate equal to the amount of tax that would be payable at the lowest marginal rate on the excess over the first tax threshold of the relevant annual benefit amount. The rebate decreased by 12.5 cents for each dollar of taxable income in excess of the annual benefit amount.

The RIMHYPO model calculates policy consistent beneficiary rebates, based on rates of social security allowances input through the user interface.

Tax Rebate for Low Income Aged Persons

The 1996-97 Budget announced that from 1996-97, the age pensioner rebate would be provided to all persons who are at or above age pension age, considered to be residents for age pension purposes, and with incomes below the pensioner rebate cut out threshold. (Ref. regulation 150AD *ITR*) As a transitional measure the rebate will be at a level equivalent to half the pensioner rebate for 1996-97 with the rebate being paid to those low income aged persons who qualify for the rebate from 1997-98.

(Ref. sub regulation 150AD(a) *ITR*)

This measure is included in the RIMHYPO taxation code by extending the scope of the age pensioner rebate:

- for periods before July 1996, the age pensioner rebate is only payable to people who receive an age pension payment;

- for 1996-97, the age pensioner rebate is payable to age pensioners at the full rate and to non-pensioners of pension age who satisfy the income test at half the full rate. The income test for non-pensioners shades out the rebate for incomes above the age pension rebate threshold at the same rate as for the full age pensioner rebate (12.5 cents per extra \$1 of income); and
- for 1997-98 and later years the age pensioner rebate is available to everyone of age pension age subject to the age pensioner rebate income test.

These changes cannot be adjusted through the interface, as the parameter is tied to the age pensioner rebate. The effect of the extension of the age pensioner rebate to non-pensioners in the code is only seen where a person or couple are ineligible for the age pension for reasons other than age. This would include anyone who is disqualified under assets test arrangements but would otherwise qualify under the income test.

The Government's announced New Tax System arrangements increased the amount of the maximum rebate by \$250 for single pensioners and \$175 for each member of a couple. This changes with the Pensioner rebate in the Taxation Parameters – Other Rebates screen of the RIMHYPO interface.

Dependent Spouse Rebate (DSR)

Section 159J of the *ITAA 1936* provides for a rebate of tax in respect of a dependent spouse. (Ref. Table of Rebates in section 159J(2) of the *ITAA 1936*) Prior to 1 July 2000 there was a higher 'with child rate' of rebate, although this was being phased out by freezing the amount of rebate until it was less than the indexed 'without child' rate. From 29 September 1994, a spouse caring for children could claim a direct payment from the Department of Family and Community Services. This payment was income tested on the income of the caring spouse and any amount paid deducted from any amount of DSR that would otherwise have been available. Since 1 July 2000, the with child DSR and other child care allowances have been subsumed into the Family Tax Benefit Part A and B.

As the presence of children is not modelled in RIMHYPO, the DSR without child rate is imputed to the higher earner in all couples. The maximum rebate amount will then be income tested against the income of the lower earner.

The maximum no child DSR for 1992-93 was \$1,177. Under section 159HA *ITAA 1936* this amount is indexed each year by the CPI (calculated to 3 decimal places) for the year ending on the 31 March immediately preceding the year of income. In 1999/2000 it was \$1,340.

Under section 159J(4) of *ITAA 1936* the DSR is reduced by \$1 for every \$4 by which the dependant's separate net income for the year exceeds \$282. This threshold is not indexed.

Section 159J(6) of the *ITAA 1936* defines 'separate net income' as including any amount that is included in assessable income of the dependant but does not include family tax payments under the SSA. Nor does it include maternity allowance, maternity

immunisation allowance, child disability allowance and so on. (Section 159J(6) of *ITAA 1936* contains a comprehensive list of exclusions.)

Generally the term is taken to mean amounts which are income in the generally accepted sense, less expenses incurred in gaining that income. Thus certain amounts, such as equity imputation credits, which are taxable income are not separate net income. Disability support pension is not taxable, but it is separate net income. Amounts which are allowable deductions for taxable income purposes, such as (for the self employed) superannuation contributions, are not deductible from separate net income.

RIMHYPO calculates separate net income as salary, investment income and all DSS pension and allowance payments both taxable and non taxable. Investment fees and fund fees (as in the non concessional scenario) are deductible, but contributions and insurance premiums are not.

Family Tax Initiatives/ One Off Savings Bonuses

A number of new family tax initiatives have been announced in the New Tax System arrangements. These have not been incorporated into RIMHYPO as the model does not allow for children as indicated previously.

Bonuses were also announced in the New Tax System arrangements to compensate those who live mainly on income earned from their investments. RIMHYPO also does not model these as they are once off compensation amounts, payable from July 2000.

Low Income Rebate

From 1993-94, individuals with taxable income less than \$24,450 are entitled to a rebate of \$150, reduced by 4 cents for every \$1 of taxable income in excess of \$20,700. (Ref. section 159N *ITAA 1936*) These amounts are not currently indexed, although RIMHYPO permits indexation as specified by the user.

In calculating the amount of pensioner rebate used by a member of a pensioner couple, in order to determine if any excess rebate may be available to the other partner, the low income rebate is not to be taken into account in reducing the tax liability offset by the pensioner rebate. (Ref. regulation 151(6)(d) *ITR*)

It is intended that from 1 July 2000, these thresholds should be amended to reflect the New Tax System parameters. This will mean that individuals with taxable income less than \$23,750 will be entitled to a rebate of \$150, reduced by 4 cents for every \$1 of taxable income in excess of \$20,000. The legislation is currently awaiting legislative priority.

Superannuation and retirement benefits

RIMHYPO allows users to select from the following benefit types in retirement:

- Superannuation pension *or* rollover annuity;
- Allocated pension; *or*

- Eligible Termination Payment, which is taxed and may be disposed of in the following ways:
 - immediate consumption (ie dissipation);
 - investment in interest bearing securities;
 - investment in an ordinary savings account; or
 - investment in capital gaining assets (eg shares).

RIMHYPO allows the user to select any one or any combination of the above benefit forms as the retirement benefit taken by the hypothetical individual.

Reasonable Benefit Limits

The amount of *concessionally taxed* superannuation benefits a person is allowed to receive over his or her lifetime is limited under the Reasonable Benefit Limits (RBLs). The RBLs rules are set out in Division 14 of Part III of the *ITAA 1936*.

Since 1 July 1994, the RBLs have been expressed as flat dollar limits. Where a person takes at least 50 per cent of superannuation benefits as a *RBL complying* superannuation pension or rollover annuity, the flat dollar (pension) RBL was initially \$800,000 (\$1,012,181 for 2000/01) otherwise the (lump sum) RBL was initially \$400,000 (\$506,092 for 2000/01). These limits are indexed annually to movements in average weekly ordinary time earnings. Indexation occurs on 1 July each year, based on the movement in AWOTE over the year to the immediately preceding March quarter. The resulting outcome is indexed and rounded up to the nearest \$10. (Ref. sections 140ZD(3) *ITAA 1936*) Where a person receives benefits before age 55, the *lump sum* RBL is discounted by 2.5 per cent for each whole year of age of the person under 55. (Ref. section 140ZD(1)(a) *ITAA 1936*)

RIMHYPO indexes the base level of the RBLs to the annual level of AWOTE in the model. The model assesses individuals against the indexed RBL thresholds in the year benefits are received and discounts the lump sum RBL where benefits are received before the preservation age. RIMHYPO does not specifically allow for a lag in the RBL assessment. However, according to SIS reg 1.06(5)(a), after 1 April 2000, individuals who roll over their money into an allocated pension do not need to draw down a pension payment in the first financial year. The RBLs assessment would thus occur in the next financial year, with the indexed RBLs being higher than in the first financial year. This can be simulated in the model by making the person unemployed for a year before retirement if desired.

Subdivision F of Division 14 of *ITAA 1936* sets out the benefits counted against a person's RBLs, while Subdivision H of *ITAA 1936* sets how much of each type of benefit counts towards the RBL. The RBLs generally count the following types of benefit:

- eligible termination payments:
 - 100 per cent of the retained amount of the pre-July 1983 component of the ETP;
 - 100 per cent of the retained amount of the post-June 1983 *taxed* element of the ETP;
 - 85 per cent of the post-June 1983 *untaxed* element of the ETP; and
 - 100 per cent of the retained amount of the CGT exempt component of the ETP.
- the capital value of a superannuation pension (which under subdivision J of *ITAA 1936* excludes the amount of any undeducted contributions):
 - all of the capital value attributable to pre-July 1983 service;
 - where the pension *is* a rebatable superannuation pension, all of the reduced capital value attributable to post-July 1983 service; and
 - where the pension *is not* a rebatable superannuation pension, 80 per cent of the reduced capital value attributable to post-July 1983 service.
- the amount of any ETP that is rolled over to purchase a rollover annuity:
 - 100 per cent of the pre-July 1983 component of the rolled over ETP;
 - 100 per cent of the post-June 1983 *taxed* element of the rolled over ETP; and
 - 85 per cent of the post-June 1983 *untaxed* element of the rolled over ETP.

At this stage, RIMHYPO does not deal with ‘untaxed’ superannuation benefits and so does not have to discount any components of such benefits.

The RBLs *exclude* any concessional components of benefits, undeducted contributions and benefits rolled over into a roll over fund. Roll over benefits are assessed against the RBLs when the roll over fund pays them out.

The RBLs only count the value of such benefits received by a person since 16 February 1990. (Ref. section 140ZC(1)(c) *ITAA 1936*) When a person receives such a benefit, its value is recorded and the recorded value carried forward, indexed by AWOTE. (Ref. section 140ZA(4) *ITAA 1936*) In assessing a current year benefit against the RBLs, the indexed value of previously received benefits is taken into account.

The RBLs assessment in RIMHYPO does not count concessional components, undeducted contributions or benefits rolled over to another superannuation fund or rollover fund. Because RIMHYPO will generally only examine benefits received after July 1992, the January 1990 threshold date does not apply and the model will consider all superannuation benefits for RBLs purposes.

To qualify for the higher pension RBL, a person must take at least 50 per cent of their superannuation benefits (current and previous) as a pension or annuity that satisfies the 'pension and annuity standards' set out in the regulations. (Ref. section 140L *ITAA 1936*) A current benefit is assessed against the lump sum RBL if:

- the current benefit is an ETP or non-complying pension or annuity and:
 - the sum of complying pension or annuity benefits that the person has received is less than 50 per cent of total indexed benefits (including the current benefit) the person has received; or
 - the sum of the ETP and any previous benefits that were not complying pension or annuity benefits exceeds 50 per cent of the pension RBL; or
- the current benefit is a complying superannuation pension or annuity and:
 - the sum of the benefit and any previous complying pension or annuity benefits of the person is less than 50 per cent of total indexed benefits the person has received; or
 - where total indexed benefits exceed the pension RBL, the sum of the benefit and any previous complying pension or annuity benefits of the person is less than 50 per cent of the pension RBL.

A pension or annuity satisfies the 'pension and annuity standards' if it satisfies all the following conditions:

- the pension or annuity is payable at least annually throughout the life of the primary beneficiary and if there is a reversionary beneficiary, annually throughout the reversionary beneficiary's life. Further provisions allow reversionary beneficiaries to receive a reversionary benefit until they reach age 16, the cessation of full time study or age 25, whichever is later;
- the size of payments of benefit in a year must be fixed, allowing only for variations as specified in the contract;
- the benefit must be indexed to the lesser of 5 per cent annually or the year on year increase in the CPI each quarter;
- the purchase price of an annuity must be wholly converted into annuity income;
- the benefit must not have any residual capital value;
- the benefit must not be commutable more than 6 months after it commences to be payable, except where:
 - the commutation represents payment of a payment guarantee on the death, within a period not exceeding 10 years, of the principal and any reversionary beneficiaries; or

- the commutation ETP is rolled over directly to another complying superannuation pension or complying annuity;
- the value of any reversionary benefit does not exceed 100 per cent of the benefit payable to the primary recipient;
- the pension or annuity is not transferable to any other person other than a reversionary beneficiary on the death of the current recipient; and
- the capital value of the pension or annuity cannot be used as security for a borrowing.

(Ref. regulation 53J *ITR* and sub regulations 1.05(2) and 1.06(2) *SIS Act*)

RIMHYPO only allows ETP benefits prior to reaching retirement age. The model carries the value of these prior benefits forward, indexed to annual movements in AWOTE in the model.

Benefits paid to a person before retirement age are assessed against the discounted lump sum RBL. Benefits received after retirement are assessed to see which RBLs applied. This is done by testing whether the sum of the indexed pre retirement benefits, current ETP benefits and allocated pension benefits exceeds 50 per cent of total benefits or 50 per cent of the pension RBL. RIMHYPO applies the tests for complying superannuation pension and rollover annuity benefits to pension and annuities as part of the RBL assessment.

Once the RBL assessment is done RIMHYPO determines the amount, if any, of the excessive benefit. RIMHYPO assumes the person takes pension or annuity benefits first, allocated pensions second and lump sum benefits last.

Benefits in excess of the RBLs are treated as follows:

- excessive lump sum benefits are taxed at the highest marginal rate of personal income tax plus the Medicare Levy; and
- the excessive proportion of any superannuation pension benefit would reduce the rebatable portion of the whole pension to less than 1, rather than being taxed at the individual's marginal rate. (Ref. section 140ZQ *ITAA 1936*)

Superannuation pensions and rollover annuities

The assessable income of a taxpayer includes any amount derived from a superannuation pension or annuity, excluding the 'deductible amount'.

(Ref. section 27H *ITAA 1936*)

The deductible amount is equal to the 'Undeducted Purchase Price' (UPP) of the pension or annuity, divided by the number of years the pension or annuity is expected to be payable (the 'relevant number'). The relevant number will generally equal:

- the actual number of years where the term of the pension or annuity is fixed;

- where the pension or annuity is only payable during the lifetime of a nominated person, whether the original recipient or not, a number equal to the life expectancy of that person. Where a pension or annuity includes a reversionary benefit, the relevant number will be the *greater* of the life expectancy of the initial and the reversionary beneficiary. Life expectancy is looked up from the Australian Life Tables applicable to the year in which the annuity is purchased; or (Ref. Regulation 9 *ITR*)
- in more complex cases, a number calculated by the Commissioner of Taxation based on all relevant factors.

RIMHYPO assumes pensions or annuities are payable for the life of the recipients. In a single person case the pension or annuity is payable for the life of that person only, while for a married couple, the payment period depends upon whether the pension or annuity includes a reversionary benefit. Where a reversionary benefit is payable, RIMHYPO assumes the pension or annuity is payable for the life expectancy of the longest lived recipient. RIMHYPO does not model the case of surviving dependent children or other more complex cases.

RIMHYPO calculates the relevant number from the 1985-87 Australian Life Tables for years before 1995 and uses life tables from the POPMOD demographic model for years from 1995 onwards. RIMHYPO uses a new POPMOD life table for each 5 year period from 1995 on and automatically selects the appropriate life table to use based on the year a person retires.

The definition of UPP for a superannuation pension or annuity depends upon when the pension or annuity was purchased. For pensions or annuities purchased before 1 July 1994, the *ITAA 1936* defined UPP as:

- that part of the *purchase price* of the pension or annuity paid before July 1983 that did not comprise deductible or rebatable contributions; *plus*
- that part of the *purchase price* paid after June 1983 that was not a deductible contribution, reduced by any taxed or untaxed elements of the post June 1983 component of any ETP rolled over to purchase the pension or annuity;
- for the purposes of the definition of UPP in the *ITAA 1936*, *purchase price* of a pension or annuity means the sum of any contributions made or amounts paid to acquire the pension or annuity and excludes fund earnings. (Ref. section 27A(1) *ITAA 1936*)

This definition of UPP was more restrictive for superannuation pensions and deferred annuities than for rollover annuities.

For pensions and annuities purchased on or after 1 July 1994, the UPP is defined as being equal to the amount of any *undeducted* included in the purchase price of the pension or annuity. Undeducted contributions are the person's own contributions made after 30 June 1983 to secure the superannuation benefit for which the person was not entitled to a tax deduction. (Ref. section 27A(1) *ITAA 1936*)

Where a person receives a superannuation pension from a ‘taxed superannuation fund’, the person is entitled to a tax rebate on the assessable pension or annuity payment. (Ref. Part III, Subdivision AAB *ITAA 1936*) The rebatable pension or annuity payment is equal to the payment less the deductible amount. From 1 July 1994 onwards, the rebate rate for all pensions or annuities qualifying for the rebate is 15 per cent. (Ref. section 159SM(1) *ITAA 1936*) This rebate rate is reduced where part of the pension or annuity is in excess of the RBL (Ref. division 14 *ITAA 1936*) The reduction proportion is calculated as part of the person’s RBL assessment.

Superannuation pensions paid from a fund that is not a ‘taxed superannuation fund’ are not rebatable. (Ref. section 159SM(2) *ITAA 1936*)

RIMHYPO currently assumes all superannuation pensions are paid from taxable superannuation funds and does not model the pre-July 1994 rebate arrangements. Accordingly, RIMHYPO calculates the rebate as equal to the rebate percentage (15 per cent) times the assessable pension or annuity payment.

Complying superannuation funds are exempt from tax on that part of their income that is attributable to their current pension liabilities. (Ref. sections 282B and 283 *ITAA 1936*) Life insurance companies are exempt from tax on any income that would be exempt income of a superannuation fund policyholder (Ref. section 110C *ITAA 1936*) and in respect of that proportion of their assessable income attributable to exempt immediate annuity policies. (Ref. section 112A *ITAA 1936*)

RIMHYPO calculates the cost of superannuation pensions and rollover annuities on the basis that the investment income underlying these income streams is exempt income of the issuer in both the concessionally taxed and non-concessional counterfactual cases. This is done in the counterfactual cases because it would be impractical to tax such income in the funds concerned at the individual’s marginal rate and because the pension and annuity rules aim to ensure there is not excessive tax deferral.

Allocated pensions

An allocated annuity or pension is a benefit paid from an account with a life company or superannuation fund that allows a person to draw down from that account, subject to limits on the minimum and maximum drawdown amount, for as long as the account balance lasts. The annuity contract or rules of the fund must include certain minimum conditions:

- the annuity or pension cannot be transferred except to a reversionary beneficiary on the death of the primary beneficiary or of another reversionary beneficiary;
- the capital value of the annuity or pension and the income from it cannot be used as security for a borrowing;
- payments of the annuity or pension must be made at least once annually; and
- with the exceptions of the first and final financial years, payments in a year (other than by way of commutation) must be within the maximum and minimum limits calculated in accordance with Schedule 1A of the *SIS Regulations*. (Ref. sub regulations 1.05(4),(5) and 1.06(4),(5) *SIS Regulations*)

Allocated pension payments are taxed in the same manner as superannuation pension or rollover annuity payment, with a deduction for the undeducted purchase price and rebate calculated in the same manner as outlined above. However, they do not satisfy the conditions for complying superannuation pensions or annuities set out in *ITR 53J* and do not count for the pension RBL.

Schedule 1A of the SIS Regulations sets out the drawdown factors for allocated pensions. Those factors were calculated on the following basis:

- the minimum drawdown factor is based on the pension valuation factor for a CPI indexed lifetime annuity with an 85 per cent reversionary factor for the person's age at 1 July each year; and
- the maximum drawdown factor is based on the pension valuation factor for a non-indexed single annuity payable to age 80 based on the person's age at 1 July each year.

Commutations of allocated pensions are treated as ETPs.

RIMHYPO calculates allocated pension payments based on the minimum and maximum drawdown limits set out in Schedule 1A of the SIS Regulations. The model calculates commutation payments as being equal to any amount in excess of the maximum payment limit. At this stage, RIMHYPO does not include any taxation treatment of commutations of allocated pensions because at this stage RIMHYPO does not allow active 'portfolio shifting' during the course of retirement.

Eligible termination payments

Eligible termination payments are defined in section 27A(1) of the *ITAA 1936* and include:

- retirement, termination and similar payments made in consequence of the termination of the taxpayer's employment. These payments include ex gratia termination payments from an employer and payments from a superannuation fund (except pension or annuity payments) or approved deposit fund; and
- payments from the commutation or residual capital value of a superannuation pension and certain annuities (including deferred annuities) are also treated as ETPs.

This definition includes all of the accumulated superannuation benefits in RIMHYPO.

Eligible termination payments consist of the following components:

- the *concessional component*, which is that part of the ETP attributable to a bona fide redundancy payment, approved early retirement scheme payment or invalidity payment. From July 1994 these components are exempt from tax.
 - Invalidity payments are defined in section 27G of the *ITAA 1936* and equal:

AB
C

where:

A is the amount of the ETP.

B is the number of whole days from the time the employment was terminated until the 'last retirement date' of the person. The last retirement date is the date by which the person's employment would normally end (eg where there is a compulsory retirement date) but for invalidity or in the absence of such a date, age 65.

C is the sum of the person's eligible service period for the benefit in days (see below for details of eligible service period) and B.

- An invalidity payment is only payable if the person is certified by two medical practitioners as no longer ever being able to perform any employment for which that person is reasonably qualified because of education, training or experience. This definition under Subsection 27G(b)(i)(A) is effective from 1 July 1994 and is much more restrictive than the previous definition which related invalidity to the person's particular employment.
- *Undeducted contributions*, which are that part of the superannuation benefit comprising contributions made after June 1983 for which no deduction was allowable to any person. These will generally only equal the member's own non-deductible contributions. This component is not taxable.
- The *non-qualifying component*, which is an anti avoidance provision that can effectively be ignored. It deals with the commutation of annuities that do not wholly consist of rolled over ETPs. *RIMHYPO does not model this component.*
- The *excessive component*, namely the amount of an ETP that is determined to be in excess of the person's reasonable benefit limit entitlement. This component is taxable at the highest marginal tax rate plus Medicare levy (see the section on RBLs page 36).
- The *pre-July 1983 component*, which arises where the ETP is attributable to days of service before 1 July 1983. This component is calculated according to the following formula:

$$(\text{ETP} - \text{Co} - \text{NQ} - \text{EC}) \times \frac{\text{Pre-1 July 1983 eligible service days}}{\text{Total eligible service days}}$$

where:

ETP is the amount of the ETP;

Co is the amount of the concessional component;

NQ is the amount of the non-qualifying component; and

EC is the amount of the excessive component.

- The eligible service period of an ETP for this calculation is the period starting at the start of the earliest employment or period of membership of any element of the benefit being paid.
- 5 per cent of the pre-July 1983 component of the ETP is included in the person's assessable income and taxed at marginal rates. (Ref. section 27C *ITAA 1936*)
- The *post June 1983 component* is equal to the amount of the ETP reduced by all of the other components. The taxation of this component is discussed below.

RIMHYPO divides superannuation payments into undeducted contributions, the pre-July 1983 component and the post-June 1983 component. RIMHYPO deals with concessional components (arising as a result of invalidity) but ignores those arising from redundancy or bona fide early retirement and the non-qualifying component.

The post June 1983 component of an ETP may comprise further elements. These are:

- the *untaxed elements of the post-June 1983 component*. Essentially, these are those parts of the post June 1983 component of a benefit that are not paid from a taxed superannuation fund, approved deposit fund or as a consequence of the commutation of a rollover annuity or which are specifically nominated as 'untaxed elements' by the fund under section 27AB(4). These payments represent the part of the post-June 1983 component of a benefit that are either paid directly by an employer or in respect of which the 15 per cent contributions tax was not paid. Generally such components will only arise in respect of ETPs paid by untaxed superannuation funds (mainly public sector funds) or directly by employers; and
- the *taxed elements of the post-June 1983 component*. These are those parts of the post June 1983 components paid from taxed superannuation funds, ADFs or as commutations of annuities. They represent payments from sources liable to the 15 per cent tax on contributions, hence the term 'taxed'.

These elements are fully included in the taxpayer's assessable income (Ref. section 27B *ITAA 1936*) and the tax assessed is then reduced by a rebate of tax under subdivision AAA of Part III of the *ITAA 1936*. The rebate reduces the tax paid on each dollar of ETP income to an amount equal to the lesser of the tax payable at the person's marginal rate of tax and the tax payable under the ETP tax scales. This is a very complex calculation involving a rebate rate equal to the difference between each income tax rate and each ETP tax rate.

The ETP tax rates are applicable to the elements of the post-June 1983 components are:

| | Taxed elements | Untaxed Elements |
|---------------------|-----------------------|-------------------------|
| Below ETP threshold | 0% | 15% |
| Above ETP threshold | 15% | 30% |
| Before age 55 | 20% | 30% |

(Ref. section 159SA *ITAA 1936*)

The low rate ETP thresholds are indexed annually to AWOTE and are set out below:

| Year | Threshold Amount |
|-------------|-------------------------|
| 1991/92 | \$73,776 |
| 1992/93 | \$76,949 |
| 1993/94 | \$77,796 |
| 1994/95 | \$79,586 |
| 1995/96 | \$83,168 |
| 1996/97 | \$86,495 |
| 1997/98 | \$90,474 |
| 1998/99 | \$93,731 |
| 1999/2000 | \$96,637 |
| 2000/2001 | \$100,696 |

RIMHYPO models the tax on the *taxed elements of the post-June 1983 component* of ETPs by calculating the tax on the ETP as the lesser of tax at the ETP tax rate and tax at marginal rates for each dollar of ETP income. The code works by determining the point on the tax scale where ETP tax commences to be payable and then calculating the tax from that point. This entails a different equation for each marginal tax rate in the model, depending upon where the ETP commences to be taxable.

Because the RIMHYPO ETP tax code *does not* deal with *untaxed elements of the post-June 1983 component* at this stage, RIMHYPO does not yet model ETPs paid from untaxed superannuation funds.

Ordinary investment income - interest bearing accounts

RIMHYPO allows users to assume that an after tax ETP and other savings of a person may be invested in a number of ways, including in an ordinary savings account or in interest bearing securities.

Where the person invests in such products, the interest income is included in the person's assessable income under section 25 of the *ITAA 1936* as ordinary income in the year it is derived. The amount included in assessable income is the actual interest paid, and is unaffected by the deeming of interest on amounts held in low interest accounts for the social security income test. Withdrawals from such an account are not assessable income of the person.

RIMHYPO allows for two types of interest bearing account for a person. The first is a savings account from which the person withdraws an amount equal to the interest earnings only. The second is an investment account from which a range of withdrawal options are allowed. In both account types, RIMHYPO includes the full amount of the account interest in the person's assessable income, and assesses income tax at the individual's marginal rate of tax.

Ordinary investment income - capital gaining assets

RIMHYPO allows users to assume that some or all of an after tax ETP and other savings of a person may be invested in capital gaining assets. Such assets generally yield their return in the following ways:

- regular income payments, such as rents or dividends; and
- the capital appreciation of the asset.

Rents on property assets or other income arising from asset ownership are included in the recipient's assessable income under section 25 of the *ITAA 1936* with deductions allowed under section 51(1) of the *ITAA 1936* for any expenses incurred in earning that income.

Similarly, any dividend income on assets such as shares is included in the recipient's assessable income and deductions are allowed for expenses in incurring the dividend. However, where the dividend is derived from a taxable Australian resident company that has paid Australian company tax, the dividend may be 'franked' with dividend imputation credits. Where this occurs, the taxpayer's assessable income is 'grossed up' by the amount of the imputation credit and the franking rebate amount deducted from the tax payable by the taxpayer on total taxable income. (Ref. Division 6, Part IIIAA, *ITAA 1936*) The dividend imputation system means that company income distributed as dividends to resident shareholders is only taxed once, at the shareholder's marginal rate of tax.

The imputation credit received by a shareholder on a dividend is equal to:

$$\text{DIV} \times \% \text{Franked} \times \frac{\text{CR}}{(1-\text{CR})}$$

Where:

DIV is the amount of the dividend payment;

%Franked is the percentage proportion of the payment notified to the shareholder in a statement from the company in respect of which the shareholder is entitled to an imputation rebate; and

CR is the applicable general company tax rate (currently 34 per cent and falling to 30 per cent for 2001/02 and beyond).

(Ref. section 160AQT, *ITAA 1936*)

RIMHYPO allows users to model rents and dividends by setting a rate of return for regular income payments from assets and by allowing users to specify the franked proportion of such payments. RIMHYPO then calculates the amount of imputation rebates using the formula above and includes the grossed up amount in the person's assessable income. The imputation rebate is then deducted from the tax assessed on the person's taxable income.

RIMHYPO code will need to be amended to allow for refundable imputation credits from 1 July 2000.

Capital gaining assets also provide a return to the individual in the form of the appreciation in the capital value of the assets. Capital gains on the disposal of assets which were acquired after 19 September 1985 and which are held for 12 months or more are taxed under Part IIIA of the *ITAA 1936*. The Capital Gains Tax (CGT) provisions tax only the 'real' component of realised capital gain.

Assets acquired before 20 September 1985 are exempt from the CGT, as generally is a person's principal residence and up to two hectares of adjacent land. Gains on all assets disposed of within 12 months of purchase are fully assessable under section 25.

Up to 21 September 1999, the CGT broadly worked as follows:

- when an asset was acquired, the purchase price became its cost base. This cost base is then indexed by the quarterly CPI;
- when the person disposes of the asset:
 - if the sale price exceeded the nominal purchase price, a capital gain amount equal to the greater of the sale price less the indexed cost base or zero arose in the year in which the disposal occurred;
 - if the sale price is less than the nominal purchase price, an amount equal to the difference between the nominal purchase price and the sale price is allowed as a capital loss, the nominal value of which the taxpayer may offset against any capital gains in that or subsequent income years;
- where a capital gain amount arises in an income year the tax payable is subject to notional averaging. The tax payable is calculated as being five times the tax payable on one fifth of the gain, if one fifth of the gain is added to the taxpayer's assessable income in the year concerned. This calculation assumes the capital gain amount included in assessable income is the last element in the taxpayer's assessable income. The effect of this calculation is to reduce the extent to which 'lumpy' capital gains are taxed at higher marginal tax rates.

In summary, **for CGT events occurring after 21 September 1999**:

- any indexation of the cost base is frozen after 21 September 1999;
- if the asset was purchased prior to 21 September 1999, individuals can choose to either calculate their capital gain with the frozen indexed cost base or reduce any non indexed capital gain by the CGT discount of 50 per cent (for individuals);
- if the asset was purchased after 21 September 1999, and the asset was owned for 12 months or more prior to the CGT event, then the non-indexed gain can be discounted by 50 per cent (for individuals);

- if assets were not owned for at least 12 months prior to the CGT event, regardless of date of purchase, neither the discount nor indexation is allowable; and
- averaging is no longer allowed.

RIMHYPO allows users to specify a rate of capital gain on capital gaining assets acquired at retirement, calculates an indexed cost base and calculates the tax on the disposal of such assets allowing for the effect of averaging. RIMHYPO does not model trading in assets. Rather it assumes people acquire their capital gaining assets as investments on retirement and dispose of those assets as necessary in order to achieve a target level of gross income.

This tax needs to be remodelled in RIMHYPO. The approach could be to allow whichever result gives the better taxation outcome to be used.

CONCLUSION

As can be seen from this paper, the superannuation, personal taxation and social security legislation is complex. This paper is not intended to be a complete survey of all legislation relevant to these areas and therefore should not be used as a legal interpretation of the relevant legislation. For example, children are not modelled in RIMHYPO and benefits such as AUSTUDY, Family Tax Benefits, Parenting Payments and so on are not described here.

The paper notes that some modelling changes could be made to make RIMHYPO comply more closely with current legislation. However, with one or two limited exceptions, in practice most of these areas are highly technical and coding changes would have only a very minor impact on hypothetical runs likely to be undertaken within the Treasury (or other Government Departments).