



Judges' Pensions Amendment Bill 2007

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Judges' Pensions Amendment Bill 2007

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Links: The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

Purpose

This Bill amends the *Judges' Pensions Act 1968* (the Act) to ensure that the application of the recent reductions in the superannuation surcharge rate apply to the payment of a superannuation surcharge debt by retiring Federal Court judges. These judges are all members of the Commonwealth's Judges' Pensions Scheme.

Additional measures in the Bill include clarifying what is meant by the term 'salary' for the Act's purposes.

Background

What was (or is) superannuation surcharge?

The superannuation surcharge was announced on 20 August 1996 as part of the first Howard Government's budget. In his second reading speech, the then Parliamentary Secretary (Cabinet) to the Prime Minister noted that:

The superannuation system has been inequitably biased in favour of high income earners. Those high income earners have been benefiting from the concessional taxation treatment of superannuation to a much greater extent than low income earners. The introduction of the superannuation contributions surcharge for high income earners is this government's response to ensure that the superannuation

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system is more equitable for all Australians, while also ensuring that superannuation remains an attractive savings option.¹

In contrast, the Treasurer, in his second reading speech to the 2005 Bill abolishing the surcharge, noted that:

The superannuation surcharge was introduced in 1996 at a time when the budget was deeply in deficit as a result of Labor's economic mismanagement. It was introduced in 1996 in part to drive the budget back into balance. The government laid down a policy in 1996 to drive the budget back into balance from a \$10.3 billion deficit which the Labor Party had left in place.²

That is, according to him, the reason for the introduction of the superannuation surcharge was purely fiscal, and its restriction to the years 1996–97 to 2004–05 is due only to the improvement of the Commonwealth's budgetary position.

The income of a superannuation fund, including contributions made on behalf of a member, is subject to concessional tax treatment, if the fund satisfies certain conditions. The principal condition is that the fund satisfies the *Superannuation Industry (Supervision) Act 1993* and its regulations, which relate to matters such as vesting, the provision of information to members and financial management requirements. The concessional tax treatment means that a superannuation fund's income was generally taxed at the rate of 15 per cent rather than at the normal company or personal income-tax rates.

The introduction of the superannuation surcharge meant that the concessional tax treatment would be altered and that a 'surcharge' would apply to contributions that were subject to a tax deduction (this includes employer contributions as well as contributions made by members where there is no employer contribution and a deduction has been claimed).

The surcharge applied when a person's total income for surcharge purposes exceeded \$70 000 per annum.³ The surcharge was imposed at the rate of 1 per cent for each \$1 000

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1. The Hon. Chris Miles MP, Parliamentary Secretary (Cabinet) to the Prime Minister, 'Second reading speech: Superannuation Contributions Surcharge (Assessment and Collection) Bill 1997', House of Representatives, *Debates*, 13 February 1997, p. 887.
 2. The Hon. Peter Costello MP, Treasurer, 'Second reading speech: Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005', House of Representatives, *Debates*, 26 May 2005, p. 4.
 3. Total income for surcharge purposes is made up of tax-assessable income, superannuation contributions, fringe benefits (if any) and superannuation lump sums paid to individuals (if any). (Definition of income for surcharge purposes contained in sections 7A & 7B of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*.)

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of assessable income and superannuation contributions up to a maximum of 15 per cent where assessable income for surcharge purposes reached \$85 000 per annum, or above. These income thresholds have been indexed since that time and stood at \$99 710 and \$121 075 respectively at the time the surcharge was discontinued. Clearly, a Federal Court judge's salary has always been above the maximum threshold for surcharge purposes.

The surcharge is levied on:

- superannuation contributions for which a tax deduction has been claimed.⁴ Generally these are employer contributions made under the provisions of the Superannuation Guarantee regime, but also include contributions principally made mainly by self-employed workers who claim a tax deduction in respect of those contributions, and
- if the receipt of a superannuation lump sum (i.e. an eligible termination payment) increased the taxpayer's assessable income for surcharge purposes over the income thresholds—the superannuation lump sum received.

The surcharge previously applied to accumulated-benefits funds, i.e. the 'usual' type of superannuation fund where the members' ultimate benefit will depend on the investment performance of the fund, and continues to apply to defined-benefits funds, which are funds where the member's benefits are defined, usually on such matters as the number of years of contributions and final salary.⁵ The Judges' Pensions Scheme is a defined-benefit scheme.

Changes to the surcharge rate

The maximum surcharge rate was 15 per cent. The *Superannuation (Surcharge Rate Reduction) Amendment Act 2003* and the *Superannuation Budget Measures Act 2004* between them reduced the maximum surcharge rate to 14.5 per cent for 2003–04, and 12.5 per cent for 2004–05. The surcharge was discontinued on 30 June 2005.

Has the surcharge regime ended?

The legislation discontinuing the superannuation-surcharge regime did not simply repeal the entire suite of superannuation-surcharge legislation.⁶ Retaining the Act⁷ that imposes the surcharge allows:

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4. If a contribution to a superannuation fund is tax-deductible, that means that the amount contributed is not included in either the business assessable income for tax purposes, or, in the case of the self-employed, their personal assessable income for tax purposes.
 5. Chris Field, '[Superannuation Contributions Surcharge \(Assessment and Collection\) Bill 1997](#)', *Bills Digest*, no. 124, Department of the Parliamentary Library, Canberra, 1996–97.
 6. *Superannuation Laws Amendment (Abolition of Surcharge) Act 2005*.

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- the Commissioner for Taxation to collect any outstanding surcharge amounts in relation to the years 1996–97 to 2004–05 inclusive. The Australian National Audit Office has estimated that between \$360 million and \$750 million in surcharge remained uncollected in 2004–05 due to problems with the computerised surcharge administration system⁸
- surcharge amounts to be collected, in respect of the years 1996–97 to 2004–05, from defined-benefit fund members, when they eventually take their benefit, and
- superannuation providers to continue to report information necessary for the operation of the superannuation co-contributions scheme.

More importantly, maintaining the legislation maintains equity in the superannuation system. Simply abolishing superannuation surcharge from 1 July 2005 would have resulted in defined-benefit fund members, to whom the surcharge would have applied, not having to pay this tax. This outcome would be unfair, since accumulation-fund members have already paid this tax in respect of contributions made on their behalf (or if self-employed, tax-deductible contributions they made) between 1996–97 and 2004–05.

What is a superannuation-surcharge debt?

As pointed out above, any outstanding superannuation-surcharge amounts are collected from defined-benefit superannuation funds when a member collects their benefits.

Each superannuation fund is assessed annually for outstanding superannuation surcharge amounts owed by their members. Although unfunded defined-benefit schemes, such as the Judges' Pensions Scheme, receive assessments each year, they are not required to pay the surcharge at this time. Instead, they must maintain a 'surcharge debt account' for each member of the scheme. If the member's account is in debit at the end of the financial year, the provider also debits the account for interest, using the Commonwealth 10-year Treasury bond rate, on the amount the account is in debit.⁹

One of the main provisions of this Bill is the alteration of various formulas to facilitate the accurate collection of any outstanding superannuation surcharge debts owed by members of the Judges' Pensions Scheme.

7. *Superannuation Contribution Surcharge (Assessment and Collection) Act 1997.*

8. Australian National Audit Office, Performance Audit, [The Australian Taxation Office's Administration of the Superannuation Contributions Surcharge](#), Audit Report, No. 39, 2004–05, 13 April 2005, p. 17.

9. Liang P. Leow and Shirley Murphy, *Australian Master Superannuation Guide 2005/06*, CCH, Sydney, 2005, p. 518.

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How is this debt repaid?

Any unfunded scheme member affected by the superannuation surcharge may repay their debt account by:

- making a separate annual payment to the scheme in respect of the surcharge debit amount
- having their final benefits reduced to pay the outstanding amount (this will often involve the commutation of part of any pension payable to meet that member's surcharge obligations, or
- having any ongoing pension reduced to pay a portion of the outstanding surcharge amount.¹⁰

To which judges does the surcharge apply?

Both State and Federal Court judges are members of unfunded pension schemes. That is, a scheme operated by government where the pension entitlement of a retired judge is not backed by any assets. Rather, the pension paid on retirement is paid directly from a government's general revenue fund.

The High Court decided in its decision in *Austin v Commonwealth* (2003)¹¹ that both Judge Austin of the Supreme Court of New South Wales and Master Kings of the Victorian Supreme Court were not subject to the superannuation surcharge. The basis for this decision was the application of section 51(ii) of the Constitution, which enables the Commonwealth to make laws in respect of taxation, 'but so as not to discriminate between States or parts of States'.

The High Court's decision noted that the application of this section of the Constitution prevented the Commonwealth from applying the provisions of the special legislation in respect of the surcharge obligations of members of constitutionally protected superannuation funds.¹² The particular reasons were that:

- these provisions placed a disability or burden on the activities of the states. In particular, the High Court noted that the imposition of the surcharge on the operation

10. op. cit.

11. [Austin v Commonwealth](#) [2003] HCA 3; (2003) 215 CLR 185.

12. The legislation in question is the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997* and *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997*.

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of the New South Wales judicial pension scheme could prevent judges from serving their full tenure, and

- it was found that judges who were members of the Victorian state-government unfunded pension schemes before the commencement of these Acts were outside the operation of the Acts.¹³

The outcome of this case is that state judicial officers, who are members of State-government unfunded pension schemes, are not subject to the superannuation surcharge.¹⁴

Basis of policy commitment

These initiatives were partly announced in the 2007–08 budget papers.¹⁵

Position of significant interest groups/press commentary

Some concern has been expressed by the Chairman of the Judicial Conference of Australia, Justice Bruce DeBelle. He suggests that these changes will not be sufficient to prevent the retirement of several high-ranking Commonwealth judges. Justice DeBelle notes that several Commonwealth judges intend to retire as soon as they qualify to receive benefits, due to the increasing amount of superannuation surcharge they have to pay.¹⁶ Further press comment suggests that the proposed measures give an inequitable outcome (i.e. a 'raw deal') due to the eventual payment of the surcharge obligations by retiring Commonwealth judges.¹⁷

Pros and cons

The proposed measures allow Federal Court and other Commonwealth judges some flexibility in paying their superannuation-surcharge obligations upon retirement. Without these measures, a member of the Commonwealth Judges' Pensions Scheme would pay

13. Liang P. Leow and Shirley Murphy, op. cit., p. 522.

14. The writer understands that the Tasmanian judicial pension scheme is funded, that is, amounts have been put aside to pay the pension. Accordingly, the decision in *Austin* does not apply to this scheme. Source: Chris Merritt, 'It's time to stop this rot', *Australian Financial Review*, 6 February 2003, p. 6.

15. The Hon. Peter Costello MP, Treasurer, [Budget Measures 2007–08 – Budget Paper No. 2](#), 9 May 2007, p. 88.

16. Marcus Priest, 'Judges exodus threat forces super rethink', *Australian Financial Review*, 2 March 2007, p. 63.

17. Chris Merritt, 'Prejudice – Surcharge discharged', *The Australian*, 11 May 2007, p. 23.

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their superannuation-surcharge obligations by way of an ongoing reduction in their pension payments.

Further, the proposed changes allow the calculation of a retiring Commonwealth judge's surcharge obligations to take account of the reductions in the superannuation surcharge rate mentioned above. The current provisions of the *Judges' Pensions Act 1968* do not allow this to occur.

However, some may argue that the fact that some judicial officers who are members of State unfunded pension schemes are exempt from superannuation surcharge requires equitable treatment for members of the Commonwealth Judges' Pensions Scheme. Clearly, the proposed changes do not abolish the obligation for members of the Commonwealth Judges' Pensions Scheme to pay the required amount of superannuation surcharge.

ALP policy position/commitments

The ALP's Shadow Minister, Senator the Hon. Nick Sherry, noted that the provision of special assistance of \$0.5 million to the Attorney-General's Department for surcharge debt repayment required investigation at Senate estimates committee hearings.¹⁸ The proposed allocation was subsequently discussed at the Senate Estimates Hearing of the Senate Committee on Finance and Public Administration on 23 May 2007. No views were expressed at that hearing, or a subsequent hearing of the Senate Standing Committee on Economics.¹⁹

Financial implications

The Explanatory Memorandum notes that where a retiring federal judge elects to have their pension reduced under the commutation, rather than under the formula for calculating the ongoing reduction in the pension, the pension cost would be marginally greater. However, the expected total additional costs of including this option in the Judges' Pensions Scheme has been estimated to be less than \$1 million.²⁰

18. Senator the Hon. Nick Sherry, Shadow Minister for Superannuation and Intergenerational Finance; Banking and Financial Services, *Superannuation Measures Welcome*, media release, 10 May 2007.

19. Senate Committee on Finance and Public Administration, Senate Estimates Hearings, [Committee Hansard](#), 23 May 2007, pp. F&PA 88–9 and Senate Standing Committee on Economics, Senate Estimates Hearings, [Committee Hansard](#), 29 May 2007, p. E46.

20. *Explanatory Memorandum*, p. 2.

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As already mentioned, the Budget allocated an additional \$0.5 million to the Attorney-General's Department to pay the estimated surcharge liability incurred by retiring members of the Judges' Pensions Scheme.

Standing Appropriations

Item 14 of the Act appropriates the Consolidated Revenue Fund, to pay any outstanding superannuation-surcharge debts on the occasion of a judge's death in office or retirement.

Key issues

The key issue in this bill is the equitable application of the superannuation-surcharge regime to Commonwealth judges of both the Federal and High Courts. Without the provisions of this Act, a higher rate of superannuation-surcharge debt would be imposed on these judges than has been imposed on other high-income earners.

Main provisions

Item 1 of **Schedule 1** inserts a definition of the term 'salary' into **subsection 4(1)** of the Act. This definition is not present in the current version of the Act.

A judge's salary for the purposes of the Act is defined as the rate determined by the Remuneration Tribunal, excluding any allowances paid in lieu of any other entitlement. But salary, for these purposes, includes the value of benefits received under any salary-packaging arrangements entered into by a particular judge.

Most, if not all, of the rules governing the operation of government superannuation schemes include provisions that define what is meant by the term 'salary' for the purposes of calculating a member's entitlements. It is surprising that such a definition has not yet been inserted into the Act. This change is long overdue.

Items 2 to **7** of **Schedule 1** replace the existing formulas and supporting definitions of terms in these formulas in the Act that calculate the rate of a retiring judge's pension, when their surcharge debt account is in debt. The new sections allow the calculation of a retiring judge's pension to take account of the above-mentioned reductions in the rate of superannuation surcharge and its discontinuance from 1 July 2005.

Item 8 inserts new **section 6C** into the Act. This new section allows a retiring judge to commute part of their pension entitlement to pay any outstanding surcharge debt. Commutation is the conversion of a pension entitlement to a lump sum. This procedure is an alternative to the ongoing reduction of a judge's pension in order to pay a retiring judge's outstanding superannuation-surcharge debt in **Items 2** to **7** above.

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Items 9 and 10 allows the surviving spouse of a judge who dies in office to have part of their pension commuted in order to pay any outstanding superannuation surcharge debt, rather than have the rate of the pension worked out under the provisions of **Items 2 to 7** above.

Items 11 and 12 deal with the calculation of a pension paid to the surviving dependent children of a deceased judge in circumstances where a superannuation-surcharge debt remains unpaid. These provisions allow the rate of pension to be paid in these circumstances to take account of the commutation of part of the pension entitlements to pay any outstanding surcharge debt. Again, this is an alternative to the calculation of a pension under the provisions of **Items 2 to 7** above.

Item 14 appropriates the Consolidated Revenue Fund to pay any superannuation-surcharge debt outstanding on the occasion of a judge's retirement or death in office.

This item does not mean that a judge has their superannuation-surcharge debt paid for them.

Conclusion

A particular quirk of the Commonwealth constitution has allowed certain State judicial officers to escape the imposition of the superannuation surcharge. However, these provisions applied to all other high-income earners who had surchargable superannuation contributions made on their behalf. Thus, Commonwealth judges are being treated no differently in this matter to the great bulk of those on comparable incomes.

Those who would argue that Commonwealth judges should not be subject to this impost because their State counterparts are not subject to it would be better served arguing why State judicial officers should be exempt when all their judicial and non-judicial peers are subject to this impost.

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