

EXPLANATORY STATEMENT

Issued by the authority of the Minister for Finance and Administration

Parliamentary Contributory Superannuation Act 1948

Orders under subsection 22CK

The *Parliamentary Contributory Superannuation Act 1948* (the Act) makes provision for a contributory superannuation scheme for persons who became Members of the Parliament of Australia before 9 October 2004, known as the Parliamentary Contributory Superannuation Scheme (PCSS).

Part VAA of the Act makes specific provision for the splitting of a superannuation interest under the Act when the Secretary of the Department of Finance and Administration (the Finance Secretary) is served with an agreement or order in relation to that interest as a result of actions taken under the *Family Law Act 1975* (the Family Law Act). Part VAA allows for a separate interest in the PCSS for the former spouse of a PCSS member who has been allocated a part of the member's interest in the PCSS under such an agreement or order.

Subsection 22CK of the Act provides that the Minister may make Orders prescribing matters required or permitted to be prescribed by Part VAA. The **Superannuation (Family Law – Parliamentary Contributory Superannuation Act 1948) Orders 2004** (the Principal Orders) prescribe the matters required or permitted by Part VAA of the Act to be prescribed.

Section 22CA of the Act defines a number of terms used in Part VAA, including the term **scheme value**. The definition of **scheme value** refers to the amount determined under the Orders. The Principal Orders provide methods and/or factors that are to be used to calculate the relevant amounts in relation to this definition.

Scheme value is one of the items taken into account in the calculation of the separate interest for a former spouse and the reduction of the member's benefits as a result of the splitting of the interest.

The principal purpose of the **Superannuation (Family Law – Parliamentary Contributory Superannuation Act 1948) Amendment Orders 2005 (No. 1)** (the amending Orders) is to amend the Principal Orders to take into account the existence of a surcharge debt in respect of a PCSS member when calculating the scheme value in respect of the member's interest in the scheme.

The *Superannuation Contributions Tax (Assessment and Collection) Act 1997* provides for a superannuation surcharge regime in relation to the employer superannuation contributions for high-income earners. In the PCSS the superannuation surcharge is usually accumulated in the member's surcharge debt account until the member's benefit is paid. It is then paid to the Australian Taxation Office and the member's benefits are reduced to have regard to that payment.

An order or agreement to split a superannuation interest considers the interest net of surcharge and therefore does not allocate the surcharge debt between the parties. The Principal Orders do not adequately take this into account with the effect that, in respect of the interest for a PCSS member with a debit in their surcharge debt account the separate interest transferred to the former spouse may be greater than it should be and the consequent reduction of the member's interest may be greater than it should

be. Further details of the operation of the surcharge regime and the effect of the Principal Orders are included in **Attachment A**.

The amending Orders amend the Principal Orders to ensure that the process of creating the separate interest for a former spouse and subsequent reduction of the member's interest works equitably from the date of effect of these Orders when the member is a contributing member with a debit in his or her surcharge debt account.

The amending Orders also ensure that where a case has already been dealt with prior to the making of these Orders, there will be no impact on any separate interest set up for the former spouse but there will be a recalculation of the reduction of the member's interest to ensure that reduction is not higher than intended.

The details of the Orders are explained in **Attachment B**.

The amending Orders have been prepared in consultation with an actuary and the Office of Legislative Drafting and Publishing.

The instrument is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The amending Orders will commence on the day after they are registered on the Federal Register of Legislative Instruments.

ATTACHMENT A

THE SURCHARGE DEBT ACCOUNT AND INTEREST SPLITTING

As a result of the surcharge regime the Act provides for the reduction of benefits available to certain PCSS members who have a debit in their surcharge debt account on cessation of membership.

That regime, in relation to unfunded defined benefit schemes like the PCSS, requires the Australian Taxation Office (the ATO) to advise the Scheme of surcharge assessments in relation to members. Those assessments are accumulated in a surcharge debt account for the affected member, who may make payments to reduce or eliminate that account at any time, until benefits become payable. At that point the amount in the surcharge debt account is paid to the ATO and the member's benefit is reduced accordingly.

When a separate interest is created under the Act for the former spouse of a member, as a result of a superannuation split in a property settlement, that interest is based on a transfer amount. The term **transfer amount** is defined in section 22CA of the Act. The amount arises from the splitting agreement or order which may require the transfer of a percentage of the member's interest or a specified (base) amount or a method of calculating such an amount. The definition requires that, where the order or agreement specifies a percentage, that percentage must be applied to the greater of the family law value or the scheme value. Where the order or agreement specifies, or provides a method of calculating, a base amount then the member interest must be valued. In such cases if the family law value is greater than the scheme value the transfer amount is the base amount. Alternatively if the scheme value is greater than the family law value then the transfer amount is calculated by applying to the scheme value the proportion that the base amount is to the family law value.

The term **family law value** is defined in section 22CA of the Act to be the amount that is the value of a superannuation interest as determined under the *Family Law Act 1975* and regulations under that Act (FLA). The FLA values an interest in the PCSS as net of any amount in the member's surcharge debt account, that is, FLA value is net of surcharge. That debt is therefore not split between the member and their former spouse.

The term **scheme value** is defined in section 22CA of the Act to be the amount determined under the Orders. The methods and factors provided by the Principal Orders to calculate the scheme value do not contain any reference to the member's surcharge debt account and therefore provide a value that includes the amount in the surcharge debt account, that is, scheme value is gross of surcharge.

The member's interest is reduced by the application of a transfer factor to the interest. The term **transfer factor** is defined in section 22CA of the Act to be the number calculated by dividing the transfer amount by the scheme value.

Actuarial advice received by the Department of Finance and Administration is that to achieve equity between the member and the former spouse where the member has a surcharge debt, it is necessary to use the scheme value net of surcharge to calculate the transfer amount and the scheme value gross of surcharge to calculate the transfer factor. The Principal Orders do not provide for the use of net and gross scheme values in this way.

The operation of the Principal Orders can be demonstrated through considering the following case:

A member has an interest in the PCSS that has a value of \$110,000 and has a surcharge debt of \$10,000. This interest has an FLA value of \$100,000 being the net value.

All things being equal the Principal Orders would provide that the scheme value of that interest, being a gross value, is \$110,000 which is higher than the FLA value.

An agreement or court order specifies that a base amount of \$100,000, being 100% of the FLA value, should be transferred to the former spouse.

Under the definition of transfer amount, used in the calculation of the former spouse's separate interest, the amount transferred to the former spouse would be recalculated as 100% of the scheme value giving the former spouse an interest of \$110,000.

The transfer factor used to reduce the member's benefits would be 100% which would reduce the member's benefit to zero. As a result of the split of the interest there would be no money left in the member's account to pay the surcharge debt of \$10,000.

In respect of the case above, if the operative time of the agreement or order is after the commencement of the amending Orders the amended provisions will operate as follows:

The FLA value of the member's interest would remain at \$100,000 (ie, net of the member's surcharge debt of \$10,000)

The scheme value used to calculate the transfer amount would be net of the surcharge debt, that is \$100,000, the same value as the FLA value. The amount transferred to the former spouse would be 100% of that value or \$100,000.

The scheme value used to calculate the transfer factor for the purposes of reducing the member's interest would be the gross amount giving a transfer factor of 90% reducing the interest by \$100,000, making the member's benefit immediately after the interest split \$10,000. If the member's benefit was to become payable to the member at that time it would be sufficient to pay the surcharge debt attached to the interest that has been split between the member and the member's former spouse.

In cases where the operative time is before the commencement of the amending Orders the provisions inserted by the amending Orders will operate to ensure that no amounts transferred to a former spouse will be subject to retrospective reduction. However where the member's interest has been overly reduced, the provisions will allow for a recalculation.

**SUPERANNUATION (FAMILY LAW – PARLIAMENTARY
CONTRIBUTORY SUPERANNUATION ACT 1948)
AMENDMENT ORDERS 2005 (NO. 1)**

Section 1 – Name of Orders

This section provides that the name of the instrument is the **Superannuation (Family Law – Parliamentary Contributory Superannuation Act 1948) Amendment Orders 2005 (No. 1)** (the Orders).

Section 2 - Commencement

This section provides that the Orders commence on the day after they are registered on the Federal Register of Legislative Instruments.

Section 3 – Amendment of *Superannuation (Family Law – Parliamentary Contributory Superannuation Act 1948) Orders 2004*

This section provides that Schedule 1 amends the Principal Orders, that is, the Superannuation (Family Law – Parliamentary Contributory Superannuation Act 1948) Orders 2004.

SCHEDULE 1 – AMENDMENTS

Item 1 – Definition

Item 1 inserts a definition of **family law commencement day** into subsection 1.03(1). That day is 18 May 2004 being the day on which the *Superannuation Legislation Amendment (Family Law and Other Matters) Act 2004* took effect. That Act amended the *Parliamentary Contributory Superannuation Act 1948* (the Act) to provide for the creation of a separate interest for a former spouse of a PCSS member and the subsequent reduction of a member's interest where a splitting order or agreement is served on the Finance Secretary.

Item 2 – Scheme value

Part VAA of the Act provides for two separate valuations of a member's interest in the PCSS for the purposes of determining the transfer amount. (The transfer amount is a relevant matter in the calculation of the separate interest for the former spouse and the related reduction of the member's interest.) The first of these is the family law value which is the amount determined under the FLA. The other valuation is the scheme value that is defined to mean the amount determined under the Orders. The transfer amount will be based on whichever is the greater of these two valuations.

The FLA provides default methods and factors for determining the value of a defined benefit interest such as is available to members of the PCSS. However, on 12 May 2004, the Secretary of the Attorney-General's Department approved specific methods

and factors to determine the value of an interest that a person has in the PCSS for the purposes of the FLA.

Both the default and the scheme specific methods and factors ensure, where there is a debit in the member's surcharge debt account at the time of valuation, that the family law value of a member's interest is net of the amount of the debit. This is necessary to ensure that the member is left with sufficient interest in the PCSS to allow for a reduction in respect of surcharge when a benefit becomes payable. Otherwise it would be possible for the member to be left with insufficient funds in the PCSS to reimburse the payment of the surcharge if, for example, the splitting order or agreement required the transfer of 100% of the interest to the former spouse.

Prior to the amendments section 2.01 provided for the calculation of the scheme value in a number of circumstances. Paragraph 2.01(a) provided that if the operative time of an agreement or order served on the Finance Secretary is before the commencement of Part VAA of the Act, the scheme value is the family law value.

Subparagraph 2.01(b)(i) provided that, if the operative time is on or after the commencement of Part VAA of the Act, the scheme value is to be determined by using the methods and factors set out in Schedule 1 to the Principal Orders. The methods are the same as those used to obtain the family law value under the specific process approved by the Secretary of the Attorney-General's Department on 12 May 2004 however they do not provide for the reduction of the amount where there is a debit in the member's surcharge debt account. The factors provided in Schedule 1 to the Principal Orders reflect the different actuarial assumptions that apply to the PCSS. (In this respect they differ from any factors determined under the FLA which are based on general assumptions.)

Subparagraph 2.01(b)(ii) provided that, in the case where the operative time is on or after the commencement of Part VAA of the Act, the scheme value is to be determined by an actuary if it is not able to be determined under subparagraph 2.01(b)(i).

Item 2 substitutes section 2.01 with new sections 2.01 and 2.01A. New section 2.01 applies for the calculations of the scheme value where the member does not have a debit in his or her surcharge debt account and essentially replicates the effects of section 2.01 as previously drafted.

New subsection 2.01A(1) applies where the member does have a debit in his or her surcharge debt account. New subsection 2.01A(2) is similar in effect to subsection 2.01(2) but is subject to the following subsections.

New subsection 2.01A(3) provides that, for cases that occur after the commencement of these Orders, where scheme value is to be used to calculate the transfer amount it should be reduced by the amount in the surcharge debt account. This ensures that the amount transferred to the former spouse does not include the amount by which the member's benefit will be reduced as a result of the surcharge debt.

New subsection 2.01A(4) provides that, for cases that occur after the commencement of these Orders, where scheme value is to be used to calculate the transfer factor it should not be reduced by the amount in the surcharge debt account. This ensures that the member's benefit will not be over reduced.

New subsection 2.01A(5) applies to cases that were finalised before the family law commencement day and provides for the recalculation of the transfer factor to ensure

that the reduction of the member benefit reflects the provisions in new subsection 2.01(4). Although there will be no recalculation of the amount transferred to the former spouse, the member's reduction will be less than previously calculated.

New subsection 2.01A(6) applies to cases that were finalised after the family law commencement day but before the commencement of these Orders. This provision will also recalculate the transfer factor for the member to ensure that the reduction of their benefit will be less than previously calculated. There will also be no impact on the amount transferred to the former spouse.