PS Superannuants
The Association of Public Sector Superannuants Inc.
Formerly SA Superannuants
Established 1927

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2022-23 Pre-budget submission to the Australian Government

From: *The Association of Public Sector Superannuants Inc.* representing the interests of its members who receive defined benefit pensions having all, or at least the employer-funded component, paid from an **untaxed source**. This is a term not well understood and it can create the false impression that people receiving these pensions have enjoyed more favorable tax treatment than other Australians. **The opposite is true.** When all factors affecting net incomes for retirees are taken into account untaxed-source defined benefit pensions deliver smaller net incomes than would be the case if the same amount of personal and employer contributions needed to fund the pensions had been paid into a taxed fund. This is explained in more detail below.

Untaxed-source pensions are currently being paid to at least 230,000 civilian and defence force retirees distributed across the electorates of all Australian states and territories. Many of these pension recipients have partners so that the total number of retirees dependent on the pensions would be substantially more than 230,000.

Summary

This submission contains the following six proposals for changes to existing retirement income arrangements, along with supporting argument.

1. People of age pension age and above be permitted to make **non-concessional** contributions to superannuation without having to satisfy the work test.
2. Age pension income to be tax-free for all recipients.
3. In the determination of a person's transfer balance value the single valuation factor of 16 currently being applied to defined benefit pensions, without regard to the pension recipient's age, be changed to an actuarially determined, age-related factor.
4. The indexation of Commonwealth superannuation pensions (CSS and PSS), which is currently Consumer Price Index (CPI) only, become the better of the CPI and the Pensioner and Beneficiary Living Cost Index (PBLCI).
5. Where after-tax, personal contributions by themselves are sufficient to create a tax-free component for a defined benefit pension greater than 10% of the pension's gross value the 10% cap on the component of the pension not counted in the age pension income test should not apply.
6. The taxable income limits on Commonwealth Seniors Health Card (CSHC) eligibility to be substantially increased, or removed.

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Introduction

The Association of Public Sector Superannuants Inc. (PS Superannuants) was previously the *South Australian Government Superannuated Employees Association* which traded as SA Superannuants. Until 2019 its membership consisted entirely of people relying on retirement income derived from membership of the South Australian Superannuation Scheme which is established under South Australia's *Superannuation Act 1988.* Following the winding up of the *Superannuated Commonwealth Officers Association* (SCOA) in June 2019 SA Superannuants opened up its membership to Commonwealth superannuants. This has seen many members of the Commonwealth's CSS and PSS schemes join the Association. The change in name of the Association was made to reflect this change in the composition of its membership and leadership.

There has always been common ground between the retirement interests of people receiving the South Australian pension and those receiving Commonwealth pensions such as the CSS pension. This is due to the fact that both pensions are untaxed-source pensions which means that no tax has been paid by the source delivering the pension prior to its commencement. As a consequence of this, the pensions, on commencement, are taxed, and assessed for the Medicare levy, as normal income when the recipient is less than 60 years old. After this age they continue as taxable income on which a 10% tax offset can be claimed. At least 90% of the pension income is counted in the age pension income test. Where there is additional, taxable income (including age pension) it is added to the superannuation pension income and taxed at the marginal rate for the combined income. The Medicare levy is also paid on the additional income. CSS, PSS and Super SA pensions also have in common the fact that members have paid personal contributions from their after-tax income. This means that during their working lives members have paid an effective contributions tax of over 30%. This is at least twice the maximum superannuation tax rate of 15%.

The norm for Australian Superannuation pensions is for them to be paid entirely from a taxed source which means that the source has, since 1 July 1988, paid a 15% contribution tax and up to 15% tax on earnings. Prior to age 60, pensions from a taxed source attract a 15% tax offset and after age 60 they are tax-free and exempt from the Medicare levy. Any additional, taxable income is taxed, and assessed for the Medicare levy, as if it is the only income. So, a retiree, by using both the tax-free threshold of $18,200 and tax offsets, is able to have an additional taxable income (including age pension) well in excess of $18,200 p.a. on which he/she pays no tax or Medicare levy.

PS Superannuants acknowledges that untaxed-source, defined benefit pensions have larger gross values than would be the case if they were paid from a taxed source. The reason for this is that the latter pensions have been reduced in their gross values by the tax collected prior to pension commencement. **However, due to the other differences between untaxed-source and taxed-source pensions described above it is the smaller, taxed-source pensions that deliver higher net incomes.**

Our organization represents a group of people most of whom have secure retirement incomes within the ranges thought sufficient by the *Association of Superannuation Funds of Australia* to afford 67-year-olds a modest through to a comfortable retirement: $28,775 - $45,239 p.a. for singles; $41,466 - $63,799 for couples. None of the proposals set out below involve large improvements in net incomes for any of the people we represent and none will have a large impact on the Federal budget.

The proposals are put forward as modest changes that improve the equity and integrity of the retirement income system as well as improve the net incomes of retirees relying substantially on untaxed-source superannuation income.

Proposals for change with supporting argument

1. Access to the superannuation system for people of age pension age and above.

PS Superannuants requests that all people of age pension age and above be permitted to make **non-concessional** contributions to superannuation without having to satisfy the work test.

This will involve no cost to government and would be of benefit not just to people with untaxed-source superannuation but all elderly Australians. PS Superannuants proposes that the following tax arrangements would apply to the contributions and the earnings:

- No tax deduction would be allowed for the contributions and no contributions tax would be payable on them.
- The contributions and earnings would have to be held in an accumulation account with annual earnings subject to tax.

To maintain the integrity of the superannuation system these contributions should be subject to annual limits.

This set of arrangements is aimed at assisting people of modest means to get a better return on their savings. The Association believes that the arrangements can only be a winner for the government. The individuals who choose to make use of the arrangements will have to take into account the greater short-term risk that is associated with saving through the superannuation system as compared to bank accounts. The incentive for them to do so is the larger return that superannuation funds are certain to provide over the medium to long term.

It has been put to us that people wanting a larger return on their savings can purchase shares and/or invest in managed funds. Our response to this is that many older people have had little experience in making share purchases, or with managed funds, and see these methods of saving as unfamiliar and risky. Superannuation funds, by comparison, are familiar savings vehicles which would be much preferred.

Indeed, if investing in shares or managed funds was a viable option for most retirees it would not have been necessary for the Government to allow the proceeds of house downsizing (up to $300,000 each for a couple) to be placed in the superannuation system. We were pleased to see this option provided but it is hard to understand why our much more modest proposal stated above has not been implemented. The proportion of retirees who are in a position to benefit from our proposal is much greater than the proportion who can make use of the house down-sizing provision.

Furthermore, the calculations set out below demonstrate how superannuation accounts could work to the advantage of fully retired people not in a position to use the house down-sizing provision and with little risk of reducing taxation revenue or increasing Centrelink outlays. A bank account interest rate of 2% is compared with a before-tax, and after expenses, return of 6% from a superannuation account.

Example 1: the fully retired person is currently not paying any tax and has $20,000 in a bank account earning 2% p.a. This delivers $400 interest to the person and no tax to the government. If the $20,000 is transferred to the superannuation system it is likely to deliver a 6% return before tax. So the person's superannuation account balance will increase by $1,200 before tax.
The superannuation fund will pay as much as $180 of this in tax to the government and the person's account balance will increase by at least $1,020 i.e. by at least $620 more than the increase that would have occurred had the money stayed in the bank account.

Result: the government has gained up to $180 in tax revenue and the person has gained at least $620.

Example 2: the fully retired person is currently paying tax at the rate of 19% and has $20,000 in a bank account earning 2% p.a. and the reasoning of example 1 is repeated.
Result: the government gains up to $104 ($180-$76) in tax revenue and the person gains at least $696.

Example 3: the fully retired person is currently paying tax at the rate of 32.5%, plus the Medicare levy of 2%, and has $20,000 in a bank account earning 2% p.a.
Result: the government has gained up to $42 ($180-$138) in tax revenue and the person has gained at least $758.

Impact on age pension outlays: where this strategy produces superannuation account balances larger than the original bank account balances, and the person is getting an age pension payment, that age pension payment is going to be reduced. The account balance increases will increase the deemed income used in the age pension income test and increase the value of assets used in the age pension asset test. This is another factor that can only work in the Government's favour.

2. Age pension income to be tax free

> PS Superannuants requests that age pension income be tax-free for all recipients.

Age pension is already tax-free for the overwhelming majority of recipients. The 2007 'Simpler Super' reforms had the effect of making any taxable income, being received in addition to the tax-free superannuation income, taxed as if was the only income. If there was additional income then, no matter how large the tax-free superannuation pension income was, tax and Medicare levy did not become payable on that additional income until it was well in excess of $18,200 p.a. In 2017 a limit was set on the amount of tax-free superannuation that could be received before tax would be payable on any additional income. This limit was $100,000 and half of any amount in addition to $100,000 was counted as taxable income. People with taxed-source pensions less than $100,000 p.a. continue to have their taxable income taxed as if it is their only income.

Recipients of untaxed-source pensions, after 2007, continued to receive superannuation income that was taxable (with a 10% tax offset) and all additional taxable income (including age pension) was added to the superannuation income and taxed at the marginal rate for the combined income. This still applies to all untaxed-source defined benefit pensions.

PS Superannuants is confident that members of untaxed-source defined benefit schemes are the vast majority of Australians who pay tax on age pension income. Nearly all other Australians who receive age pension income pay no tax on that income.

An alternative to this request, that would also be welcomed by PS Superannuants, is for all non-superannuation income to be taxed separately from a person's superannuation income. This would see people in receipt of untaxed-source superannuation pensions being treated, for taxation purposes, in the same way as people receiving taxed-source pensions.

3. Valuation of defined benefit pensions for transfer balance cap purposes

> PS Superannuants requests that the single factor of 16 currently being applied to defined benefit pensions, without regard to the pension recipient's age, be changed to an actuarially determined, age-related factor.

Account-based superannuation pensions have a transfer balance cap (TBC) amount that was set initially at $1.6 million without regard for the account holder's age. It was reasonable to set the amount at the same value as the account balance because:

a) the pension recipient could realise that amount by cashing in the pension, and
b) $1.6 million dollars would fund payment of a CPI indexed pension of $100,000 p.a. for the life expectancy of a 65 year old.

Where an account balance exceeded the $1.6 million cap the difference had to be withdrawn from the superannuation system or transferred to an accumulation account where earnings will be subject to tax.

Once a transfer balance cap amount had been assigned to account-based pensions PS Superannuants agrees that fairness required defined benefit pensions to be assigned a corresponding value. But it is not fair to assign the value for defined benefit pensions without taking account of a person's age because, unlike an account-based pension, a defined benefit pension cannot be cashed in except in strictly prescribed circumstances during a short period after the pension commences. To assign a fair value to a defined benefit pension the recipient's age must be taken into account.

In previous representations made in support of our Association's request for this change to be made we were advised by the former Assistant Treasurer, Hon Stuart Robert MP, that 'Using different age-based factors to value DBPs could deliver perverse results - older retirees would have more space under the transfer balance cap than their younger counterparts. This is not the intention of the TBC.'

To decide what the intention of the TBC is we have referred to the Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016. Extracts from this legislation are shown in the box below

294-1 What this Division is about There is a cap on the total amount you can transfer into the retirement phase of superannuation (where earnings are exempt from taxation). 294-5 Object of this Division The object of this Division is to limit the total amount of an individual's superannuation income streams that receive an earnings tax exemption.

We can see no object here, or anywhere else in the legislation, that requires, or justifies, applying a valuation factor to defined benefit superannuation pensions for the purpose of preventing older retirees having more space under the transfer balance cap than their younger counterparts. Indeed, use of the single amount of $1.6 million to set the transfer balance cap amount for account-based pensions had the predictable effect of ensuring that an older person with $1.6 million backing an account-based pension could receive a larger account-based income stream, that is entirely exempt from earnings tax, than a younger person.

Or the older person could take the same value pension as the younger person and have an amount left over in the account that would not be needed to fund the pension but would still be exempt from earnings tax. Consider these examples:

Example 1: a person aged 75 receiving a CPI indexed pension of $100,000 p.a. This person has a life expectancy of about 10 years and the value of the lump sum sufficient to pay the pension for this period is about $800,000.

For a person aged 80 years with a life expectancy of about 5 years the corresponding lump sum is about $500,000. A fair conversion factor for the pension of the 75 year old is not 16, but about 8 and for the eighty year old, about 5.

Example 2: two people each have a transfer balance account amount of $1.6 million being used to deliver a $100,000 p.a. (indexed) account-based pension. One of these people is aged 65 and the other 80,

Using the assumptions of Mr Robert's letter, for the person aged 65, the entire $1.6 million will be needed to pay the pension for life. This person has in their account the amount of money needed to deliver their pension and the earnings of this money is entirely exempt from tax. If they have additional superannuation it will be subject to tax on earnings.

For the person aged 80 the $1.6 million will far exceed the amount needed to fund a lifetime indexed pension of $100,000. Let us suppose the amount needed to fund the pension for life is $1 million. This older person has $600,000 in their pension account which is escaping tax on earnings after the account has funded a pension of the same amount being received by the 65 year old. This older person also has the option of receiving a pension well above $100,000 p.a. without earnings tax being collected on the assets backing the pension.

As well as seeking fair treatment for the very small fraction (less than 1%) of members of the South Australian State Pension Scheme and the Commonwealth's CSS and PSS schemes, who have pensions above $100,000 p.a., PS Superannuants has a concern that acceptance of the 16-covers-all-ages pension valuation factor might see it used in other circumstances affecting many more of its members.

A recent development on the Australian retirement income scene is the "Comprehensive Income Product for Retirement" (CIPR). An early example of a CIPR is a product offered by QSuper. The features of this product highlight the unfairness of using 16 as the valuation factor for a defined benefit pension regardless of the recipient's age. Thus, for a couple aged 70 years $300,000 will purchase a QSuper lifetime, indexed income stream of $20,053 p.a. with no reduction in the pension occurring when one member of the couple dies and, if both die before they have received $300,000 in pension payments, the difference is payable to an estate.

The defined benefit pensions of our members see a surviving spouse receiving only two thirds of the original pension and if both partners die well before life expectancy the pensions have no estate value.

A calculator on the QSuper website provides the following figures showing that the purchase price of $300,000 varies as a multiple of the annual pension value from 17.5 at age 60 to 11.2 at age 80. And yet we have a law which assigns a value to defined benefit pensions of 16 times the annual value **no matter the person's age.**

Age (years)	60	65	70	75	80
Annual Pension ($ p.a.)	17,120	18,321	20,053	22,652	26,759
Purchase price as a multiple of annual pension	17.5	16.4	15.0	13.2	11.2

4. Improved indexation for Commonwealth pensions

> PS Superannuants requests that the indexation of Commonwealth superannuation pensions (CSS and PSS), which is currently Consumer Price Index (CPI) only, become the better of the CPI and the Pensioner and Beneficiary Living Cost Index (PBLCI).

PS Superannuants has always been a supporter of Commonwealth pensions being indexed on the same basis as the age pension. This has been repeatedly rejected by both Coalition and Labor governments. The change being proposed by PS Superannuants this year can be viewed as a step in the right direction.

The only argument against age pension indexation that we give any credence to is the one which says that the age pension is a safety net payment as well as an income support payment and a separate pillar of Australia's retirement income system. We are suggesting the better of CPI and PBLCI as a way of proceeding that maintains the distinction between the superannuation and age pension pillars.

It might also be argued that increasing the indexation rate for CSS and PSS pensions amounts to the Commonwealth government supplementing superannuation for its former employees years, and decades, after employment has ceased. This is something for which there is no precedent in the private sector. This would be a valid argument against any improvement to indexation if the Commonwealth had fully funded its pensions and paid them from the taxed-source environment. The rapid accumulation of assets in the Future Fund is clear evidence that it has always been capable of doing this and has made a considered decision against doing so. The Association considers that this puts the Commonwealth under a unique obligation to seriously consider adjusting the CSS and PSS indexation rates upwards.

On the cost of going to the better of CPI and PBLCI it should be remembered that:

a) the CSS closed to new members in 1990 and the PSS in 2005.
b) a majority of the people receiving the improved indexation will be age pension recipients and so 50% of the cost of improved indexation for those people will be recovered in the form of reduced age pension payments. Many people receiving age pension and having an untaxed-source pension will currently be paying tax on the age pension income and so will return more than 70% of an indexation increase to the Commonwealth Government. Most of those who are not receiving an age pension payment will pay more than 30% of the improved indexation in tax and Medicare levy.

5. Relaxation of the 10% cap on the proportion of a defined benefit pension not counted in the Centrelink income test.

> PS Superannuants requests that where after-tax, personal contributions by themselves are sufficient to create a tax-free component greater than 10% of the pension's gross value the 10% cap should not apply

From the 'Simpler Super' superannuation reforms of 2007 until 1 January 2016 the tax-free component of taxed-source defined benefit pensions was calculated taking account of both the amount of contributions a pension recipient had paid from after-tax income and the proportion of service completed before 1 July 1983. This component of the pension was not only tax-free income after age 60, it also was not counted in the Centrelink age pension income test.

The inclusion of pre-July 1983 service in the determination of the tax-free component saw some pensions acquire high tax free components (up to 50% of the gross pension value). Effective from 1 January 2016 the Federal Government introduced a 10% cap on the amount of tax-free component that is not counted in the income test. Since then at least 90% of every defined benefit pension (taxed-source and untaxed source) must be counted in the income test.

There is a small fraction of defined benefit pension recipients whose personal after-tax contributions are sufficient to produce a tax-free component of more than 10%. The Commonwealth's PSS scheme pensions and its CSS non-indexed pension, stand out from other defined benefit pensions as far as having pension recipients in this category is concerned. The small number of people involved ensures that the cost will have little impact on the budget.

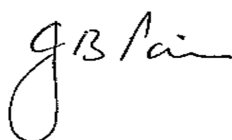
This is another matter where it is revealing to compare treatment of defined benefit pensions with that of Comprehensive Income Products for Retirement (CIPRs). The QSuper pension referred to earlier has only 60% of its purchase price counted in the age pension asset test up to the purchaser's life expectancy and only 30% after life expectancy. The same percentages apply to the CIPR income for income test purposes. By allowing this the Federal government's **additional** age pension costs are a substantial portion of the income provided by the CIPR. Many CIPRs would have been purchased entirely with concessionally taxed money and the law is allowing for only 60% of this tax-free income to be counted in the age pension income test and 60% in the asset test. And yet we have another law that says where a defined benefit pension recipient has paid after-tax contributions sufficient to fund more than 10% of the pension he/she can only claim 10% as income that is exempt from the income test.

6. The taxable income limits on Commonwealth Seniors Health Card (CSHC) eligibility to be substantially increased or removed.

PS Superannuants requests that the income limits on eligibility for the Commonwealth Seniors Health Card be removed or substantially increased from the current levels of $92,416 p.a. for couples and $57,761 p.a. for singles.

The reason behind this request is that there is no asset test for the CSHC and income is determined by deeming of financial assets. A couple would have to have assets of about $4.2 million before losing eligibility for the CHSC and a single person more than $2.6 million. With a 5% p.a. earning rate on these assets a couple would likely have income of more than $200,000 p.a. and a single person more than $120,000 p.a. A couple with a $92,416 p.a. untaxed-source super pension and a single person with a $57,761 p.a. pension are not eligible.

Submitted on behalf of the Association.



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