FOI 3548
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From: John Pauley s 47F [redacted]
Sent: Tuesday, 14 March 2023 10:05 AM
To: Chalmers, Jim (MP) <Jim.Chalmers.MP@aph.gov.au>
Cc: s 47F [redacted]
Subject: Taxation of Defined Benefit Pensions

14 March 2023

Dr Jim Chalmers
Treasurer
Parliament House
Canberra 2601
ACT

Dear Dr Chalmers,

The Australian Council of Public Sector Retiree Organisations (ACPSRO) has been examining the wider implications of Australia's superannuation arrangements for many years. We congratulate you for bringing the issue of the underlying and emerging cost of those arrangements to public attention. This is something we have highlighted in our position paper which we provided to you prior to the last election. We have attached a copy of that paper for your information.

We are, however, dismayed that as part of your investigations into superannuation you are considering "consulting on the taxation of defined benefit pensions" and that you may not fully appreciate the position of, or the complexity of, defined benefit pension recipients.

We are also unsure as to what you mean when you mention the taxation of defined benefit pensions. Some defined benefit pensions are subject to tax, others which are fully funded are not, and there are also schemes which fall in between these. So while there has been much written in the media in relation to the underlying value of defined benefit pensions and seeking that the proposed $3 million cap for the 15% concessional tax rate also be applied to such pensions, developing arrangements which do not create unintended consequences will be extremely difficult.

Unlike retirees who have an account based pension, and also those who have significant sums remaining in their accumulation account, defined benefit pensioners have no ability to adjust their situation as taxation laws are changed. It has been our experience that changes can often harshly impact on those defined benefit pensioners on lower incomes and miss their intended target. Furthermore, even when such harsh impacts have been clearly highlighted to government we have experienced a total reluctance for any remedies to be put in place.

As you would be well aware, defined benefit pensions which are funded as they fall due are already taxed like other income. For those defined benefit pensions which are fully funded, such as the Victorian scheme, the benefit available to members has already been adjusted downwards to take account of tax treatment applied by the ATO to these schemes. Therefore the tax treatment of defined benefit pensions is quite different to that of both account based pensions and lifetime income streams which are currently tax exempt.

Defined benefit pensions are also subject to two death taxes. Firstly, upon the death of the initial member, the amount available to their spouse is reduced by 33%. This is in stark contrast to funds held in an account based pensions where there are no death taxes levied and the full balance of the fund is passed to the spouse. Secondly, upon the death of the spouse there is no residual balance in the fund, an effective 100% death tax. Again, in stark contrast, the balance of account based pensions becomes part of a person's estate. As you would be well aware and have publicised widely, superannuation has been used by many as a means for tax effective estate planning, and not for retirement planning. Defined benefit pensions clearly cannot be used for estate management purposes.

Furthermore, despite many defined benefit retirees making contributions on an after tax basis into their fund, when assessing eligibility for a part age pension the maximum offset which can be applied is 10%. In contrast, a retiree taking out a lifetime income stream is able to offset a flat 40% of that income stream, despite all contributions being made on a concessional tax basis.

Finally, the manner in which the transfer balance cap is applied to a defined benefit pension fails to adequately consider both the actuarially determined value of that pension, nor its taxation, both during the accumulation phase and while in pension mode. This failure results in defined benefit pensions already being more harshly treated under the current superannuation legislation and introducing changes to the transfer balance cap would further complicate an already complex area. ACPSRO has previously made comment in relation to the transfer balance cap and those comments are perhaps more relevant in light of your recent comments. A copy of that submission is attached for your information.

It is clear that defined benefit pensions are already subject to taxation in a number of ways that account based pensions and lifetime income streams are not. There are numerous other areas where defined benefit pensions receive inferior treatment by the tax and social security systems in Australia.

ACPSRO would be pleased to meet with you and discuss in more detail these issues, and why you consider there is any reason to change the tax treatment of defined benefit pensions. What recent commentary also misses is that there are around one million households in Australia where the retirees are either fully or partially dependent upon a defined benefit pension in their retirement. The vast majority of these retirees performed essential front line government services, such as members of the ADF, teaching, nursing, emergency services and policing and supporting the essential administrative functions of government.

Unfortunately, these retired public servants are often seen as "fat cats", yet the average pension payment under the Commonwealth defined benefit scheme is only $46,700, with the median payment being somewhat below this figure. Defined benefit pensions offered by state governments are even lower than this. However, in today's retirement space the benefits available to those receiving an account based pension are far more generous. Unlike our defined benefit pensions which are funded explicitly, the funding of account based pensions and lifetime income streams is hidden behind a complex array of tax concessions which you have clearly identified will soon cost more than the cost of the age pension, and which the Grattan Institute has determined most of the benefit goes to the wealthiest section of our community.

Finally, it is interesting to note that with the balance of super funds expected to eventually reach $7 to $10 trillion, the cost to the budget of these hidden expenses is expected to grow exponentially In contrast, defined benefit pensioners are a declining cohort as most schemes have been closed for nearly 30 years.

I look forward to the opportunity to meet with you to further discuss these important matters that impact on over 1 million Australian households.

Yours sincerely

John Pauley
President
Australian Council of Public Sector Retiree Organisations

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