

Australian Council of Public Sector Retiree Organisations (ACPSRO)

SUBMISSION TO SUPERANNUATION SYSTEM REVIEW PHASE 3 - Structure

SUMMARY OF RECOMMENDATIONS

Issue 1

The Australian Council of Public Sector Retiree Organisations (ACPSRO) is concerned that the structure of both the CSS and the PSS does not allow trustees to claim pre July 1988 funding credits and causes additional tax to be paid by pension recipients

Recommendation 1

To enable CSS and PSS pension recipients to benefit from the application of Pre July 1988 funding credits, ACPSRO recommends that the Government changes the structure of the CSS and PSS so that unfunded employer contributions are paid into the CSS or PSS superannuation fund at the time of the benefit payment. This would enable the CSS/PSS Trustee to claim a tax credit for the contribution tax liability. With the tax credit equalling the contribution tax liability there would no extra cost to the employer.

Or

Alternative Recommendation 1

ACPSRO recommends the Government makes regulations under the authority of division 307 of the *Income Tax Assessment Act 1997* to specify that CSS and PSS benefits that accrued before 1 July 1988 be treated as element taxed in the fund. This would have the same affect as applying Pre 1 July 1988 Funding Credits to the CSS and PSS in respect of benefits that accrued before 1 July 1988.

Issue 2

Citing precedents, ACPSRO is concerned that CSS and PSS pensioners may be compelled to fund government revenue.

Recommendation 2

ACPSRO recommends that the trustees of the CSS and PSS continue to have control of members' superannuation money when in the pension phase.

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Introduction

ACPSRO is concerned that the structure and design of some of the superannuation funds provided by the Commonwealth for its employees such as the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme defined benefit plan (PSS) has caused pension recipients from those superannuation funds to be taxed unfairly. The way the CSS and PSS are structured renders the funds ineligible to claim pre July 1988 funding credits. This causes pension payments that accrued in the superannuation fund before 1 July 1988 to be subject to tax. Other unfunded public sector superannuation funds such as the New South Wales State Superannuation Scheme (SSS) are able to utilise Pre 1 July 1988 funding credits which in turn enable pensions financed from pre 1 July 1988 accruals to be tax-free to recipients over age 60.

Also ACPSRO is concerned with the structure of the CSS and PSS where member's accumulated entitlements in the CSS or PSS superannuation fund are paid to the Commonwealth (into consolidated revenue) to pay pension payments. This money, to fund future pension payments, is no longer under the control of the trustees and forms part of government revenue and is then used to fund normal government expenditure.

Issue 1

The structure of both the CSS and PSS does not allow trustees to claim pre July 1988 funding credits and causes additional tax to be paid by pension recipients

Tax applied to unfunded CSS pensions that have an accrual period before 1 July 1988 is inequitable when compared to the tax being applied to pension recipients from other non Commonwealth unfunded superannuation schemes. The inequity arises out of the inability to apply Pre 1 July 1988 Funding Credits to CSS superannuation retirement benefits. The same situation applies to the unfunded component of PSS defined benefit pensions and pensions paid from the military superannuation schemes such as the Defence Force Retirement and Death Benefits (DFRDB) and the Military Superannuation Benefit Schemes. For simplicity we have only referred to the CSS and PSS in the submission dealing with this issue.

The *Income Tax Assessment Act 1997* contains a provision to allow unfunded superannuation schemes to utilise Pre 1 July 1988 Funding Credits. This mechanism is designed to ensure that superannuation benefits that accrued before 1 July 1988 in an unfunded superannuation scheme are regarded as if they were funded from a taxed source and accordingly taxed as an element taxed. This avoids benefits that accrued before 1 July 1988 from being taxed

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as untaxed benefits. This is necessary as tax was not applied to superannuation funds (earnings or contributions) before 1 July 1988 and accordingly no taxes were applied to such accruals in funded or unfunded superannuation schemes.

A good description and purpose for Pre 1 July 1988 Funding Credits was provided at paragraph 9.2, Chapter 9 of the Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No. 3) Act 2006*. The paragraph states:

“9.2. Since 1 July 1988 most contributions (eg, employer and other deductible contributions) to superannuation schemes have been subject to a 15 per cent tax. Funding credits were granted to unfunded superannuation schemes so that contributions made after 1 July 1988 to fund benefits that accrued prior to 1 July 1988 are not taxed. This ensures equity with funded superannuation schemes which only pay tax on contributions from 1 July 1988.”

However, with regards to CSS and PSS superannuation benefits there is no mechanism to ensure equity with funded superannuation schemes for benefit accruals before 1 July 1988. Pre 1 July 1988 Funding Credits cannot be used by the CSS and PSS Trustee and as a result when benefits are paid out of the CSS or PSS the component of the payment that accrued before 1 July 1988 is taxed as if it was paid from an untaxed superannuation scheme. Unfunded State Superannuation Schemes were able to utilise Pre 1 July 1988 Funding Credits to ensure that tax is applied equitably against the payment of their superannuation benefits, that is, no tax paid on benefit accruals before 1 July 1988.

The reason why Pre 1 July 1988 Funding Credits cannot be applied in the CSS and PSS is due to the way the Commonwealth structured the CSS and PSS to pay retirement benefits. The Trustees of unfunded State Superannuation Schemes chose to pay their superannuation benefits out of their respective superannuation funds after receiving unfunded contributions from the employer at the time of retirement or benefit payment. When the unfunded employer contribution was paid into the superannuation fund at the time of benefit payment, no contributions tax is paid on that part of the employer contribution that is funding accruals before 1 July 1988 as the tax that would have been paid on those employer contributions is offset by Pre 1 July 1988 Funding Credits. Therefore, even though benefits that accrued before 1 July 1988 were not funded until the time of retirement or benefit payment and with no contributions tax effectively being paid on those employer contributions (similar arrangement to the CSS and PSS) the benefit payment is regarded as being paid from a taxed source and taxed accordingly.

The difference between the CSS/PSS and other unfunded superannuation schemes that are entitled to utilise Pre 1 July 1988 Funding Credits is that the

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Commonwealth chose to pay CSS/PSS retirement benefits out of Commonwealth revenue rather than out of the CSS/PSS superannuation fund. That is, when a benefit becomes payable the member's accumulated member and productivity contributions in the CSS and PSS superannuation funds are paid out of the CSS and PSS superannuation funds and into Commonwealth revenue. The Commonwealth then adds employer contributions to the benefit payment and pays the CSS or PSS superannuation benefit to the benefit recipient out of Commonwealth revenue. This process is prescribed in section 112 of the *Superannuation Act 1976* and section 16 of the *Superannuation Act 1990*.

Paying superannuation benefits in the reverse way to the manner in which unfunded State Superannuation funds pay their retirement benefits, has resulted in no employer contributions actually being paid by the Commonwealth into the CSS or PSS superannuation fund and therefore there is no contribution tax liability generated to enable Pre 1 July 1988 Funding Credits to offset any tax liability. The result is that unfunded pre 1988 accruals in the CSS and PSS are element untaxed and taxed accordingly when unfunded pre 1 July 1988 accruals in other unfunded superannuation funds are regarded as element taxed and not subject to tax where the recipient is aged 60 and over.

The method of paying CSS and PSS superannuation benefits is grossly unfair, especially as the Commonwealth Government has set up a mechanism for benefit recipients of other unfunded superannuation schemes to receive equitable tax treatment with funded superannuation schemes. CSS/PSS superannuation scheme benefit recipients miss out on equitable tax treatment of their superannuation benefits only because the Commonwealth Government chose to pay superannuation benefits through the Consolidated Revenue Fund rather than through the CSS or PSS superannuation fund. There is no difference in the end result irrespective of the payment mechanism other than the loss of the application of Pre 1 July 1988 Funding Credits and CSS and PSS benefit recipients paying tax on pre 1 July 1988 accruals, which is tax free for everyone else. Accordingly, we believe that there is no reason why CSS and PSS benefit recipients should not be taxed the same way as other recipients of unfunded superannuation schemes in respect of their unfunded superannuation benefits that accrued before 1 July 1988. CSS and PSS pension recipients would be able to benefit from the application of Pre July 1988 funding credits if the structure of the CSS and PSS was changed so that unfunded employer contributions were paid into the CSS or PSS superannuation fund at the time of the benefit payment. This would enable the CSS/PSS Trustee to claim a tax credit for the contribution tax liability. With the tax credit equalling the contribution tax liability there would no extra cost to the employer.

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Recommendation 1

To enable CSS and PSS pension recipients to benefit from the application of Pre July 1988 funding credits, ACPSRO recommends that the Government changes the structure of the CSS and PSS so that unfunded employer contributions are paid into the CSS or PSS superannuation fund at the time of the benefit payment. This would enable the CSS/PSS Trustee to claim a tax credit for the contribution tax liability. With the tax credit equalling the contribution tax liability there would be no extra cost to the employer.

Or

Alternative Recommendation 1

ACPSRO recommends the Government makes regulations under the authority of division 307 of the *Income Tax Assessment Act 1997* to specify that CSS and PSS benefits that accrued before 1 July 1988 be treated as element taxed in the fund. This would have the same effect as applying Pre 1 July 1988 Funding Credits to the CSS and PSS in respect of benefits that accrued before 1 July 1988.

Either suggested solution would enable a fair and equitable tax treatment to apply to CSS and PSS pensioners as intended for other unfunded superannuation schemes through the application of Pre 1 July 1988 Funding Credits.

Issue 2

CSS and PSS pensioners funding government revenue

At the time of retirement CSS and PSS members' accumulations in the CSS and PSS superannuation fund is paid out of their respective superannuation fund and into government revenue. Pension payments are then paid by the Commonwealth out of government revenue to pensioners.

As the funds held in the superannuation fund are paid out to the Commonwealth the trustee loses control of those funds. The trustee has to rely on the good will of the Commonwealth to provide the money each fortnight so that pension payments can be made.

The tax and superannuation legislation do not allow superannuation funds to pay accumulated funds to an employer other than where the employer is the Commonwealth or a State. This is mostly because the employer could become insolvent and the money lost. The worry is that should a future global financial crisis affect Australia and Australia has difficulty repaying its debts, a future government may decide to arbitrarily reduce, suspend or cancel CSS and PSS pension payments.

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There are precedents. The first occurred when the Government reduced CSS pensions by up to 20% in 1931 in accordance with the Financial Emergency Act 1931. The second occurred in 1986 when the government reduced the annual indexation of pensions by 2% due to high inflation. ACPSRO believes that Trustees should continue to have control of members' superannuation money when in the pension phase.

This issue refers to that part of a member's accrued contributions and earnings in the fund that are used by the member on retirement to purchase a non indexed pension component (in the case of the CSS) or an indexed pension component (in the case of the PSS).

No reference has been made to the Military schemes as they are structured differently with no transfer of money to the Commonwealth for the DFRDB and only a small amount (productivity component) with the MSBS. Further there is no superannuation fund for the DFRDB.

Recommendation 2

ACPSRO recommends that the trustees of the CSS and PSS continue to have control of members' superannuation money when in the pension phase.