10% Cap Paper for SCOA Australia AGM

Background

The 1922 Act, CSS and PSS pensions are all defined benefit pensions. A defined benefit pension (DBP) has the following characteristics:

- The pensions are paid out of the super fund or, in the case of Commonwealth superannuation pensions, out of consolidated revenue;
- Employees have been able to contribute to the fund (compulsory for Commonwealth funds until 2008);
- The part of the pension funded by the employer is taxed if paid from an "untaxed fund" such as a Commonwealth superannuation fund; and
- When they retire, pensioners may purchase additional untaxed pension using their own contributions.

Before the tax changes of 2007, all of a DBP was subject to income tax, and account-based pensions (formerly called allocated pensions) were subject to a flat tax of 15% for those aged over 60. After the changes, the part of a Commonwealth DBP funded by the employer contribution was still taxed, but with a 10% tax offset, and the part funded by the pensioner's own contributions became tax-free. Account-based pensions also became tax-free for those over 60. These changes meant that if a Commonwealth defined benefit pensioner had any other income, it was taxed at their marginal tax rate, but a person with an account-based pension had any other income it was taxed "starting from zero", as Peter Costello said in his Budget speech.

The tax changes of 2007 included a change in the method of calculation of the amount of a DBP that was considered to represent the part of the DBP funded by the pensioner's own contributions, which meant that people with service before 30 June 1983 were able to have a significant amount of up-front employer contributions treated like after-tax contributions. I have been contacted by a number of older CSS pensioners with CSS pensions that had a tax-free part of well over 10% - two said that they had 50% tax-free. The majority were reversionary pensioners with quite modest pensions after years of CPI indexation.

Before those tax changes, the whole DBP was included in the income tests for the Age Pension, the Disability Support Pension (DSP), the means test for aged care accommodation and the Commonwealth Seniors Health Card (CSHC). After the tax changes, only the taxed part was included in those income tests. The present Government now says that was an oversight, and it should not have happened.

Before the tax changes, for the income tests for the Age Pension, the DSP and the means test for aged care accommodation, an actuarial calculation based on life expectancy had been used to deem the income associated with an account-based pension, but the account-based pension had been included in the income test for the CSHC (based on taxable income). After the tax changes, account-based pensions were no longer included in the income test for the CSHC, because they no longer formed part of the taxable income. That was another oversight.

The 2007 tax changes were made during the height of the mining boom, and had the affect of making a permanent hole in the Budget. The incoming Labor government knew that there was a problem, and instituted the Henry Tax Review. That resulted in only two major tax changes, the Mining Super Profits Tax, and the Carbon Tax, both since repealed. The Henry Tax Review was supposed to look into the taxation of our defined benefit pensions, and mentioned them in its issues paper, but in the end it did not do anything about them. The Matthews Review was supposed to look at the interaction between the taxation of our pensions and the welfare system, but it did not do that either.

After the next change of government, the present government introduced legislation to simplify the treatment of account-based pensions by deeming income based on their value, like other assets, and adding the deemed income to the income test for the CSHC. Those changes came into force from 1 January 2015 and were grandfathered.

In the lead-up to this year's Budget, in an article published in the *Daily Telegraph* on 7 May, the then Minister for Social Services, Scott Morrison, claimed that he had just discovered that the untaxed part of a DBP was not included in the income test for the Age Pension, and as a result some retired public servants, members of State defined benefit pension schemes, who did not have to pay any tax on their generous pensions, were "double-dipping" and claiming Age Pensions which they did not need, and he was going to put a stop to it.

After the Budget, an omnibus bill was introduced to implement a number of the measures announced in the Budget, including the proposed to limit the amount of a DBP that could be excluded from the income test for the Age Pension to 10% of the whole DBP. When it became apparent that the Senate would be unlikely to pass the Bill, it was broken up into a number of smaller bills.

The Social Services Legislation Amendment (Defined Benefit Income Streams) Bill 2015 was introduced into the House of Representatives on 23 June 2015, and passed the same day, without debate. It went to the Senate later that day and was passed on 24 June, after only three speeches. In both Houses, the introductory speech simply said that the measure would apply to all defined benefit superannuation schemes other than the military schemes that had been exempted because of "the unique nature of military service". By 24 June, the largest component of the composite bill, the change in the assets test to come into force from 1 January 2017, had already passed both houses of Parliament, it was the last week of the Budget sitting and members were looking forward to going back to their electorates. Both Labor and the Greens supported the Bill.

There was very little consultation before the Bill was passed. The information supplied by the Government was misleading and many people here in Canberra, including the local Liberal Senator, were led to believe that all Commonwealth superannuation pensions were exempt, not just the military ones. According to Senator Rachel Siewert (Greens), ACOSS, the Welfare Rights Network, Uniting Care and COTA supported this change. However, the peak body representing public sector superannuation pensioners, the Australian Council of Public Sector

Retiree Organisations (ACPSRO) was not consulted, and SCOA was not approached. Other providers of DBPs, such as UniSuper (with 40,000 pensioners whose pensions have a tax-free component of 33%), were not consulted either.

The information provided to Senators was this: the Department of Social Services said that there were 140,000 benefit recipients with defined benefit income streams, that 55% of those had no deductible amount, and that 46,000 would lose an average of $82.70 a fortnight and a further 1,700 would lose their benefits altogether. However, during Senate Estimates, the DSS could not say how many defined benefit schemes there were, and it appears that Senators were not provided with information about the incomes of those who would be affected. They did not realise that it would affect many people on very low incomes.

Curiously, it appears that no information was provided to explain why the cap was set at 10%. If the Government had really been trying to deliver fairness and equity, I cannot understand why they did not set a dollar value for the cap instead of a percentage, to protect those on low incomes.

Why SCOA Opposes this Change

1. This change will affect retirees who have made irrevocable decisions.
On retirement, instead of taking their member contributions as a lump sum, some former public servants have chosen to purchase additional pension using their member contributions. Once they have done that, they can no longer access the underlying asset, and they cannot leave it to their children. However, if they had chosen to take their contributions as a lump sum, they could have purchased an account-based pension that would have allowed them to access their capital if they needed to invest it in whichever way they chose.

2. This change in the treatment of defined benefit pensions is at odds with the present government's frequent assurances that governments should not make fundamental changes to retirement income policy that adversely affect retirees who have made irrevocable decisions based on the assumption that there will be no changes that adversely affect their retirement income..

3. This change will reduce the retirement income of many older Australians, some on very low incomes. For example, in the Commonwealth's civilian pension schemes, 10% have pensions of less than $10,000, and a further 20% have pensions in the range $10,001 to $20,000. Many of these are reversionary pensioners receiving only 67% of the original contributor's pension. Over 90% of reversionary pensioners are female (Source: CSC Annual Reports).

4. Some of the people affected by this change will suffer hardship. Those who will be most affected will be those who are renting, particularly if the range of items in the GST is expanded to include rent.

5. Recently the Prime Minister has stressed the need for fairness. However, while recent changes to the treatment of account-based pensions were grandfathered, the change to the 10% cap has not been grandfathered. It could be argued that it

did not need to be grandfathered because it was only correcting an oversight at the time of the 2007 changes to retirement income policies. However, those who retired after those changes would probably have been unaware of the pre-2007 situation and would have believed that the new arrangement would continue. After 2007, many more people (particularly PSS members) used their member contributions to purchase additional pension, and the recent Long Term Cost Report for the CSS and PSS assumed that in future even more people would do so. To be fair, ACPSRO recommends that the 10% cap should also be grandfathered.

6. Those affected by the 10% cap are likely to have already been adversely affected by other recent changes that have made life more difficult for elderly people, such as the ending of the Dependant Spouse Tax Offset this year, the changes to the Net Medical Expenses Tax Offset in the past few years, and the ending of the dental scheme for those with chronic illnesses in 2012. They will also be adversely affected if the rate of the GST is increased to 15% and/or its range is extended to cover items such as medical services.

7. The implementation of the measure has been handled very poorly – it appears that Centrelink sent the same vague email to all CSS and PSS pensioners, even those whose pensions did not contain a tax-free component. The email caused unnecessary alarm and confusion, and many recipients phoned SCOA and or Centrelink to find out what was going on. It would have been far more sensible if Centrelink had contacted only those who were going to be affected, and had told them by how much.