SCOA

Superannuated Commonwealth Officers' Association Inc.

2013/2014 Pre-Budget Submission

January 2013

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Executive summary

The Superannuated Commonwealth Officers' Association (SCOA)

For nearly 90 years SCOA has represented the interests of:

- Retired Australian and Territory Government employees and Government business enterprise employees;
- People in the public service who will receive a Commonwealth superannuation benefit or lump sum on retirement;
- Former employees who have deferred (preserved) their pension entitlement; and
- The dependants of all of the above.

SCOA's current priorities include:

- Fair indexation of Commonwealth superannuation pensions;
- Changes to superannuation taxation to remove discrimination against public sector pension recipients;
- Simplification of the tax system; and
- Returning the Age Pension income test taper rate to 40 cents in the dollar.

SCOA participates in Government reviews and committees and makes submissions regarding legislative reform on retirement income, compensation, taxation, concessions, health and ageing. SCOA assists individual ComSuper and Comcare clients to receive their correct entitlements. As public sector superannuants, we also pursue broader issues affecting ageing Australians including implementation of the proposed National Dental Scheme, improved aged care accommodation and home care service issues.

SCOA has made a number of submissions to Government inquiries notably to:

- The Matthews Review of Pension Indexation Arrangements in Australian Government Civilian and Military Superannuation Schemes;
- The Harmer Pension Review;
- The Henry Tax Review; and
- The Cooper Review of Superannuation.

All SCOA's submissions have pointed out the need for the Government to develop a comprehensive and coherent retirement incomes policy which simplifies current arrangements and which ensures that those receiving the Age Pension and public sector superannuation pensions are able to maintain their purchasing power by having a pension index that reflects street prices.

> The average Commonwealth superannuation pension in 2011/2012 was less than the combined couple rate of the Age Pension of $29,614 p.a. in July 2012. It should be noted that the single Commonwealth superannuation pension in most cases supports two people.

Key messages

The key messages that SCOA wishes to be reflected in the budget outcomes for 2013-2014 are:

- Maintaining the purchasing power of retirement incomes to keep pace with increases in the real cost of living.
- Indexation which retains the value of Commonwealth superannuation pensions;
- Equitable tax treatment. No discrimination against people according to the source of their pension;
- Equity in assessing income. Those on similar incomes should be able to access the same benefits; and

We wish to point out that:

- Our requests are affordable.
- We are not seeking special treatment for our constituents.
- We are asking for the removal of anomalies which result in discrimination.
- In other cases we are asking for regulations to be changed.

SCOA's recommendations

SCOA recommends that:

1) The Government should ensure that Commonwealth and Defence Superannuation Pensions are indexed by an index that reflects movements in street prices, such as the rate of change of Male Total Average Weekly Earnings (MTAWE).

2) The taper rate for the Age Pension income test should be reset to the former rate of forty cents in the dollar.

3) Superannuation pensions paid from an "untaxed source" should be paid as after tax non-assessable income and not added to non-superannuation income to determine the marginal tax rate to be applied to that non-superannuation income.

4) The superannuation pensions paid from an 'untaxed source', where superannuation benefit accruals commenced before 1st July 1988, be treated for tax purposes in the same manner as superannuation pensions paid from a 'taxed source' that commenced before 1st July 1988.

5) The CSS and PSS pension income that is "untaxed superannuation income" should be excluded from the income test for the Commonwealth Seniors' Health Card (CSHC) and the Senior Australian and Pensioner Tax Offset (SAPTO). Also, that the current eligibility limits for access to CSHC be increased to $60,000 for singles, and to $90,000 for couples, and be indexed annually as per the base rate of the single person Age Pension.

6) Holders of the Commonwealth Seniors Health Card (CSHC) should receive the same concessions for hearing tests and the fitting and maintenance of hearing aids as those receiving the Age Pension.

7) That the PBS Safety Net limits for single persons aged over 65 should be half the PBS Safety Net limits for couples or families.

8) That ambulance services be made a free health entitlement like treatment in a public hospital, and be considered to be part of Medicare.

9) That for those with taxable incomes below $30,000 and tax liability of $300 or less, the 20% tax offset on net medical expenses in excess of $2,060 be replaced by a 20% rebate on net medical expenses in excess $2,060.

Recommendations in detail

Recommendation 1: The Government should ensure that Commonwealth and Defence Superannuation pensions are indexed by an index that reflects movements in street prices such as the rate of change of Male Total Average Weekly Earnings (MTAWE).

Recipients of Government pensions, allowances, and health cards have many things in common such as low incomes and increasing need for health and aged care services. Yet the indexation applied to the range of pensions, allowances and thresholds is inconsistent, resulting in inequity across the senior community.

For example, Age, Service and War Widows pensions are indexed in line with the greater of the CPI or the Pensioner and Beneficiary Living Cost Index (PBLCI), benchmarked to 27.7% of Male Total Average Weekly Earnings (MTAWE). However Commonwealth superannuation pensions are indexed at the CPI rate only, an indexation methodology abandoned for the Age Pension more than a decade ago when it became apparent that CPI indexation was insufficient to maintain pensioners' living standards.

Further, the fees levied in retirement villages are increased in line with increases in the Age Pension whereas Commonwealth superannuants' pensions are indexed by usually smaller increases in the CPI; this is discriminatory. The single rate of the Age Pension has rightly increased by approximately 160% in the past 23 years, whereas Commonwealth superannuation pensions have increased by only half that amount.

Our recommendation is a general statement of principle that is consistent with Labor's long held principles of fairness and equity. We do not want favoured treatment; just pension indexation that allows us to maintain our standard of living.

Prior to the 2007 election the Labor Government created great expectations for fair pension indexation for Commonwealth superannuants by writing letters to them that clearly indicated an intention to fix the indexation inequity . The Government's refusal to deliver fair pension indexation for Commonwealth superannuants following the election was seen as a betrayal by many of those affected. They say that it demonstrated a failure of the Government to stand by the ALP's long held principles of fairness and equity. They feel as if they are being treated like second class Australians.

Increases in Commonwealth superannuation pensions are not maintaining parity with the Age Pension, as the graph at Attachment A indicates. While they are almost equal now, in ten years the Age Pension for a couple will be about 20% higher than the average Commonwealth superannuation pension, if the latter remains indexed by the CPI. Commonwealth superannuation pensions are mostly the main source of retirement income for Commonwealth superannuants and their spouse/partner. Three Senate Committees (2001, 2002 and 2008) all supported a change to a wage-based means of indexing Commonwealth superannuants' pensions.

Fair indexation is affordable and can be provided without affecting the budget bottom line.

The Future Fund, established to pay Commonwealth superannuation pensions from 2020 contained $80 billion at 30 September 2012. With appropriate legislative change, it could be used to meet the cost of funding fair pension indexation for Commonwealth superannuants without adversely affecting its capacity to pay Commonwealth superannuation pensions from 2020, pensions that are easily affordable from annual revenue collections.

The gross cost of fair indexation in the first four years would be $208m; a very small portion of the total annual budget[1]. This cost would be reduced due to clawback from increased tax revenue and reduced Age Pension expenditure. This clawback is estimated by the Government to be a minimum of 30%.

Unfunded Commonwealth superannuation liabilities are expected to decrease from 9.6% of GDP in 2009 to 2.8% by 2049 (2010 Intergenerational Report). Annual budget outlays on Commonwealth superannuation pensions have already peaked and are now in decline. There is no unfunded superannuation liability for the PSSap. The last of the military defined benefit schemes, the MSBS, is most likely to close in the near future which will significantly reduce unfunded superannuation liabilities.

Thirteen years ago, a change from CPI indexation to indexation by the better of the CPI and 25% of MTAWE for the Age Pension cost approximately five to ten times as much as increasing Commonwealth superannuation pensions by the same percentage as the Age Pension. The cost of that change was readily absorbed and without the need for the creation of a Future Fund.

Recommendation 2: The taper rate for the Age Pension income test should be reset to the former rate of forty cents in the dollar.

CSS and PSS pensioners used to regard the Age Pension as a safety net that they could fall back on because the purchasing power of their 1922 Act, CSS or PSS pensions was eroded by CPI indexation. However, the change in the taper rate to 50c in the dollar for CSS and PSS Pensioners who have started receiving the Age Pension after 20 September 2009 means that they have not be able to maintain their living standards, because increases in their Age Pension have failed to compensate for the shortfall in their superannuation pension due to CPI indexation. The increase in the taper rate for the income test also means that some of those who were ineligible to apply for the Age Pension before 20 September 2009 have had to wait longer before they could access it.

It should also be noted that since the inclusion of salary sacrifice in the income test for the Age Pension, they have been discouraged from salary sacrificing to another superannuation fund to provide for their old age. We recommend that the taper rate for the Age Pension Income Test should be reset to forty cents in the dollar.

Recommendation 3: That superannuation pensions paid from an “untaxed source” be paid as after tax non-assessable income and not added to non-superannuation income to determine the marginal tax rate to be applied to that non-superannuation income.

The tax treatment of additional non-superannuation taxable income applied to a person receiving an element untaxed superannuation income stream is inequitable when

[1] Matthews Report Appendix J, p.66

compared to that of a person receiving an element taxed superannuation income stream. The following example illustrates this.

Assumptions: Taxpayers are over 60 with private health insurance.

Type of income	Superannuation income stream element taxed	Superannuation income stream element untaxed
	Pensioner A	Pensioner B (CSS/PSS/1922 Act)
Superannuation pension	$40,000	$40,000
Non-superannuation income	$20,000	$20,000
Total income	$60,000	$60,000
Tax	$0	$6,947
Medicare Levy	$60	$900
Net income	$59,940	$52,153
Tax on $20,000 non-superannuation income	$0	$6,800
Medicare Levy on $20,000	$60	$300
Total tax and Medicare Levy on $20,000	$60	$7,100

The additional $20,000 non-superannuation income for Pensioner B is taxed at the rate of 35.5%. The tax is as follows:

32.5% marginal tax rate ($20,000 x 32.5%) =	$6,500
1.5% tax rate for loss of low income tax offset ($20,000 x 1.5%)=	$300
1.5% Medicare Levy ($20,000 x 1.5%)=	<u>$300</u>
Tax on additional $20,000 non-superannuation income	$7,100

On the other hand, the additional $20,000 non-superannuation income received by Pensioner A is taxed at the rate of 0.3%. The calculation is as follows:

0% marginal tax rate for $18,200 ($18,200 x 0%)=	$0
19% marginal tax rate for $1,800 ($1,800 x 19%)=	$342
Less low income tax offset	<u>-$342</u>[2]
Net tax before Medicare Levy	$0
Reduced Medicare Levy	<u>$60</u>
Net tax plus Medicare Levy on additional $20,000 non-superannuation income=	$60

The $7,040 difference between the two outcomes stems from when the employer chose to pay superannuation contributions for their employees. Former Commonwealth employees should not be penalized because the Commonwealth chose to defer payment of employer contributions until the person applied for a pension instead of paying contributions when the person was employed. This is inequitable especially in regard to the marginal tax rate applied to non-superannuation income and the reduction in the low income tax offset (LITO).

We suggest that the income stream from an untaxed superannuation source be separated out as special income and taxed separately, as is the case with income from

[2] The balance of the low income tax offset is non-refundable.

a taxed income stream. This would be more equitable. All other non-superannuation income should be assessed as normal assessable income.

The Senate Standing Committee on Economics report of February 2007 on the review of “Tax Laws Amendment (Simplified Superannuation) Bill 2006 (Provisions and related bills)” supported this change.

Recommendation 4: The superannuation pensions paid from an ‘untaxed source’, where superannuation benefit accruals commenced before 1st July 1988, be treated for tax purposes in the same manner as superannuation pensions paid from a ‘taxed source’ that commenced before 1st July 1988.

To accomplish this, the Government should make regulations in accordance with Division 307 of the Income Tax and Assessment Act 1997 to specify that CSS and PSS benefits that accrued before 1 July 1988 be treated as element taxed in the fund.

Before 1 July 1988 superannuation funds did not pay tax on earnings or on employer contributions. Accordingly, before 1 July 1988, there was no difference between a taxed and an untaxed superannuation scheme as all pension benefits paid from superannuation schemes and funds were taxed at marginal tax rates.

Under “Better Super”, benefit recipients aged sixty and over do not pay tax on superannuation benefits paid from a taxed source. This means that from 1 July 2007 no tax has ever been paid (by the taxed superannuation fund or its benefit recipients) on superannuation benefits that accrued before 1 July 1988. Commonwealth (CSS and PSS) superannuation pension recipients, however, still pay tax on Pre-1 July 1988 benefit accruals.

It is inequitable that tax is applied to unfunded CSS and PSS pensions that have an accrual period before 1 July 1988, when pension recipients from other non Commonwealth unfunded superannuation schemes pay no tax at all on their superannuation pensions (including the Pre-1 July 1988 component) once they have reached sixty years of age. The inequity arises out of the inability to apply Pre-1 July 1988 Funding Credits to CSS and PSS superannuation retirement benefits.

The *Income Tax Assessment Act 1997* contains a provision to allow unfunded superannuation schemes to utilise Pre-1 July 1988 Funding Credits. However, with regard to CSS and PSS superannuation benefits, there is no mechanism to ensure equity with funded superannuation schemes for benefit accruals before 1 July 1988.

Attachment B provides more detail about the tax inequity applying to Commonwealth Superannuation Scheme pensions with benefit accruals before July 1988.

A possible solution to correct the inequitable tax treatment applied to CSS and PSS benefit recipients with accruals before 1 July 1988 would be for the Government to make regulations in accordance with 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. This would then enable a fair and equitable tax treatment for CSS and PSS pension recipients.

Recommendation 5: The CSS and PSS pension income that is "untaxed superannuation income" should be excluded from the income test for the Commonwealth Seniors' Health Card (CSHC) and the Senior Australian and Pensioner Tax Offset (SAPTO). Also, that the current eligibility limits for access to CSHC be increased to $60,000 for single persons, and to $90,000 for couples, and be indexed annually by movements in the maximum rate of the single Age Pension.

Income streams from taxed superannuation funds are not subject to income tax, and therefore do not form part of taxable income. Therefore they are not included in the income test for the CSHC or SAPTO (formerly SATO).

However, income streams paid from an untaxed superannuation fund, such as the Commonwealth's CSS indexed pension and the unfunded component of the Commonwealth's PSS indexed pension, are counted as income for the income test for the CSHC and for SAPTO.

It is unfair and discriminatory for retirement incomes paid from an untaxed superannuation fund to be included as income for the income test of the CSHC and SAPTO whilst retirement incomes from a taxed superannuation fund are excluded. There is no reason why retirement incomes from untaxed superannuation funds should be treated differently from income from *taxed* superannuation funds.

The only difference between the income streams from the two types of superannuation funds is when the employer chose to pay the employer contributions in relation to providing superannuation benefits for their employees. Former Commonwealth employees should not be penalised because the Commonwealth chose to defer payment of employer contributions until the person claimed their pension instead of when they fell due while the person was still an employee.

We understand that some defined benefit funds have been declared to be taxed funds, yet Commonwealth funds have not. We do not understand why this should be the case. We also understand that declaring our funds to be taxed funds could be done by regulation and that it would not require an Act of Parliament.

The current Commonwealth Seniors Health Card eligibility limits were set in July 2001, and an increase in the asset test levels is well overdue. Since then, the CPI has risen over 30% and the CSHC eligibility limits have not changed. A 20% increase in the threshold for single persons, and a 12.5% increase in the threshold for couples, would be very reasonable, as is the need for annual indexation.

The additional cost of increasing the income test limits would be $64.8 million per year if there were no change to the tax treatment of superannuation from a taxed source. This estimate is based on the latest available data for 2009-10. Most of that cost could be offset by changing the tax treatment of superannuation from a taxed source to prevent people on high tax-free private sector superannuation pensions from accessing the benefits of the CSHC.

If the tax treatment of superannuation income from a taxed source were changed to taxation at the rate of zero percent, their superannuation from the taxed source would be included in their taxable income (even if they don't pay any tax on that superannuation income) and hence in the income test for the CSHC. Any other income that they might earn would be taxed at the relevant marginal tax rate. That would offset the cost of increasing the income test limits, by reducing the number of people eligible for a CSHC and also by increasing income tax receipts.

Recommendation 6: That holders of the Commonwealth Seniors Health Card (CSHC) should receive the same concessions for hearing tests and the fitting and maintenance of hearing aids as those receiving the Age Pension.

Age Pensioners are provided with a Pensioner Concession Card (PCC) entitling them to free Hearing Aids and associated services provided certain requirements are met. The Federal Government provides funding through the Office of Hearing Services (part of the Department of Health and Ageing) that manages the Australian Government Hearing Services program.

SCOA recommends that the same concessional treatment be granted to those retirees who are in possession of a CSHC (ie. their income is below the $50,000/$80,000 current limits).

Recommendation 7: That the PBS Safety Net limits for single persons aged over 65 should be half the PBS Safety Net limits for couples or families.

Low-income older single people with multiple conditions often have difficulty paying for their prescriptions, particularly in the cold winter months when they also have to contend with big electricity and gas bills. Typically, they do not reach the applicable PBS Safety Net limit until towards the end of the calendar year. It is inequitable that single people should have the same safety net limits as couples or families.

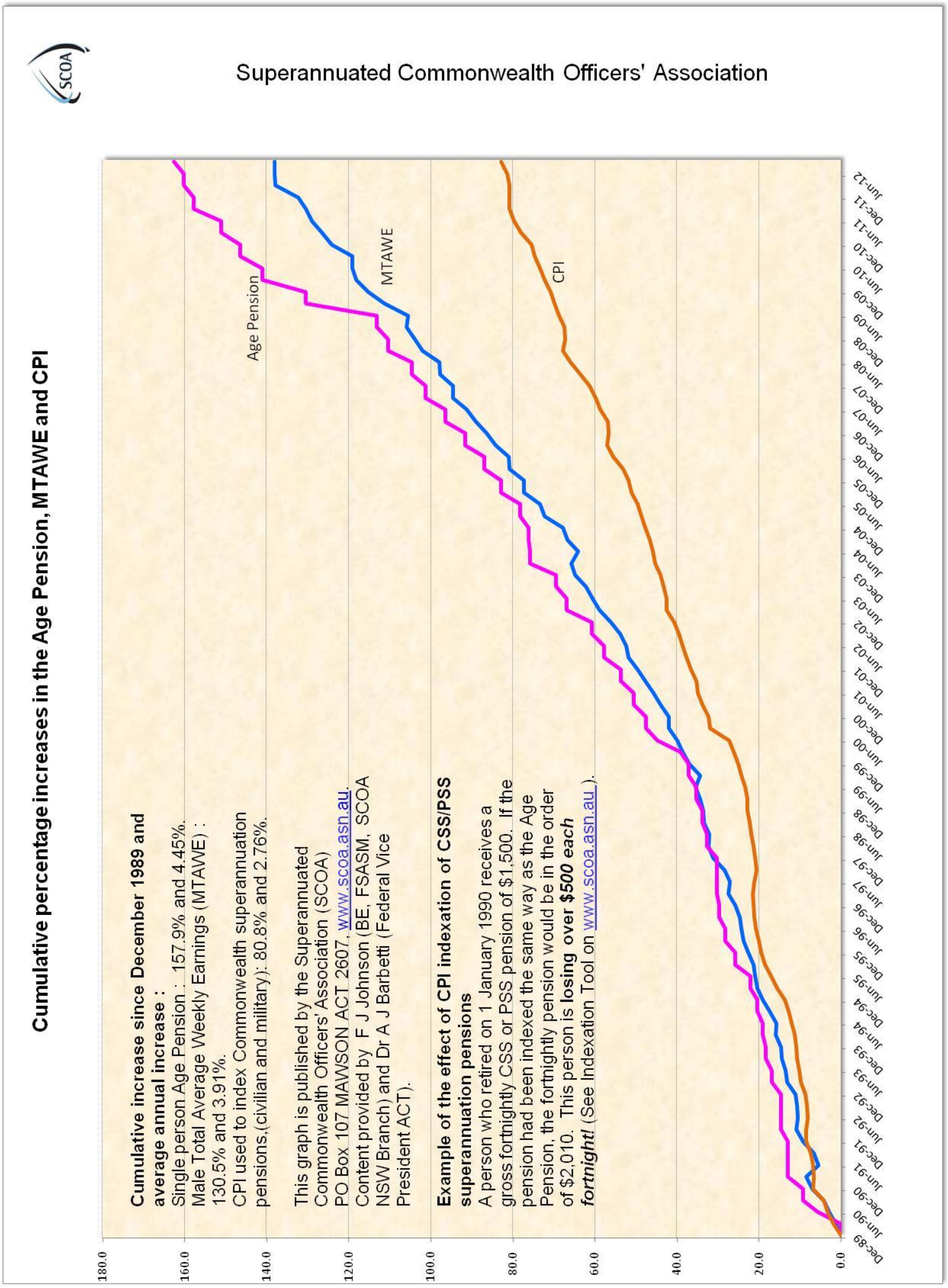
Recommendation 8: That ambulance service be made a free health entitlement like treatment in a public hospital, and be considered to be part of Medicare.

The current system of funding for ambulance services needs to be overhauled because too many consumers are delaying essential treatment, which may lead to increased overall treatment costs in many cases. Ambulances are free in Queensland and Tasmania, but in the rest of Australia many people have to pay, either directly or through private health insurance or other subscription schemes.

Recommendation 9: That for those with taxable incomes below $30,000 and tax liability of $300 or less, the 20% tax offset on net medical expenses in excess of $2,060 be replaced by a 20% rebate on net medical expenses in excess of $2,060.

The present tax offset is helpful only to those who have a sizeable tax liability and provides no help to those who pay little or no tax. Because of the way that their pensions are taxed, most Commonwealth superannuation pensioners cannot benefit from it. The proposed change would assist not only low-income Commonwealth superannuation pensioners, but also some other low-income people who currently pay little or no tax.

Attachment A: Cumulative percentage increase in: Age Pension, CPI (used to index Commonwealth superannuation pensions) and MTAWE



Attachment B: Elaboration on the tax inequity applying to Commonwealth Superannuation Scheme pensions with Benefit Accruals before July 1988

The tax inequity applying to Commonwealth Superannuation Scheme pensions with benefit accruals before July 1988 arises through the inability to apply Pre-1 July 1988 Funding Credits to CSS and PSS superannuation retirement benefits.

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 element taxed. This saves benefits that accrued before 1 July 1988 from being taxed as untaxed benefits. This is necessary as tax was not applied to contributions to or earnings of superannuation funds before 1 July 1988 and accordingly no taxes were applied to such accruals in funded or unfunded superannuation schemes.

A good description of Pre-1 July 1988 Funding Credits and their purpose is 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 (e.g., 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. 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 were paid from an untaxed superannuation scheme. Unfunded State Public Sector superannuation schemes were able to utilise Pre-1 July 1988 Funding Credits to ensure that tax is applied equitability 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 or PSS appears to be due to the way the Commonwealth chose to pay CSS and PSS retirement benefits. The Trustees of unfunded State Public Sector 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 is paid into the superannuation fund at the time of benefit payment, no contributions tax is effectively 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 is taxed accordingly.

The difference between the CSS and PSS and other unfunded superannuation schemes that are entitled to utilise Pre-1 July 1988 Funding Credits is that the Commonwealth chose to pay CSS and PSS retirement benefits out of Consolidated Revenue rather than out of the CSS superannuation fund. That is, when a benefit becomes payable the member's accumulated member and productivity contributions in the CSS or PSS superannuation fund are paid out of the CSS or PSS superannuation fund and into Consolidated 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 Consolidated Revenue. This process is prescribed in section 112 of the *Superannuation Act 1976* and section 16 of the *Superannuation Act 1990*.

The Commonwealth's method of payment of unfunded superannuation benefits (as opposed to the States' method), has resulted in no employer contributions actually being paid by the Commonwealth into the CSS or PSS superannuation fund. The result is that the Commonwealth generates no contribution tax liability to enable Pre-1 July 1988 Funding Credits to offset any tax liability. This means that unfunded pre 1988 accruals in the CSS and PSS are element untaxed, and taxed accordingly, while 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 and 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 cost 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 benefit recipients paying tax on Pre-1 July 1988 accruals, which is tax free for everyone else. Accordingly, SCOA believes that there is no reason why CSS and PSS benefit recipients should not be taxed the same way as other recipients of unfunded superannuation scheme benefits in respect of their unfunded superannuation benefits that accrued before 1 July 1988.

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