NET INCOMES OF PUBLIC SECTOR SUPERANNUANTS

TALK TO SCOA, SA MEMBERS
16 APRIL 2014
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INTRODUCTION

- This document is the outline of a talk given by Dr ray Hickman to a meeting of SCOA Australia members held in Adelaide on 16 April 2014.
- Ray is a member, and former president, of SA Superannuants the organisation representing the interests of members of the South Australian Government's state pension scheme. This scheme pays untaxed-source pensions having the same tax and means-testing properties as superannuation pensions paid by the Commonwealth Government.
- The talk outlined the different taxation and means testing of untaxed-source pensions compared to taxed-source pensions and the effect these differences have on net incomes of the recipients of the two types of defined benefit pensions.
- Generally, taxed-source pensions deliver larger net incomes than the corresponding (equivalent) untaxed-source pensions even though an untaxed-source pension nearly always has a larger gross value than its taxed-source equivalent. The main exceptions to this occur when the pension values are relatively small.

PLEASE NOTE!

- 1. The figures in the slides 15-17 have been calculated from a spreadsheet created by the author and then checked against ATO online calculators.
- 2. The comparisons made in the slides 15-17 are of a CSS pension and a pension paid by the NSW government having a gross value equal to 91% of the CSS pension. This is to allow for the fact that the NSW pensions are taxed-source pensions that have been reduced in their gross values by the taxes paid by the NSW funds when the pensions were in the accumulation phase.
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- 3. Taxed-source pensions have, since 2007, been allowed an additional tax-free component that corresponds to service completed before July 1983. This increased tax-free component also reduces the amount of the super pension that is counted in the Centrelink income test for age pension allowing people with taxed-source pensions to receive significantly larger age pension payments than people with untaxed-source pensions of the same gross value.
- 4. The author would welcome feedback from readers on any aspect of the material contained in this document. This feedback should be sent to him at barefootactuary@bigpond.com

NET INCOME

- **For most people**

- Super pension

+

- Non-super income

+

Age pension or CSHC

Gross income

Net income

-Tax&M/care

****influenced by type of super pension and not just the amount****

DEFINED BENEFIT PENSIONS (DBPs) AND ALLOCATED PENSIONS (APs)

Defined benefit

Pensions paid by the C/wealth and most States for many years. e.g. Super SA and CSS

Mostly closed to new members except for military personnel and judges.

Can be cashed in only in prescribed circumstances. Not considered to have an asset value.

Allocated

These are the norm now in both the public and private sectors. They did not become available until after 1983

Account-based and can be cashed in at any time. Have both an income value and an asset value.

TAXATION STATUS OF SUPER PENSIONS

- **Taxed-source pensions:** paid from money held in the fund that has been subject to tax on contributions and earnings since 1 July 1988.
- **Examples:** all allocated pensions, defined benefit pensions paid by the NSW and Victorian Governments

- **Untaxed-source pensions:** paid from money held in the fund that has **not** been subject to tax on contributions and earnings since 1 July 1988.
- **Examples:** all Commonwealth defined benefit pensions and pensions paid by SA, WA and Tasmanian State Governments

EFFECT OF 1 JULY 1988 TAXES ON PENSION VALUE

- The same amount of money paid into a taxed source delivers a smaller pension than if it had been paid into an untaxed source. The reason is depletion of fund assets by tax.

- To compensate for this recipients of taxed-source pensions pay less personal income tax.

- **Usually a person is better off getting the smaller pension from a taxed-source than the larger pension from an untaxed-source.** **<u>The reason is that only the post-July 1988 fraction of the pension is reduced but the entire pension is concessionally taxed.</u>**

WHAT WOULD OUR PENSIONS BE IF THEY HAD BEEN TAXED-SOURCE FROM THE START?

Year pension commenced	% of your untaxed-source pension	
	Super SA	CSS
1988 or before	100	100
1993	98	98
1998	97	96
2003	95	94
2008	93	91
2013	91	89
Working lifetime of 35 years assumed		

TAX OFFSETS

- 15% tax offset on taxed-source pensions for ages 55-59 years
- 10% tax offsets on untaxed-source pensions from age 60
- Dependent spouse tax offset (DSTO) for spouses born before 1 July 1952
- Senior Australians and pensioner tax offset (SAPTO)
- Low income tax offset (LITO)

- **Most tax offsets only reduce tax to zero i.e. some or all of an offset may not be usable. Most tax offsets do not reduce the Medicare levy.**
- **DSTO is being phased out and this could happen with SAPTO.**

TAXATION OF SUPER PENSIONS

Taxed-source

1988-2007

Taxed as normal income with 15% tax offset allowed from age 55.

2007 to present

Tax-free from age 60. Not counted as taxable income.

Untaxed-source

1988-2007

Taxed as normal income

2007 to present

10% tax offset from age 60. In 2014 tax is zero up to $36,000 for singles, $48,000 for couples.

Superior to taxed source pension up to these values **when there is no other income and before age 65.**

TAXATION OF NON-SUPER INCOME (INCLUDING AGE PENSION) AFTER AGE 60

When super pension is taxed-source

1988-2007

Added to super income and taxed at marginal rate for the combined income.

2007 to present

Taxed as if it is the only income.

In 2014 tax on $18,200 of non-super income is $0 for singles no matter how large the super pension is. After 65 SAPTO allows $0 tax up to $32,279.

When super pension is untaxed-source

1988 to present

Added to super income and taxed at marginal rate for the combined income.

In 2014 some tax is payable on any non-super income over $36000 (singles) or $48000 (couples). On $18200 up to $6000 would be payable.

SUPER PENSIONS AND THE COMMONWEALTH SENIORS HEALTH CARD (CSHC)

- **Before 2007**
- all, or nearly all, super pension income was counted for CSHC eligibility and medicare levy purposes.

- **After 2007**

Allocated pension and taxed-source defined benefit pension income is not counted for CSHC eligibility or for calculation of the medicare levy.

All or most of an untaxed-source defined benefit pension continues to be counted for CSHC eligibility and medicare.

MEANS TESTING OF DEFINED BENEFIT PENSIONS

Taxed-source super pension (NSW & VIC)

Before 2007

All, or nearly all, the pension is counted in the income test with 40% taper rate used.*

After 2007

Amount counted in the income test is reduced where membership goes back before 1983

Age pension increased for most of those working before 1983

Untaxed-source super pension(CSS/Super SA)

Before 2009

All, or nearly all, the pension is counted in the income test with 40% taper rate used*

After 2009

All, or nearly all, the pension is counted in the income test with 50% taper rate used.

Age pension entitlement reduced for most people whether working before 1983 or not.

THE EFFECT OF DIFFERENCES BETWEEN TAXED-SOURCE AND UNTAXED-SOURCE PENSIONS

- The next three slides display net incomes for CSS pensions of $25,000 p.a. and $50,000 p.a. and compare those net incomes with the net incomes delivered by equivalent NSW defined benefit pensions ($22,750 p.a. and $45,500 p.a.)

- For the case of couples displayed in slide 17 the other income has been assumed to be in the hands of the partner who is **not** the recipient of the defined benefit pension

- Of the examples given the smaller NSW pensions deliver larger net incomes except for the case of the single person aged less than 65 and receiving a NSW pension of $22, 750 p.a. (slide 16). The reason is that this person is not yet eligible for an age pension payment. When he/she reaches the qualifying age for a part age pension payment he/she will have a larger net income than the CSS superannuant with the $25,000 p.a. pension (slide 15).

- The better net incomes for the taxed-source pension recipients result from them paying no tax or medicare levy and/or receiving additional age pension.

NET INCOMES FOR DIFFERENT DEFINED BENEFIT PENSIONS

Single person who retired in 2008 aged 60+ years after 35 years service				
	Smaller pensions		Larger pensions	
	CSS	"NSW"	CSS	"NSW"
Super	**$25000**	**$22750**	**$50000**	**$45500**
Age Pension	$8920	$12889	$0	$1858
Other income	$5000	$5000	$10000	$10000
Gross income	**$38920**	**$40639**	**$60000**	**$57358**
Tax	$4196	$0	$11047	$0
Tax offsets	$4316	$2675	$5100	$2675
Net tax	$0	$0	$5947	$0
Medicare	$583	$0	$900	$0
Net income	**$38337**	**$40639**	**$53153**	**$57358**
"NSW" advantage	**+$2302**		**+$4205**	

NET INCOMES FOR DIFFERENT DEFINED BENEFIT PENSIONS

Single person who retired in 2008 aged 55-58 years after 35 years service				
	Smaller pensions		Larger pensions	
	CSS	"NSW"	CSS	"NSW"
Super	**$25000**	**$22750**	**$50000**	**$45500**
Age Pension	$0	$0	$0	$0
Other income	$5000	$5000	$10000	$10000
Gross income	**$30000**	**$27750**	**$60000**	**$55500**
Tax	$2242	$0	$11047	$0
Tax offsets	$2945	$445	$5100	$445
Net tax	$0	$0	$5947	$0
Medicare	$450	$0	$900	$0
Net income	**$29550**	**$27750**	**$53153**	**$55500**
"NSW" advantage	**-$1800**		**+$2347**	

NET INCOMES FOR DIFFERENT DEFINED BENEFIT PENSIONS

Couples who retired in 2008 aged 60+ years after 35 years service				
	Smaller pensions		Larger pensions	
	CSS	"NSW"	CSS	"NSW"
Super	**$25000**	**$22750**	**$50000**	**$45500**
Age Pension	$21624	$25593	$6624	$14562
Other income	$5000	$5000	$10000	$10000
Gross income	**$51624**	**$53343**	**$66624**	**$70062**
Tax	$3346	$0	$8873	$0
Tax offsets	$3909	$?	$5200	$?
Net tax	$0	$0	$3673	$0
Medicare	$141	$0	$800	$0
Net income	**$51483**	**$53343**	**$62151**	**$70062**
"NSW" advantage	**+$1860**		**+$7911**	

CHANGING THE TAX STATUS OF A PENSION

- 1. The pension must be funded.
- 2. Tax must be paid on the money backing the pension.
- 3. The pension will be reduced in its gross value from the value it would have had as an untaxed-source pension.
- There is probably enough money in the Future Fund to fund existing commonwealth pensions now **but no Commonwealth Government is likely to do this in the near future.** The reasons are:
- i. this would increase age pension outlays immediately and reduce tax revenue in the medium to long term
- ii. The employer loses control of the assets backing the pension which must be used in the best interests of the pension recipient (subject to the fund rules).

IMPROVING NET INCOME FOR CSS AND SUPER SA PENSION RECIPIENTS

- **Plan A:** age pension indexation for the super pensions

- **Plan B:** continuation of tax offsets
- and/or separate taxation of super and non-super income.
- and/or splitting income for tax purposes
- Equitable means testing for age pension and CSHC

‘I SEE A BAD MOON RISING, I SEE TROUBLE ON THE WAY’

Australia’s Future Tax System (the Henry review)

Recommendation 2

Abolition of LITO and SAPTO and use of a higher tax-free threshold.

This recommendation has the potential to increase tax payable by recipients of untaxed-source pensions such as the CSS and Super SA pensions.

Recommendation 88

A comprehensive means test for the age pension where assets are deemed and there is no separate assets test.

This recommendation has the potential to increase the income test taper rate beyond the current 50%. If this happens all recipients of defined benefit pensions receiving a part age pension will have their age pension payment reduced.

MEANS TESTING OF ALLOCATED PENSIONS

- Most, and sometimes all, of an allocated pension income is not counted
- For most allocated pensions it is the asset test, not the income test that determines age pension payment.

Example

- A single person drawing $12,000 p.a. from an account established with $250,000 will get a full age pension.

- $12,000 of defined benefit pension income gives about $3500 less than the full age pension ($2500 for a couple).

KEY DATES FOR TAXATION OF SUPER AND MEANS TESTING FOR AGE PENSION

- **1983:** for lump sums the amount accruing after 1983 was taxed at 30% (Hawke/Keating)
- **1988:** super fund income taxed, lump sum rate reduced from 30% to 15%, tax offset of 15% introduced for taxed-source pensions

  (Hawke/Keating)
- **2007:** Simpler super: 10% tax offset for untaxed source pensions from age 60; taxed-source pensions tax-free

  (Howard/Costello)
- **2009:** Age pension reform: income test taper rate increased to offset the cost of full pension increases. (Rudd/Gillard)