

12 June 2015

Committee Secretary  
Senate Standing Committee on Community Affairs  
Parliament House  
Canberra ACT 2600

Dear Senators

I am writing this submission as an objector to the Social Services Legislation Amendment (Fair and Sustainable Pensions) Bill 2015. This objection specifically concerns Schedule 1 – Defined Benefit Income Streams and its implications for the assessable income used in determining the Aged Pension payments to members of defined benefit superannuation schemes.

I am a retired public servant who worked for the NSW Department of Planning for 30 years and was a contributor to the NSW State Superannuation Scheme. The State Super Scheme (which closed to new members in 1985) is a defined benefit scheme; it provides a defined income stream based on the number of units held by the retiree and the maximum unit entitlement is determined by the final salary of the retiree.

The Explanatory Memorandum attached to the Bill explains that payments from a defined benefit income stream, less a **deductible amount**, are taken into consideration in the Income Test for income support payments. The **deductible amount** is calculated by reference to the **tax-free component** of the income stream, as determined in accordance with the Income Tax Assessment Act 2007.

Section 307 of the Income Tax Assessment Act indicates that the **tax free component** includes several components of which **undeducted contributions** are a major part. These are the personal contributions made by the retiree from their after-tax salary (up to 1 July 2007 when salary sacrificing was allowed in the State Super Scheme).

### An average member of a defined benefit scheme

The data presented to the Senate Committee on 4<sup>th</sup> June 2015 indicated that almost 48,000 people are receiving payments from a defined benefit income stream and also qualify for a part pension. My analysis of the data from the Department estimates that the average annual income for these members of defined benefit schemes is only \$27,550, i.e. about \$1,060 per fortnight. This is nearly 20% less than the full rate for the Age Pension for a married couple. Furthermore, the DSS data shows that two-thirds of the people in defined benefit schemes are receiving less from those income streams than the Age Pension rate for a married couple.

On retirement, a member of the NSW State Super Scheme receives a nominal amount of \$5.50 per fortnight for each unit they hold; this is reduced by 15% tax on employer contributions (since 1988) and investment earnings, giving a net payment of about \$5 per fortnight unit. A member of the Scheme would need about 212 units if they were to receive the average defined benefit scheme income of \$1,060 per fortnight.

A member of the Scheme qualifies for one unit for each \$260 of annual salary. So a member with 212 units would have been receiving a salary of \$55,000 prior to retirement (or possibly slightly more if they had decided to abandon units).

## The average member's personal contributions to the Scheme

Members of the NSW State Super Scheme were required to make total personal contributions of almost \$500 for each unit, if they wished to maximise their income stream on retirement. So a newly retired member receiving the average defined benefit scheme income would need to have made total personal contributions of over \$100,000.

These personal contributions would comprise about 30% of a member's share of the capital in the fund by the normal retirement age of 60 (based on Benefit Estimates received from the State Super Scheme). A member of the NSW State Super Scheme has the option of commuting their income stream to a lump sum when retiring at age 60. My estimate, based on Scheme Fact Sheets etc., is that a member receiving an income stream of \$1060 per fortnight could commute this to a lump sum of about \$300,000. This would confirm that a member's personal contributions constitute 30% – 33% of the capital in the Scheme that is generating the defined benefit income stream.

## The proposed changes to the deductible amount

The Explanatory Memorandum attached to the Bill claims that a 2007 amendment to the Income Tax Assessment Act 1997 resulted in an increase to the tax-free component for some individuals. However, the Guide to Social Security Law indicates (in Section 4.9.2) that the Howard Government did not change the definition of the tax-free component; rather the Government decided to change **the deductible amount** of the defined benefit income stream from the **Undeducted Purchase Price** (as defined in the Income Tax Assessment Act 1936) to the **tax-free component** (as defined in the Income Tax Assessment Act 2007).

The Undeducted Purchase Price uses the total personal contributions, but it calculates the deductible amount by spreading the personal contributions over the life expectancy of the Scheme member. This implicitly assumes that the member's share of the capital in the fund will last as long as the member's life expectancy at age 65 (which could be over 20 years). Since the Scheme must make payments in accordance with a defined benefit income stream, there is no guarantee that the member's share of the capital will last as long as the life expectancy if the fund does not make adequate returns on its investments.

The deductible amount based on the tax-free component is calculated by using the proportion of the member's share of the capital in the fund that has come from the member's personal contributions; there is no parameter involving the life expectancy of the member or the expected life of the capital in the fund.

As my example above shows, the use of the tax-free component (as defined in ITAA 2007) to calculate the deductible amount is a fair way of assessing the proportion of the income stream which is attributable to the personal contributions made from the Scheme member's after-tax income. On the other hand, the Government's proposal to cap the deductible amount at 10% of the income stream is completely arbitrary. My analysis shows that members of the NSW State Super Scheme have made personal contributions that justify a deductible amount of about 30% of the income stream.

## Lack of warning before Budget decision

The Government has also been arbitrary in introducing this legislation without any warning in advance of the 2015-16 Budget. The Government was elected on a platform that there would be no changes to superannuation taxes or regulation in the current term.



Members of defined benefit schemes have had to make long-term plans for their retirement over their professional careers because the member's contributions could not be easily rolled over into other similar schemes. In particular, the NSW State Superannuation Scheme was seen as an attractive condition of employment and it provided an incentive for people to make career decisions that allowed them to achieve a long-term membership of the Scheme.

With the changes in the taxation of superannuation in 2007, retired members of the Scheme found that it was worth arranging their finances in order to qualify for an Age Pension. Those members who will lose their Age Pension as a result of the proposed reduction in the deductible amount could have modified their financial plan if they had sufficient warning. For example, they could have commuted part of their income stream to a lump sum in such a way that they complied with the income test and the assets test for the Age Pension.

If the Senate decides to support the proposed reduction in the deductible amount, therefore, it is recommended that the arrangements for existing members of defined benefit schemes should be protected by grandfathering provisions in the Bill. In addition, there should be a moratorium of several years on the reduction of the deductible amount to give members of defined benefit schemes who are about to retire sufficient time to modify their financial plans for their retirement.

### Are defined benefit scheme members wealthy "fat cats"?

In the week before the Budget, the Minister briefed journalists from News Limited. They published reports that the Minister would close a loophole which allows "thousands of retired public service fat cats" to participate in "a double-dipping rort under which they can claim an Age Pension while drawing income from their taxpayer funded superannuation".

The data submitted to the Senate Committee by the Department of Social Services confirms that most of the defined benefit scheme members who draw an Age Pension are struggling to maintain a comfortable lifestyle. The average annual income they are drawing from their defined benefit scheme is only \$27,550, almost 20% below the full rate for the Age Pension for a married couple. This would allow them to draw an Age Pension (for a couple) of about \$27,760, giving a combined income of \$55,310. This is \$3000 below the income required by a couple for the Comfortable Lifestyle standard as estimated by ASFA.

Two-thirds of the defined benefit scheme members in the DSS data are drawing less from their income stream than the full rate for the Age Pension for a couple, i.e. \$33,716 per year. The few members with the highest income in this group would have a combined income of about \$59,000 which is just above the income required by a couple for a Comfortable Lifestyle.

The majority of these defined benefit scheme members would not qualify as "public service fat cats" with these income levels. Since they are drawing a defined benefit income less than the full Age Pension, it is quite heartless for the Minister or News Limited to accuse them of "a double-dipping rort" and expect them to live on only their income stream. (ASFA estimates that a couple would struggle to achieve a Modest Lifestyle on an income of \$33,766, which is about the full Age Pension.)

Yours sincerely

Michael Conroy