N. E. SMITH

SUBMISSION TO
SENATE ECONOMICS COMMITTEE

RELATING TO
INQUIRY INTO THE PROVISIONS OF THE TAX LAWS AMENDMENT (SIMPLIFIED SUPERANNUATION) BILL 2006 AND FIVE RELATED BILLS

OVERVIEW

The proposed tax treatment of superannuation benefits, both in the form of superannuation lump sums and superannuation income streams, that have not been subject to tax in the fund and paid to persons aged 60 and over is inequitable. The legislation should be amended so superannuation benefits that have not been taxed in the fund and paid to persons aged 60 years and over are dealt with in the same manner as the payment of superannuation benefits to persons aged 60 and over where those benefits have been subject to tax in the fund – namely they should be tax free. As with benefits subject to tax in the fund, the full end benefits should be tax free.

The proposed tax treatment discriminates against a small percentage of the superannuated (some of “the 10 per cent of Australians with benefits in untaxed schemes”[1]).

The current 15% tax offset results in pensions taxed in the fund being freed of the taxes imposed in the fund and artificially appears to place the recipients of these pensions in the same position as recipients of pensions that have not been taxed in the fund. However many of the schemes that are not taxed in the fund are indexed defined benefit schemes. Any taxes on these schemes would have had to be borne by the Commonwealth or State Governments that operated these schemes. There is no justification for any argument that as recipients of superannuation benefits taxed in the fund will lose the benefit of the 15% tax offset once the benefits are tax free, recipients of benefits not taxed in the fund should pay a “compensating tax” in the guise of an end benefit tax because their schemes are tax exempt.

Equally, there is no justification for imposing some “compensating tax” under the guise of an end benefits tax on recipients of superannuation benefits not taxed in the fund on some inferred argument that:

- providers and beneficiaries of services to tax exempt authorities should pay an additional “compensating tax”; or

[1] Explanatory Memorandum, page 5

- persons receiving superannuation benefits not taxed in the fund should pay an additional “compensating tax” for somehow having received something at the Commonwealth’s expense.

For many of those persons, the superannuation entitlement was a fundamental element of the otherwise under-priced salary packages provided by governments prior to their recent adoption of mega salary packages. And governments of all political persuasions relied on this as part of their recruitment and retention arrangements.

The Commonwealth had ample opportunity to impose taxes equivalent to the 15% superannuation contributions and net earnings taxes on itself and the States. For whatever reason, it failed to do so. This does not justify the Commonwealth now attempting to shift the tax burden on to some persons aged 60 and more receiving lump sums or pensions not taxed in the fund.

In deciding that many superannuation payments to persons aged 60 or more will be tax free, the Government has decided to abolish the end benefits tax[2] for most individuals, changing the fundamental nature of income for the purposes of tax law – superannuation benefits will no longer form part of taxable income for many individuals aged 60 or more.

In proposing a 10% offset, the Treasurer has both arbitrarily and artificially effectively converted part of an end benefits tax into “compensating” and “penalty” taxes on persons aged 60 or more receiving superannuation pensions not taxed in the fund. As evidenced by the tables within this submission, the 10% tax offset provides only some relief for those on medium total incomes. It muddies the water and further marginalises those who have taken independent action to further provide for their needs in retirement, or who receive somewhat higher superannuation pensions.

Inequities were drawn to the Commonwealth’s attention during and after its consultation process. CPA Australia offered access to its resources and membership base to work with Treasury to develop a solution. The Commonwealth has progressed the legislation apparently without any explanation of why it has ignored the inequities and without taking up the CPA Australia offer. Rather by now using the expression “where those benefits have been subject to tax in the fund” it could seem that the Commonwealth is seeking to further muddy the water and limit the ways in which a solution could be developed.

Regardless of the intent and the wording used, the Commonwealth’s proposal will effectively result in both a:

- “compensating tax” and
- “penalty tax”

being imposed on persons aged 60 and over who receive superannuation pensions from Commonwealth and State Governments when the pensions have not been subject to tax in the fund, simply because the Commonwealth and States are tax exempt.

---

[2] Explanatory Memorandum, page 8

I contend that:

- superannuation benefits, whether in the form of superannuation lump sums or superannuation income streams, and whether or not taxed in the fund should be tax free in the hands of the recipients aged 60 and over; and
- if some form of “compensating” tax is to be imposed it should be so named and defined, calculated separately to any other income and calculated so that persons aged 60 or more receiving superannuation pensions that have not been subject to tax in the fund receive as a minimum whichever is the greater of an “after tax” equivalent of 85% of the amount otherwise payable by the fund, or that which would result from applying a 10% offset to those income streams as if the income streams were the sole source of income taxable at 2007 “index adjusted” or then prevailing personal income tax rates.

NEVILLE SMITH
11 January 2007

DETAILED SUBMISSION

This submission addresses one aspect of particular interest in the five Bills being considered by the Senate Estimates Committee. That issue is the inequities in the proposed tax treatment of superannuation benefits that have not been subject to tax in the fund and paid to persons aged 60 and over.

The submission is based primarily on the Explanatory Memorandum. I consider I do not have sufficient legal expertise to fully understand the draft Bills and accordingly I must rely on the Explanatory Memorandum.

TAX TREATMENT PROPOSED BY GOVERNMENT

The Explanatory Memorandum indicates (para 2,1):

> "… Under this simplified regime:
>
> - the payment of superannuation benefits, whether in the form of a superannuation lump sum or a superannuation income stream, to persons aged 60 and over is tax free where those benefits have been subject to tax in the fund;
> - where a superannuation benefit contains an amount that has not been subject to tax in the fund, it will continue to be subject to tax. However, where the benefit is paid to person aged 60 and over, a lower rate of tax applies than currently. This is relevant generally to those people (eg, public servants), who are members of a superannuation fund established by the Australian Government or a state government;"

More particularly, under the proposed new arrangements:

> "2.12 A superannuation benefit may comprise the following:
>
> - a tax free component;
> - a taxable component which includes:
>   - an element taxed in the fund; and / or
>   - an element untaxed in the fund.
>
> 2.13 The tax free component of a superannuation benefit is generally made up of contributions from a person's post-tax income and by amounts which represent the portion of a superannuation benefit that accrued before 1 July 1983.
>
> 2.14 The tax free component is, uniformly, not assessable income and not exempt income. That is, it is paid tax free.
>
> 2.15 The taxable component of a superannuation benefit is the total value of the superannuation benefit *less* the tax free component. The taxable component is usually made up of tax deductible contributions made to the superannuation fund by the person and / or by the employer on the person's behalf, as well as earnings on all contributions. For most people the taxable component is entirely made up of an element taxed in the fund, that is, a part that has been subject to tax at the time that contributions were made and upon earnings.

2.16 In comparison, an element untaxed in the fund usually arises in public sector superannuation plans where tax has not been paid on contributions or earnings, or from unfunded schemes."

and:

"2.17 Different taxation arrangements apply to the element taxed in the fund and the element untaxed in the fund. These arrangements are summarised in Tables 2.1 and 2.2. The tax rates specified in the tables are maximum rates of tax. The Medicare levy is also payable upon any superannuation benefit where a tax rate greater than zero per cent applies.

Table 2.1: Superannuation member benefit — element taxed in the fund (a)

Age	*Superannuation lump sum*	*Superannuation income stream*
Aged 60 and above	Tax free (not assessable, not exempt income).	Tax free (not assessable, not exempt income).

(a) Tax free component is always tax free.

Table 2.2: Superannuation member benefit — element untaxed in the fund (a)

Age	*Superannuation lump sum*	*Superannuation income stream*
Aged 60 and above	15 per cent up to the untaxed cap amount of $1 million (indexed) per superannuation plan. The top marginal rate applies to amounts above this cap.	Marginal tax rates and 10 per cent tax offset.

(a) Tax free component is always tax free."

Notwithstanding the manner in which the approach has been worded, it is clear from page 8 of the Explanatory Memorandum that the intent is to abolish end benefits tax on superannuation benefits for most individuals aged 60 and over. Page 8 of the Explanatory Memorandum indicates:

"The Australian Taxation Office (ATO) will experience a reduction in the number of taxpayers who are required to lodge tax returns each year (around 152,000 taxpayers per annum based on 2004-05 tax return data) as a result of the abolition of end benefits tax."

THE PROPOSED APPROACH IS INEQUITABLE.

This treatment is inequitable.

The end benefits tax is to be eliminated for some individuals but continued at a reduced rate for other individuals as a guise for a "compensating tax" and a "penalty tax"

The proposed changes result in a further inequity for many individuals who have other sources of income or receive higher superannuation pensions. It taxes the residual end benefits tax at marginal rates, rather than subjecting it to a separate 15% flat tax.

There is a small minority who will be subject to these inequities - the Explanatory Memorandum indicates that there are "10 per cent of Australians with benefits in untaxed schemes" (page 5).

THE UNDERLYING LOGIC OF THE CHANGES

I have not been able to identify a clear statement of the logic underlying the proposed changes.

However, the use of the terms "subject to tax in the fund" and "end benefits tax" (Explanatory Memorandum page 8) indicates that the Government now considers there to be two elements to the tax on superannuation, and believes that every person should be subject to these two taxes regardless of whether the superannuation scheme is tax exempt, either directly or indirectly. The only exceptions appear to be where the government determines that one or the other will be tax free to the individual or rebated by a tax offset.

Conceptually this results in a tax in the fund and a tax on the end benefit.

The proposed treatment suggests that the Government has taken the next step and decided that if the benefit has not been "subject to tax in the fund", the previous "end benefits tax" should be split into two – some form of a "compensating tax" plus a "penalty tax" and a residual "end benefits tax" which will be rebated. Notwithstanding the convoluted wording in the Explanatory Memorandum, including the term "tax free", this is a fundamental change to the existing concept of there simply being an end benefits tax. The proposed tax arrangements effectively fundamentally change the definition of income for tax purposes.

This fundamental change in thinking gives rise to substantial inequities through the proposed tax treatments.

It seems that the change has been motivated by the fact that once recipients of pensions subject to tax in the fund receive pensions tax free those beneficiaries will lose the benefit of the 15% rebate that currently artificially appears to put them in the same after tax position as recipients of pensions not subject to tax in the fund.

The effect is that the Government now intends to impose a tax on some beneficiaries which would have the effect of compensating it for revenues it has not foregone.

PROVIDERS AND BENEFICIARIES OF SERVICES TO TAX EXEMPT AUTHORITIES SHOULD NOT BE SUBJECTED TO HIGHER TAXES BECAUSE THE AUTHORITY IS TAX EXEMPT

Except to the extent that this has otherwise been varied at law, the Commonwealth and States are tax exempt. Individuals are not obliged to impose a greater tax obligation on themselves than that imposed by the law. And individuals are entitled to deal with others on the basis that the tax status of those individuals does not inadvertently affect their tax status.

The Government intends to override all of these basic principles by imposing what are essentially a “compensating tax” and a “penalty tax” on individuals who receive pensions that have not been subject to tax in the fund.

Effectively the government intends to impose a tax on a minority of individuals to compensate it in part (and overly so at higher incomes) for its failure, inability or reluctance to impose taxes on superannuation funds operated by itself and State governments.

Imposing such a “compensating” tax is akin to the Commonwealth imposing a specific profits foregone tax on both those who provide services to and those who receive services from the Commonwealth or States and any other tax exempt bodies, (including services of tax exempt hospitals, schools, universities) in order to compensate the Commonwealth for the taxes the Commonwealth and States have not paid the Commonwealth since the Commonwealth and States have not earned profits subject to tax.

Taking this to the next level, imposing such a tax on some superannuation pension recipients is akin to taxing recipients of superannuation pensions subject to tax in the fund at normal marginal rates plus a 15% surcharge (as a “compensating tax”) rather than a 15% tax offset since the funds are only taxed at 15% rather than at the corporate tax rate.

And taking this a further logical step, imposing such a tax on some superannuation pension recipients is akin to imposing an additional “compensating tax” on those who provide services to or receive services from any entity that pays tax at less than the top marginal personal rate in order to compensate the Commonwealth for taxes not collected by the Commonwealth from the entity because of its lower tax rate.

There is no justification for the Government to impose a ”compensating tax” under the guise of an end benefits tax on a minority of individuals (while exempting the majority) to compensate for the Commonwealth’s inability or reluctance to impose taxes on Commonwealth and State government superannuation schemes.

Moreover, there is no justification for imposing such a tax in the belief that somehow these persons received some unjustified non-tax benefit at the Commonwealth’s expense.

It can hardly be said that Commonwealth and State employees sought an unreasonable benefit or that the Commonwealth and States have in some way provided unreasonable levels of superannuation benefits to their employees.

Governments variously offered what they saw as necessary "market driven salary packages" during periods of labour shortages in order to boost the attractiveness of their otherwise uncompetitive cash components of their salary packages. By the 1960s or 1970s they were offering indexed defined benefit superannuation pensions. This component of the salary package was an important factor in attracting many individuals to public service in the days prior to mega salaries for senior public servants, and prior to open senior level recruitment. In some cases Governments compelled employees to be members of their superannuation schemes. And in most cases Governments used their superannuation schemes to force retention of staff, only refunding contributions plus interest at 4.5% in the event of early retirement. Individuals traded off higher working salaries for some level of security in retirement.

As evidenced through the imposition of Fringe Benefits Taxes and also by the tax equivalent initiatives of Governments over the past decade or so, it has always been in the power of Commonwealth Governments:

- to pay taxes on their superannuation schemes;
- to fund their superannuation schemes;
- to require, or fund the States under Commonwealth Grants and other grants arrangements, to pay taxes on their superannuation schemes or to fund their superannuation schemes; or
- to have simply recognised superannuation as a fringe benefit and have taxed the States and themselves accordingly for this fringe benefit.

The Commonwealth did not successfully pursue such actions. Rather the Commonwealth decided not to impose fringe benefit or other taxes on Commonwealth and State superannuation schemes. And in most cases the Commonwealth and States also decided not to fund their schemes, and not to give individuals the right to nominate membership of external funds. Rather they directed their available funds to other matters that they considered to be priorities, including reducing net debt to as close as possible to zero. If the private sector and consumers had adopted the same attitude to individual net debt the economy would have ground to a halt as individuals attempted to save the full purchase price before buying houses, cars and a wide range of consumer durables.

In all of the circumstances, there are no grounds that justify the Commonwealth attempting to shift what could have been a tax on the Commonwealth and the States to some recipients of a superannuation pension through this "compensating tax." continued under the guise of an end benefits tax.

THE 15% TAX ON SUPERANNUATION CONTRIBUTIONS AND FUNDS IS A COST TO THE REVENUE, NOT A COST TO EMPLOYEES

There appears to be an underlying belief that the 15% tax on superannuation contributions and fund earnings is a benefit to the revenue and a cost to

employees. It is not a benefit to the revenue. If anything it is a cost to the revenue, and a cross subsidy of employers at the expense of employees.

Adopting a holistic view to Australia's combined income and profits tax, taxes are paid on personal incomes and on profits, except where the entity or income is tax exempt, or otherwise legislated.

The original tax structures reflected this logic. Individuals paid taxes on salaries, wages and superannuation benefits, etc. Entities subject to tax received tax deductions for superannuation contributions and superannuation investments and funds paid taxes on profits (or net earnings).

Certain superannuation concessions were then introduced in the form of lower rates of tax. These concessions imposed a cost on the revenue. The 15% tax on fund profits (or net earnings) is less than the standard corporate rate of tax on profits (previously in excess of 30%). A 15% tax is imposed on untaxed contributions to the superannuation funds, while the employer continues to receive a tax deduction at the corporate tax rate (30%) or his or her marginal tax (and Medicare) rate (up to 48.5%)

I do not begrudge individuals the benefits of the tax concessions that have been granted to superannuation funds. However, I strongly object to recipients being taxed more because their employer and superannuation schemes were tax exempt.

And I am concerned that employers benefit from tax deductions of 30% or up to 48.5% when the revenue receives only 15% on contributions to superannuation funds. It is disturbing that the 15% tax on contributions is at the expense of the employee rather than the employer. In essence, on an after tax basis, the employer may be paying less than the 9% statutory contribution and the employee is receiving less than the 9% statutory contribution, with the employer often benefiting at the employee's expense. Nevertheless, the 15% tax on superannuation contributions and funds is an expense to the revenue. It is not a net cost to employees. Employers benefit from the one cost to employees – the 15% tax on contributions. This 15% tax on contributions should be met by employers and not by employees out of contributions.

Effectively, through to the time they are paid to beneficiaries, pensions taxed in the fund have been subject to a 15% tax – being the 15% on contributions and the 15% on earnings.

However, this does not provide any justification to impose a "compensating tax" in the guise of an end benefits tax on pensions that have not been subject to tax in the fund because they are tax exempt.

THE 15% TAX OFFSET EFFECTIVELY MADE SUPERANNUATION CONTRIBUTIONS AND EARNINGS TAX FREE

The current 15% tax offset for individuals receiving superannuation pensions effectively reversed the 15% tax on contributions and fund earnings from which the pension was paid. Effectively it made the contributions and fund earnings

tax free at the time they were received as pensions. It thus provided an artificial parity, regardless of tax status, with pensions received from funds not subject to tax, permitting the Commonwealth not having to find a means of imposing an equivalent tax on itself and the States while honouring their long established indexed defined benefit schemes.

Put another way, currently the 15% tax offset eliminates the tax paid on contributions and earnings in the fund where pensions have been subject to tax in the fund and places beneficiaries in the same position as if there had been no tax on contributions and earnings – artificially apparently in the same position as beneficiaries of pensions not subject to tax in the fund. This apparent parity is artificial where the Commonwealth and States were committed to providing indexed defined benefits. The tax costs would have had to be borne by Commonwealth and the States without reducing the before tax benefit to recipients.

Again, this does not provide grounds for imposing a "compensating tax" in the guise of an end benefits tax on recipients of pensions not taxed in the fund. It does not justify not extending tax free status for all of the current end benefits tax to recipients of superannuation pensions not subject to tax in the fund. **Equity demands that all superannuation pensions paid to individuals aged 60 and over be tax free, whether or not the pension has been subject to tax in the fund.**

ABOVE A BASE INCOME, THE INEQUITIES ARE SIGNIFICANT

In proposing a 10% offset, the Treasurer has both arbitrarily and artificially effectively converted part of an end benefits tax into "compensating" and "penalty" taxes on persons aged 60 or more receiving superannuation pensions not taxed in the fund. As evidenced by the following tables, the 10% tax offset provides only some relief for those on medium total incomes. It muddies the water and further marginalises those who have taken independent action to further provide for their needs in retirement, or who receive somewhat higher superannuation pensions.

The 10% tax offset results in different amounts of tax payable for different pension amounts, and for different amounts of income in addition to any superannuation pension.

In order to demonstrate the magnitude of these inequities I have made a choice of pension and other income levels for my calculations. Many individuals receive indexed pensions. And many will live 30 to 40 years in retirement. At a 3% index factor, the annual benefits will double in about 23 years. By 30 years they will have increased by 243%, by 281% after 35 years and by 326% after 40 years.

The following tables quantify the inequities at various pension levels covering likely indexation growth in modest pensions, both without any additional income and with an additional income of $25,000 a year. [The individual components of the Table I and Table 2 calculations are provided in Tables 6 and 7 attached at the end of this submission.]

TABLE 1 – An Inequity Quantified - Single, Tax and Medicare Payments at 2006/07 rates (as per ATO Web Site), assuming superannuation pension is sole income and no deductions or tax offsets other than superannuation and pension offset [i.e. result excluding tax free component.]

SUPER PENSION INCOME	PENSION SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	**QUANTIFIED INEQUITY ***
5,000	-	-	-
10,000	-	-	-
15,000	-	-	-
20,000	-	100	100
25,000	-	725	725
30,000	-	1,800	1,800
40,000	-	3,950	3,950
50,000	-	6,100	6,100
60,000	-	8,250	8,250
70,000	-	10,400	10,400
80,000	-	13,050	13,050
90,000	-	16,200	16,200
100,000	-	19,350	19,350
110,000	-	22,500	22,500
120,000	-	25,650	25,650
130,000	-	28,800	28,800

* Individual receiving pension untaxed in fund disadvantaged relative to individual receiving same "income" with pension taxed in the fund. Calculated as Tax and Medicare Paid on Pension Untaxed in Fund less Tax and Medicare on Pension Taxed in Fund

TABLE 2 – Even Greater Inequities with Other Income - Single, Tax and Medicare on total "income" (superannuation pension and net other income of $25,000 a year) without other Tax Offsets (at 2006/07 rates)

PENSION + $25,000 OTHER INCOME	PENSION SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE -PAID**	**EVEN GREATER INEQUITIES WITH OTHER INCOME ***
30,000	3,225	4,300	1,075
35,000	3,225	5,375	2,150
40,000	3,225	6,450	3,225
45,000	3,225	7,525	4,300
50,000	3,225	8,600	5,375
55,000	3,225	9,675	6,450
65,000	3,225	11,825	8,600
75,000	3,225	13,975	10,750

PENSION + $25,000 OTHER INCOME	PENSION SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE -PAID**	**EVEN GREATER INEQUITIES WITH OTHER INCOME ***
85,000	3,225	17,125	13,900
95,000	3,225	20,275	17,050
105,000	3,225	23,425	20,200
115,000	3,225	26,575	23,350
125,000	3,225	29,725	26,500
135,000	3,225	32,875	29,650
145,000	3,225	36,025	32,800
155,000	3,225	39,425	36,200

* Individual receiving pension untaxed in fund disadvantaged relative to individual receiving same "income" with pension taxed in the fund. Calculated as Tax and Medicare Paid on Pension Untaxed in Fund less Tax and Medicare Paid on Pension Taxed in Fund

To express Table 2 another way, an individual aged 60 or more with other income of $25,000 a year would effectively be paying the following average tax rates on his or her superannuation pension:

TABLE 3 – Effective Tax Rate on Pension Not Subject to Tax in the Fund with $25,000 "Other Income", Single Etc. [i.e. Based on Table 2]

PENSION + $25,000 OTHER INCOME	Pension	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	**EFFECTIVE AVERAGE TAX RATE (%)**
30,000	5,000	1,075	21.5
35,000	10,000	2,150	21.5
40,000	15,000	3,225	21.5
45,000	20,000	4,300	21.5
50,000	25,000	5,375	21.5
55,000	30,000	6,450	21.5
65,000	40,000	8,600	21.5
75,000	50,000	10,750	21.5
85,000	60,000	13,900	23.2
95,000	70,000	17,050	24.4
105,000	80,000	20,200	25.3
115,000	90,000	23,350	25.9
125,000	100,000	26,500	26.5
135,000	110,000	29,650	27.0
145,000	120,000	32,800	27.3
155,000	130,000	36,200	27.8

The Government's proposal effectively imposes a combined flat rate "compensating" and "penalty tax" of between 21.5% and 27.8% on superannuation pensions of from $5,000 a year to $130,000 a year not taxed in the fund if the individual has other taxable income of $25,000 a year. [In

contrast, the 15% contributions and net earnings taxes on pensions subject to tax in the fund are currently rebated to recipients when the benefit is paid.]

The Commonwealth's proposed tax treatment is clearly inequitable.

THE 10% TAX OFFSET FURTHER HIGHLIGHTS VARIATIONS WITHIN THE APPROACH

The following table highlights critical variations within the approach resulting from the use of a 10% Tax Offset.

There is only one precise pension amount (around $71,600 pa) where applying a 10% to an income comprised solely of a superannuation pension will result in the taxpayer paying the equivalent of a 15% flat rate tax.

TABLE 4 – 10% Tax Offset Varies From 15% Flat Rate Tax - Single, Tax and Medicare Payments at 2006/07 rates (as per ATO Web Site), assuming superannuation pension is sole income and no deductions or tax offsets other than superannuation and pension offset [i.e. result excluding tax free component]

SUPER PENSION INCOME	BASIC TAX AND MEDICARE [IF NOT PENSION]	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	15% "COMPENSATING TAX"
5,000	-	-	750
10,000	600	-	1,500
15,000	1,350	-	2,250
20,000	2,100	100	3,000
25,000	3,225	725	3,750
30,000	4,800	1,800	4,500
40,000	7,950	3,950	6,000
50,000	11,100	6,100	7,500
60,000	14,250	8,250	9,000
70,000	17,400	10,400	10,500
80,000	21,050	13,050	12,000
90,000	25,200	16,200	13,500
100,000	29,350	19,350	15,000
110,000	33,500	22,500	16,500
120,000	37,650	25,650	18,000
130,000	41,800	28,800	19,500

The 10% tax offset appears designed to ease in the 15% "compensating tax" and have less impact on recipients of small pensions. However, it equally has the effect of imposing a substantially greater "compensating tax" on pensions above $71,600 pa.

Where the pension is the sole source of income and in excess of about $71,600, the taxpayer ends up paying the equivalent of a flat rate tax of more that 15%.

For example, if the annual pension income is as much as $100,000 pa (whether through indexation or otherwise), the flat rate tax jumps to 19.4%. With a pension of $130,000 pa it jumps to 21.5%.

A 15% “compensating tax” would require that:

- individuals on pensions of $5,000 pa pay $750 in taxes;
- individuals on pensions of $10,000 pa pay $1,500 in taxes; and
- individuals on pensions of $15,000 pa pay $2,250 in taxes

With the 10% tax offset, these individuals would not pay any tax.

The results of applying a 10% tax offset are entirely arbitrary. Not only is there no justification for applying a “compensating tax” (as detailed above), but the 10% tax offset used is so fundamentally flawed that that the 10% could almost have been randomly generated. It imposes a greater tax burden on some recipients, and no tax burden on other individuals receiving benefits from the same source.

As would be expected from Tables 2 and 3 (earlier), any vestige of equity or objectivity disappears as soon as individuals have income in addition to a superannuation pension not subject to tax in the fund. This is evident from Table 5.

TABLE 5 – A “Penalty Tax” is Effectively being Arbitrarily Imposed - Single, Tax and Medicare on total “income” (superannuation pension and net other income of $25,000 a year) without other Tax Offsets (at 2006/07 rates as per ATO Web Site)

PENSION + $25,000 OTHER INCOME	PENSION NOT SUBJECT TO TAX IN FUND - **TAX AND MEDICARE PAID**	15% “COMPENSATING TAX” ON PENSION PLUS MARGINAL RATES ON ($25,000) OTHER INCOME	**EFFECTIVE ARBITRARY “PENALTY TAX” ***
30,000	4,300	3,975	325
35,000	5,375	4,725	650
40,000	6,450	5,475	975
45,000	7,525	6,225	1,300
50,000	8,600	6,973	1,627
55,000	9,675	7,725	1,950
65,000	11,825	9,225	2,600
75,000	13,975	10,725	3,250
85,000	17,125	12,225	4,900
95,000	20,275	13,725	6,550
105,000	23,425	15,225	8,200
115,000	26,575	16,725	9,850
125,000	29,725	18,225	11,500
135,000	32,875	19,725	13,150
145,000	36,025	21,225	14,800
155,000	39,425	22,725	16,700

* Effective Arbitrary “Penalty Tax” results from:

Tax and Medicare paid on pension not subject to tax in fund plus other income ($25,000) at marginal rates less 10% super pension rebate

Less

15% “compensating tax” on pension

Tax and Medicare on ($25,000) other income at marginal rates when pension is tax free

The failure to separate the flat “compensating tax” from the other income and to apply marginal rates to both with a 10% tax offset effectively results in a substantial arbitrary “penalty tax”, in this example ranging from $650 to $16,700 a year. The “penalty tax” becomes increasingly horrendous as individuals on indexed pensions grow older and older.

IN SUMMARY:

Regardless of the intent and the wording used, the Commonwealth’s proposal will effectively result in both a:

- “compensating tax” and
- “penalty tax”

being imposed on persons aged 60 and over who receive superannuation pensions from Commonwealth and State Governments when the pensions have not been subject to tax in the fund, simply because the Commonwealth and States are tax exempt.

I contend that:

- superannuation benefits whether in the form of superannuation lump sums or superannuation income streams, and whether or not taxed in the fund should be tax free in the hands of the recipients aged 60 and over; and
- if some form of “compensating” tax is to be imposed it should be so named and defined, calculated separately to any other income and calculated so that persons aged 60 or more receiving superannuation pensions that have not been subject to tax in the fund receive as a minimum whichever is the greater of an “after tax” equivalent of 85% of the amount otherwise payable by the fund, or that which would result from applying a 10% offset to those income streams as if the income streams were the sole source of income taxable at 2007 “index adjusted” or then prevailing personal income tax rates.

ATTACHMENTS

SOME BACKGROUND

Before introducing its legislation into the Parliament the Commonwealth would have been aware, both through the consultation process and otherwise, that a number of individuals and organisations consider the tax proposals to be inequitable.

It is not clear to me whether the inequities already identified to the Treasurer and Treasury, have been considered. I have not found any statement of the Treasurer or the Treasury's view of the inequities that have been identified. I have not had a response to the detail of the individual November 2006 submissions I made to the Treasurer, the Prime Minister and the other Cabinet Ministers in November 2006. As the material published by Treasury does not provide a clear statement of the detailed intent of the individual actions I have to draw the underlying logic to some of the actions proposed by the Government from the wording used by the .Commonwealth.

I have not explored all consultation process submissions to identify everyone who identified inequities, and all of the inequities they have identified. However, both the Government Employees Superannuation Board and CPA Australia identified inequities.

The tax treatment was questioned by the Government Employees Superannuation Board in its 9 August 2006 submission during the consultation process. On page 6 of Appendix 1 of its submission the GESB posed the question:

> "It is assumed that the 10% tax offset proposed for members of untaxed schemes provides parity with the tax free pension provided to members of taxed schemes?"

and stated:

> "Seems inequitable that pensions from untaxed schemes will be counted as assessable income whereas pensions from taxed schemes will not."

CPA Australia identified inequities in its 7 August 2006 consultation process submission. In its detailed statement it said:

> "We believe … equivalent benefits should be provided to members of untaxed funds."

and

> "… a more equitable way to treat benefits from untaxed schemes can be found. We would be happy to provide access to our resources and membership base in order to work with Treasury to develop a solution."

I do not agree with some of the issues raised by CPA Australia, but the important point is that CPA Australia did identify that it was inequitable that pensions from untaxed schemes will be counted as assessable income whereas pensions from taxed schemes will not

I was out of Australia when the consultation process was initiated, but during November 2006 I made individual submissions to the Treasurer, Cabinet

Ministers, my local member, Western Australian senators and other senior members of the Commonwealth Parliament.

In my initial submission to the Treasurer and others I advanced a partial incremental analysis. I had also prepared tables based on 2007 tax rates published in the West Australian on 11 May 2005.

In this submission I have attempted to avoid incremental analysis. Rather I have attempted to work from the base in order to provide a complete analysis. I have now used the 2007 tax rates published on the ATO web site in this submission.

THE PUBLIC PERCEPTION

Notwithstanding that the proposal intends to continue to tax superannuation pensions not subject to tax in the fund that are received by persons aged 60 or more, there seems to be a public perception that there will be no income tax on any superannuation pensions received by individuals aged 60 and over.

The Hon. P Costello said on the 7:30 Report on 24 October 2006 that he intended there would be "no tax on a pension" from 1 July 2007. He did not limit this statement to pensions from taxed funds. News.com.au reproduced an article from The Australian on 5 January 2007 stating:

> "Effective from July 1 this year, Peter Costello has scrapped the 15 per cent exit tax paid when superannuation savings are finally withdrawn by the over-60s."

This implies that there is a public perception that persons aged 60 or more receiving superannuation benefits will be treated equally, that the end benefits tax will be abolished in full and the pension will be tax free. However such is not the intent. It is clearly intended to eliminate the end benefits tax for many individuals but attempt to collect what are effectively a "compensating" intermediary tax and a "penalty" tax under the guise of a reduced end benefits tax on a minority.

TABLE 6 – SINGLE, TAX AND MEDICARE PAYMENTS AT 2006/07 RATES (AS PER ATO WEB SITE), ASSUMING **SUPERANNUATION PENSION IS SOLE INCOME** AND NO DEDUCTIONS OR TAX OFFSETS OTHER THAN SUPERANNUATION AND PENSION OFFSET [I.E. RESULT EXCLUDING TAX FREE COMPONENT.]

SUPER PENSION INCOME	BASIC TAX & MEDICARE	PENSION TAXED IN FUND -TAX AND MEDICARE				PENSION UNTAXED IN FUND - TAX AND MEDICARE				
		15% OFFSET	BEFORE CHANGE	AFTER CHANGE	BENEFIT	BEFORE CHANGE	10% OFFSET	AFTER CHANGE	BENEFIT	INEQUITY *
5,000	-	750	-	-	-	-	500	-	-	-
10,000	600	1,500	-	-	-	600	1,000	-	600	-
15,000	1,350	2,250	-	-	-	1,350	1,500	-	1,350	-
20,000	2,100	3,000	-	-	-	2,100	2,000	100	2,000	100
25,000	3,225	3,750	-	-	-	3,225	2,500	725	2,500	725
30,000	4,800	4,500	300	-	300	4,800	3,000	1,800	3,000	1,800
40,000	7,950	6,000	1,950	-	1,950	7,950	4,000	3,950	4,000	3,950
50,000	11,100	7,500	3,600	-	3,600	11,100	5,000	6,100	5,000	6,100
60,000	14,250	9,000	5,250	-	5,250	14,250	6,000	8,250	6,000	8,250
70,000	17,400	10,500	6,900	-	6,900	17,400	7,000	10,400	7,000	10,400
80,000	21,050	12,000	9,050	-	9,050	21,050	8,000	13,050	8,000	13,050
90,000	25,200	13,500	11,700	-	11,700	25,200	9,000	16,200	9,000	16,200
100,000	29,350	15,000	14,350	-	14,350	29,350	10,000	19,350	10,000	19,350
110,000	33,500	16,500	17,000	-	17,000	33,500	11,000	22,500	11,000	22,500
120,000	37,650	18,000	19,650	-	19,650	37,650	12,000	25,650	12,000	25,650
130,000	41,800	19,500	22,300	-	22,300	41,800	13,000	28,800	13,000	28,800

* Individual receiving pension untaxed in fund disadvantaged relative to individual receiving same “income” with pension taxed in the fund. Calculated as Tax and Medicare - Pension Untaxed in Fund less Tax and Medicare - Pension Taxed in Fund

TABLE 7 DETAILED - SINGLE, TAX AND MEDICARE ON TOTAL "INCOME" (**SUPERANNUATION PENSION AND NET OTHER INCOME OF $25,000 A YEAR**) WITHOUT OTHER TAX OFFSETS (AT 2006/07 RATES AS PER ATO WEB SITE)

PENSION + $25,000 OTHER	BASIC TAX & MEDICARE	PENSION TAXED IN FUND -TAX AND MEDICARE				PENSION UNTAXED IN FUND - TAX AND MEDICARE				
		15% OFFSET	BEFORE CHANGE	AFTER CHANGE	BENEFIT	BEFORE CHANGE	10% OFFSET	AFTER CHANGE	BENEFIT	INEQUITY *
30,000	4,800	750	4,050	3,225	825	4,800	500	4,300	500	1,075
35,000	6,375	1,500	4,875	3,225	1,650	6,375	1,000	5,375	1,000	2,150
40,000	7,950	2,250	5,700	3,225	2,475	7,950	1,500	6,450	1,500	3,225
45,000	9,525	3,000	6,525	3,225	3,300	9,525	2,000	7,525	2,000	4,300
50,000	11,100	3,750	7,350	3,225	4,125	11,100	2,500	8,600	2,500	5,375
55,000	12,675	4,500	8,175	3,225	4,950	12,675	3,000	9,675	3,000	6,450
65,000	15,825	6,000	9,825	3,225	6,600	15,825	4,000	11,825	4,000	8,600
75,000	18,975	7,500	11,475	3,225	8,250	18,975	5,000	13,975	5,000	10,750
85,000	23,125	9,000	14,125	3,225	10,900	23,125	6,000	17,125	6,000	13,900
95,000	27,275	10,500	16,775	3,225	13,550	27,275	7,000	20,275	7,000	17,050
105,000	31,425	12,000	19,425	3,225	16,200	31,425	8,000	23,425	8,000	20,200
115,000	35,575	13,500	22,075	3,225	18,850	35,575	9,000	26,575	9,000	23,350
125,000	39,725	15,000	24,725	3,225	21,500	39,725	10,000	29,725	10,000	26,500
135,000	43,875	16,500	27,375	3,225	24,150	43,875	11,000	32,875	11,000	29,650
145,000	48,025	18,000	30,025	3,225	26,800	48,025	12,000	36,025	12,000	32,800
155,000	52,425	19,500	32,925	3,225	29,700	52,425	13,000	39,425	13,000	36,200

* Individual receiving pension untaxed in fund disadvantaged relative to individual receiving same "income" with pension taxed in the fund. Calculated as Tax and Medicare - Pension Untaxed in Fund less Tax and Medicare - Pension Taxed in Fund