

**From:** John Graham  
**Sent:** Monday, 15 January 2007 12:57 PM  
**To:** Economics, Committee (SEN)  
**Cc:** Rob De Haas  
**Subject:** DERB Submission to Senate Committee Please acknowledge Receipt

**Mr. Peter Hallahan**  
**Committee Secretary**  
**Senate Economic Committee**  
**Economics.sen.aph.gov.au**

**A Brief Summary of a Submission to the Senate Economics Committee relating to,  
Taxation Reform to Superannuation Commencing July 1<sup>st</sup> 2007, and DFRB/DFRDB  
Defence Superannuation**

As part of the 2006 Federal Budget, the Treasurer introduced a “Plan to Simplify and Streamline Superannuation. The Treasurer’s response to inquiries on this matter, for DFRB /DFRDB /Contributors/ Superannuants was given in a letter dated 14<sup>th</sup> of July 2006. Public Sector Superannuation schemes were to be excluded from the benefits on the basis that those schemes were ‘unfunded’.

A differing opinion has been given by Robert Hodge B.Tax FASFA, the Senior Advisor (Tax), Association of Superannuation Funds of Australia. His letter is contained in the submission.

The succeeding Defence superannuation scheme, MSBS, resembles the Public Service Scheme (PSS) in that, on retirement, the members receive a total refund, with interest, of their total contributions to the fund, In the case of MSBS, this includes any contributions they may have made to DFRB and DFRDB, because those contributions had been successively absorbed into the new funds.

Mr. Costello has stated that his main reason for not treating all superannuants equally, is that “Benefits paid from an untaxed source would still be taxed under the government’s plan. To remove the tax on these benefits would mean that members of these funds would pay no tax on this part of their superannuation. This would be an unfair advantage to members of these funds as they have not paid the contributions and earnings tax that 90 per cent of Australians have paid on their benefits.”

Mr. Costello is mistaken, or has been ill advised. **This is an incorrect concept: Taxation on these elements was only introduced ‘post 1988’. From 1948 to 1988, both Public and Private sector funds, for taxation purposes, were treated in exactly the same manner.**

**Even though there was no DFRB fund post 1972, effectively, those who were discharged up to the date of introduction of those taxes do not come into your definition that all Public Sector superannuants had an 'advantage'.**

Indeed the Private Sector funds had the advantage of their funds being invested, tax free, up to 1988, whilst the Public sector funds were applied to the Governments spending plans (or at least, DFRB/DFRDB 'Funds'). Advantage to the Public Sector Funds? No! Financial advantage to the Government? Yes Defence superannuants paid for their pension in the same way as Private sector schemes. No taxation was levied on any Superannuation scheme, Public or private Sector, until 1988. You will have to read the paper to appreciate the implications of this.

DFRB/DFRDB superannuants were compelled to join these schemes, and compelled to pay a fixed percentage of their Military Pay, after-tax in contributions. With no option to decline membership, and join some of the excellent commercial schemes available, at that time. The PSS and MSBS receive total refund of their contributions in the form of a lump sum. DFRB superannuants don't. They have to take an advance on their benefit, and accept a lower superannuation fortnightly payment to obtain a 'lump sum'.

The 'old' Parliamentary pension fund, I understand, is considered 'unfunded' and the new, is classified 'funded'. I consider this funded classification was decided on to give Parliamentarians a future tax free future superannuation income. **These parliamentarians have a choice of available Superannuation funds, to which the Government forwards its contributions. Public sector superannuation contributors have never been given this choice, including those currently serving / employed.**

### **Recommendation**

I urge you to abandon the discriminatory policy against Public Sector Superannuants, and grant the full proposed concessions, regardless of funding classification, to all Australians. If not, DFRB/DFRDB superannuants should not be included as 'unfunded'.

**An indication of public support for this proposal is indicated on <http://www.petitionspot.com/petitions/> and [www.ozveteranforce.com](http://www.ozveteranforce.com)**

**JA Graham**

**15<sup>th</sup> January 2007**

**Mr. Peter Hallahan**  
**Committee Secretary**  
**Senate Economics Committee**  
[Economics.sen@aph.gov.au](mailto:Economics.sen@aph.gov.au)

**A Submission to the Senate Economics Committee on the Tax Laws Amendment  
(Simplified Superannuation) Bill 2006 and Funding Status of the Defence Forces  
Retirement Benefits (DFRB) and Defence Forces Retirement and Death Benefits Funds  
(DFRDB)**

*AIM*

**To Achieve equity for Defence Force Superannuants and All Australians**

*INTRODUCTION*

**General.**

1 As part of the 2006 Federal Budget, the Treasurer introduced a “Plan to Simplify and Streamline Superannuation”. All comments in Red are those of the author of this paper.

2 The Treasurers response to inquiries on this matter, for DFRB /DFRDB Contributors/ Superannuants was given in a letter to the Hon Phillip Ruddock, dated 14<sup>th</sup> of July 2006, in reply to an inquiry from one of his constituents:

“In some superannuation funds no employer contributions are made until the person is ready to retire and no contributions or earnings tax has been paid on this element of their superannuation benefits. Funds with members’ interests containing untaxed elements mainly effect military personnel and public servants.”

“Under the Government’s plan, an individual’s own personal (after tax) contributions to superannuation would continue to be received tax free in retirement.” In addition, from 1 July 2007, any investment earnings and employer contributions that have been taxed in the fund would also be paid tax free to a person aged 60 or over.”

“Benefits paid from an untaxed source would still be taxed under the government’s plan. To remove the tax on these benefits would mean that members of these funds would pay no tax on this part of their superannuation. **This would be an unfair advantage to members of these funds as they have not paid the contributions and earnings tax that 90 per cent of Australians have paid on their benefits.**”

This is an incorrect concept: Taxation on these elements was only introduced ‘post 1988’. From 1948 to 1988, both Public and Private sector funds, for taxation purposes, were treated in exactly the same manner. Even though there was no DFRB fund post 1972. Effectively, those who were discharged up to the date of introduction of those taxes do not come into your definition that all Public Sector superannuants had an ‘advantage’.

Indeed the Private Sector funds had the advantage of their funds being invested, tax free, up to 1988, whilst the Public sector funds were applied to the Governments spending plans (or at least, DFRB/DFRDB ‘Funds’). **Advantage to the Public Sector Funds? No. Financial advantage to the Government and Private Sector Funds? Yes!**

Admission to the DFRDB was not allowed to new members after the introduction of MSBS, in 1991. Thus, there are relatively few who can be claimed to have escaped paying the taxes that the Private Sector paid between 1988 and 1991.

“However, in recognition that the tax on superannuation has been reduced for people receiving benefits from taxed sources, taxes will also be reduced on benefits paid from untaxed sources for people aged 60 and above”.

To deny the benefits **to the whole of the community**, for this relatively small number of Defence personnel, is morally indefensible. I believe the Treasurer has been incorrectly advised on the facts of this matter.

“The 30 per cent rate of tax on lump sums will be reduced to 15 per cent up to a total of \$700,000, with any excess taxed at the top marginal rate.”

“A 10 per cent offset will apply to pensions paid from an untaxed source.”

“There are substantial benefits for retirees receiving benefits from untaxed sources. Under the plan it is proposed, for people aged 60 and over, pensions,(including existing pensions) received from an untaxed source would be taxed at marginal rates, but would receive a tax offset of 10 per cent of the total taxable part of the pension. Currently such pensions are taxed at the individual’s marginal rate with no offset.”

“For example, a person who receives a pension of \$56,000.00 with a deductible amount of \$6000 (for contributions made from their after-tax income) would have a taxable pension of \$50,000. The deductible amount of \$6000 would be paid tax-free. The tax offset would be 10 per cent of \$50,000 (that is \$5,000). The actual reduction in tax payable would depend on the person’s circumstances including the impact of other tax offsets.”

“I note finally that it does not matter when the military pension was commenced for individuals to benefit from these changes. From 1 July 2007, as long as the individual is aged 60 or over they will receive the benefit of the changes outlined above.”

“I trust this information will be of assistance to” (name suppressed).

(Signed) Peter Costello “<sup>1[1]</sup>

### **Another Opinion**

3. Another opinion has been given to me by Robert Hodge B.Tax FASFA, the Senior Advisor (Tax), Association of Superannuation Funds of Australia, as follows:

“Our understanding is that prior to 1988 superannuation funds were not taxed on either the contributions to the fund or the investment earnings on those contributions. The Australian taxation office may be able to confirm the taxation arrangements at the relevant point in time.”

“Generally, benefits paid out of superannuation schemes run by the Commonwealth Government for their own employees, judges and parliamentarians have two components. One component represents a member financed benefit (paid for out of the member’s own ‘after tax’ contributions and earnings on those contributions); the other part represents the employer financed benefit (which is paid out of consolidated revenue). Where a benefit is paid out of consolidated revenue this is referred to as an ‘untaxed element’ - the money

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<sup>1[1]</sup> Treasurer’s letter to The Hon Philip Ruddock dated 14<sup>th</sup> of July 2006

has never been subject to income tax. The term ‘unfunded’ also relates to these benefits because the money has never been separately put aside by the employer for the specific purpose of funding these liabilities as they arise.”

“My understanding is that the DFRDB scheme is a part contributory, part unfunded defined benefit scheme. That is, the benefits paid are in part financed by member contributions and in part by the employer, the Government, out of consolidated revenue. As such, benefits paid from the scheme would thus have a ‘taxed’ and an ‘untaxed element’.”

“Our understanding is that under current taxation arrangements, the member financed component of a pension benefit is fully assessable but is subject to a 15% pension rebate and a further separate deduction (referred to as the undeducted purchase price or UPP) related to the employee’s own contributions and calculated using the pensioner’s life expectancy. The employer financed component is fully assessable at marginal tax rates. The differential taxation treatment arises from the fact that the member financed component is paid out of money that has previously been subject to taxation (either in the hands of the employee or in the fund) while the employer financed component has never been subject to taxation.”

**Robert Hodge B Tax FASFA**

**Senior Policy Adviser**

**Association of Superannuation Funds of Australia**

**Email dated 1 September 2006 10AM**

## **BACKGROUND TO THE DFRB SCHEME**

4. This background brief has been prepared to outline the development of Defence Force Superannuation which is necessary to understand, in examining the effects of this proposed legislation.

5. The Defence Forces Retirement Benefits Scheme legislation was introduced in 1948 in conjunction with a general review of policy to the Defence forces. The possibility of a uniform scheme of retirement benefits for permanent members of the Defence Force was assisted by the introduction of a pay code for the Forces in July 1947, bringing members of the Navy, Army and Air Force on to a uniform base of pay and allowances. Associated with the revised pay code, was the introduction of lower retiring ages for Army Officers, more in line with those for officers of Navy and Air and the reduction of the compulsory retiring age for other ranks of the Army and Air Force from 60 to 55 years. The DFRB Scheme was introduced to meet the special needs of the Defence Force for retirement benefits under the new conditions of service. The type of scheme that resulted was similar to other public sector schemes in existence, particularly the Commonwealth Superannuation Scheme (CSS). Broadly, this involved the establishment of an actuarially based superannuation scheme, the membership of which was compulsory, financed partly by members’ contributions and partly by government subsidy and administered by an independent statutory authority. The scheme was based on recommendations of a committee under the chairmanship of the Minister for Defence and Post War Reconstruction, the Honourable J.J. Dedman, M.P.<sup>2[2]</sup>

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<sup>2[2]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972, Chapter 1, paragraph 23.

## **Costs.**

6. It was accepted that the scheme would be ultimately funded on a full actuarial basis, but the novelty of some of the provisions led to an interim arrangement for financing the benefits. The cost of providing the benefits was not apportioned between the contributors and the Commonwealth in strict shares, but the accumulated contributions of the member were paid into a pension account, the Commonwealth meeting the cost of the benefit once the contributions of the member were exhausted. Some adjustments were legislated to make the scheme more equitable for members.<sup>3[3]</sup> The method of financing the member's share of 22 ½ % of the cost by means of a percentage rate of contribution was consistent within numbers of private superannuation plans, in the 60's. Pre 1959 contributors had to pay additional contributions to obtain the same benefits as those who entered after that date.<sup>4[4]</sup>

## **Review of the DFRB Scheme.**

7. The Report from the Joint Select Committee on Defence Forces Retirement Benefits Legislation of May 1972 (Jess Report) concluded the original scheme, although providing a short term answer of providing retirement benefits for Defence personnel had not provided a lasting solution. In fact, the remedies had tended to create their own problems. In particular, problems had arisen in regard to Officer Retirement and the provision of retirement benefit for invalidity Jess also stated "it is also clear that the arrangements that have been made for financing the cost of benefits have worked to the disadvantage of contributors. This is particularly the case with those members of the scheme who entered before 1959.....The relief afforded to members confronted with very high rates of contribution of allowing pre-1959 entrants to 'freeze' their contributions at selected levels thereby rejecting the Fund's share of further entitlement has created its own problems."<sup>5[5]</sup>

8. The plight of certain pre-1959 contributors was of concern to private members and of Senators of all parties with the operation of the legislation.<sup>6[6]</sup> There is little doubt that Jess rectified many of the problems in the act, particularly for pre 1959 contributors.

## **Indexation of Defence Force Superannuation.**

9. Defence Force Superannuants, who have made an important contribution to the quality of life enjoyed by this country, are falling behind in their retired incomes that are the basis of their standard of living and quality of life. If average weekly earnings are increasing at a faster rate than the CPI then those whose income is tied to the CPI will be left behind in the quality of life they can afford. Not being accorded the full benefits of this proposed legislation will mean they will once again not be treated in an equitable manner.

## **Equity with the rest of the community**

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<sup>3[3]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Chapter 1, page 9, paragraph 25.

<sup>4[4]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Chapter 1, page 11, paragraph 26.

<sup>5[5]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Introduction, page 7, paragraph 7.

<sup>6[6]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Introduction, page 7, paragraph 7.

10. It is understood that Federal Parliamentarians and Reserve Bank officers have access to schemes that, which ensure that superannuants maintain relativity, as retirees, to the present day workforce but this is not deemed necessary, by the Government, for its own employees.

### **Reversion on Completion of Repayment of Commutation**

11. There is no provision for reversion to the full value of retired pay once the Commutation Lump Sum has been repaid. Once the Commutation Lump Sum has been repaid, in the interests of equity, the pension should revert to the full value. However this is not the purpose of this submission, but is referred to illustrate the discriminatory way governments have treated retired servicemen over the years. Governments seem to hold retired Defence personnel in contempt, and natural justice apparently counts for little.

### **The Principle of Funding.**

12. At the time of presentation of the Jess Report, the DFRB scheme was pronounced to be “partly funded” by that Committee, along similar lines to those stated by Mr. Robert Hodge, earlier in this paper. <sup>7[7]</sup> **The DFRB was only partly funded because the Commonwealth did not fund its share.** This meant that the Commonwealth did not contribute to the DFRB Fund but met its liability on a ‘pay as- you- go’ basis’

### **Investment of funds.**

13. Members’ contributions were invested mainly in Commonwealth bonds. Earnings were in the range of 6.0 to 6.5 percent. The earnings were not taxed. **No tax was payable on the earnings of superannuation funds, *Public or Private Sector, until 1998***

**14. The Commonwealth did not contribute toward the DFRB/DFRDB Funds, thus not contributing to the health of it.**

### **Taxation of Superannuation Funds.**

15. Taxation of funds, both Public Sector and Private sector, did not come into effect until 1988. Up until 1988, the taxation treatment of Private and Public Sector Superannuation schemes was the same ie,

1. · There was no tax on earnings of either type of fund;
- 2.
3. · There was no tax on the funds themselves; and
- 4.
5. · All contributors were treated in the same manner in their annual Taxation Returns; and all were treated in the same manner, by the Taxation Department, ‘on retirement’.

### **Refund of Surplus Contributions.**

16. Section 22 of the principal Act required the Commonwealth Actuary to undertake periodical reviews of the state and sufficiency of the DFRB Fund as at 13 June 1964 and thereafter at intervals of not less than five years.

17 A surplus of contributions to pre-1959 contributors was made to them in the early 70’s. The surplus existing at the time of the transfer of members’ contributions, in 1972, was

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<sup>7[7]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Chapter 1, page 13, paragraph 39.

appropriated by the government of the day. At that same time the PM of the day, stated that he would ensure that it would be made impossible for any future determination as to whether contributions were in 'surplus'.

18. The Fund was still in surplus at the time of transfer, but Jess could not report on that, as the Report of 1965, by the Commonwealth Actuary, had still not been made available at the time of the Report.<sup>8[8]</sup> This was caused by tardiness on the part of the DFRB Board (later Comsuper).

### **Disposal of DFRB Fund and Assets.**

19. The total DFRB assets were transferred to consolidated revenue at the time of establishment of DFRDB, including surplus contributions that had been reported by the Commonwealth Actuary, as outlined in the previous paragraph. All DFRB serving contributors were transferred to the DFRDB Scheme, without choice.

### **Comparative Benefits between Commonwealth Superannuation Schemes.**

#### **DFRB/DFRDB**

20. The basic entitlements are:

- **Fortnightly Benefit** A pension determined by the person's rank and years of service;
- 1. · **Commutation** An ability to commute four years of superannuation **and accept reduced fortnightly superannuation payments;**
- **Surviving Spouse's Benefit** On the death of the contributor, of 5/8ths of contributor's pension, before commutation; and
- **Lump Sum** There was no entitlement to a lump sum by a refund of member contributions on reaching pension-able age and having the required years of service, as there is for an MSBS member, or for the Public Service.

#### **MSBS.**

21. The basic entitlements are:

- **Employer Benefit** The employer benefit is that part of the benefit paid by the Department of Defence, including the productivity benefit. If a member has reached age 55 and is genuinely retiring from the workforce, he/she may take the employer benefit as a full lump sum or convert 50% or more of it to pension;<sup>9[9]</sup>
- 2. · **Member Benefit** The member benefit is made up of the member contributions and interest accrued at the earning rate of the MSBS Fund. Member benefits can be taken as an immediate lump sum. If the member

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<sup>8[8]</sup> From Joint Select Committee on Defence Forces Retirement Benefits Legislation, dated May 1972 Chapter 5, page 46, paragraph 180.

<sup>9[9]</sup> Retirement Benefits Office Leaflet M20



transferred from the DFRDB Scheme the member benefit includes the member's DFRDB contributions.

### **Public Service Scheme (PSS).**

22. It is enough to say that eligible Public Servants also receive a total refund of their contributions, with interest, under similar conditions of contributors to MSBS, and have done so for very many years. *Thus, they have, ultimately, contributed nothing to their pensions. This scheme can fairly be classified as 'unfunded'*

### **A Fair Go**

23. The Prime Minister last year appeared on the media asking for 'a fair go', from the public, regarding the then recent Parliamentary Superannuation amendments. That scheme includes indexation, to Parliamentary Superannuants, based on current remuneration rates of serving parliamentarians, and reversionary benefits for widows of MPs. Well, how about a fair go for the Government's own employees?

24. The legislators had no idea that this Superannuation taxation reform would be down the line, and the anomaly now exposed should be considered an unintended consequence, and rectified.

25. You have the opportunity to fix some of the inequities imposed on ex- servicemen, rather than add to them, over the years. Please do so.

### **Post 1988 DFRDB Contributor.**

26. Post 1988 contributors should be given due consideration, on the amount of offset/tax exemption, for the time they had been in the scheme prior to 1988 when no taxation was levied on funds, or on earnings of funds.

27. Parliamentary Superannuation benefits include continued alignment with current Parliamentary remuneration, something that has been deemed essential for them, but not for the Government's very own employees. The Government treats Defence superannuants in a poorer manner than Aged or Single Parent pensioners in relation to indexation.

28. DFRB/DFRDB superannuants were compelled to join these schemes, and compelled to pay a fixed percentage of their Military Pay, after-tax, in contributions. With no option to decline membership, and join some of the excellent commercial schemes available, at that time.

**29. However, the 'old' Parliamentary pension fund, I understand, is considered 'unfunded' and the new, is classified 'funded'. I consider this funded classification was decided on to give Parliamentarians a future tax free superannuation income. These parliamentarians have a choice of available Superannuation funds, to which the Government forwards its contributions. Public sector superannuation contributors have never been given this choice, including those currently serving.**

30. There is a perception of incredible discrimination against Defence Personnel in many matters, over the years, and this incorrect classification of DFRB/DFRDB is a further example of this attitude by government. It is not, in 2006, too late to rectify some of this by providing equity with the remainder of the community, in this taxation matter.

31. It is Government that has created this anomalous situation, by accessing the contributor's funds for its own purposes, and manipulating the legislation by classifying the schemes as unfunded, thus escaping its responsibility of a fair system to its employees a system in which the contributors had no choice, or say in the matter.

32. The legislators had no idea that this Superannuation taxation review would be down the line, and the anomaly now exposed should be considered as an unintended consequence of former/current legislation.

33. Should you apply the proposed policy to *all Australians*, you will have achieved true simplicity, and wiped out many anomalies imposed on ex-servicemen, by government

**34. You have the opportunity to fix some of the inequities imposed on Ex-servicemen, over the years, rather than add to them. Please do so.**

**Recommendation**

34. I urge you to abandon the discriminatory policy against Public Sector Superannuants, and grant the full proposed concessions, regardless of funding classification, to all Australians. If not, DFRB/DFRDB superannuants should not be included as 'unfunded'.

J.A Graham  
**15<sup>th</sup> January 2007**

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