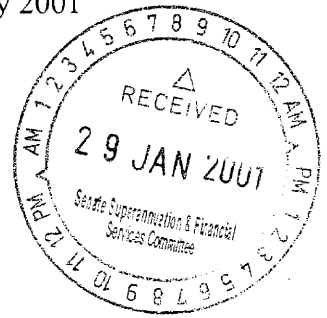5 Saville Close
MELBA ACT 2615

W: 02 62657575
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23 January 2001

The Secretary
Senate Select Committee on Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Sir,

1.   I make this submission in relation to the Defence Forces Retirement and Death Benefit Scheme (DFRDB). Some aspects might be applicable to other funds.

Very small or negative superannuation benefits for long serving members

2.   My major complaint is that members serving longer than 20 years are provided with negligible or negative employer benefits unless they are promoted, but only a minority is promoted. This statement seems incorrect, and I did not believe it myself until I had done some rough calculations while investigating Superannuation Surcharge Levy obligations shortly before leaving the RAAF after 36 years service. I realised then that I had received negative benefits for the past sixteen years.

3.   The anomaly arises because the rate of increase in the annual benefit with additional years of service is insufficient to compensate for the years by which the payment is delayed by that additional service. I suspect that the rate was deliberately lowered to compensate for promotion which in most cases is not applicable. Details are provided in my attached letter of 12 Jan 98.

4.   The benefit at the 20 year mark is generous, but it includes a retention benefit (paid separately under MSBS) and compensation for compulsory age retirement. Never-the-less, the fact that the 20 years service entitlement is generous is no excuse for failing to provide a benefit for further service, particularly as members are forced to remain in the scheme.

5.   The truth or otherwise of my observation can be easily determined by comparison of the Present Values of expected benefit streams. The initial benefit and the life expectancy of the recipient are known, and figures for the expected rise in wage rates and rise in CPI are available from the Australian Government Actuary. I have requested Department of Defence, Comsuper, the Australian Tax Office, and the Australian Government Actuary to calculate Present Values, but all have refused to do so.

6.   My recommended solution to the problem is to provide all beneficiaries with lump sum payments for service in excess of 20 years. The appropriate amount would be the 28% per annum benefit paid by MSBS. Beneficiaries who have received an employer benefit because of promotion after 20 years service could have the lump sum payments reduced by the amount of the pension benefit.

7.   My letter of 3 Jan 01 to the Administrative Appeals Tribunal, since recalled, is **enclosed.**

Compulsory early receipt of pension

8.   Beneficiaries are forced to take most of their benefit as a pension from the moment they resign. However, most work for a further twenty or so years. During that time they do not necessarily need the entire pension, but must receive it. The requirement is therefore

contrary to the Government's encouragement to save for retirement. Further, the beneficiaries pay marginal tax rates on the pension; this considerably disadvantages them in relation to members of most superannuation funds.

9. The problem is exacerbated by the Superannuation Surcharge Levy. The pension is treated as income for purposes of determining whether the levy is payable, and can cause beneficiaries to pay levies on their current employers' superannuation contributions.

10. The solution is to allow members to rollover all or part of their pension until they leave the workforce.

Anomalous Superannuation Surcharge Levy Calculations (Double Counting)

11. For Superannuation Surcharge Levy purposes employer contributions are counted as income both when they are accrued (notional earnings) and when they are paid (pension payments). This mistake of using both accrual and traditional accounting practices probably arose because the drafters of the legislation did not realise that ex-service personnel receive benefits before they leave the workforce.

12. The solution is to adjust income downwards by the amount of pension received. This would be consistent with making the adjustment upwards to cater for current employer contributions (notional or otherwise).

Anomalous Superannuation Surcharge Levy Calculations (Calculation of Notional Surchargeable Contributions Factors)

13. The calculation of notional employer benefits is monstrously incorrect. Over my last three years of service I was assessed as receiving superannuation of about $80,000 when in fact I had money taken from me! Although a simple precise method of determining changes in Present Values is available, as discussed earlier, this method is ignored; the Tax Office instead uses tables supplied by the Australian Government Actuary which are pure gobbledegook. The reason the tables are so wrong is that they ignore the most important factor, promotion. High achievers are thus grossly undertaxed in comparison to the Government's intention, and others are overtaxed to compensate.
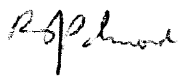
14. The solution is to use the Present Value method to calculate employer superannuation contributions.

Member Statements

15. DFRDB member statements are misleading because they do not show changes to Present Values. They give an indication that future benefits are rising substantially, when they are in fact rising very slowly or falling.

16. Present Value estimates, and their changes from previous years, should be shown clearly on all annual statements to members.

Yours sincerely

R.J.SALMOND

Enclosures:

1. Letter Salmond to Minister for Defence Industry, Science and Personnel and others dated 12 January 1998.

2. Letter Salmond to Administrative Appeals Tribunal dated 3 January 2001

5 Saville Close
Melba
ACT 2615

Tel: (02) 6265 1530   12 January 1998

Minister for Defence Industry, Science and Personnel
Comsuper
Insurance and Superannuation Commission
Australian Taxation Office

For Information:
Opposition Spokesman for Defence
Armed Forces Federation of Australia
Regular Defence Force Welfare Association
Finance Editor, *The Age*
Finance Editor, *The Sydney Morning Herald*
Finance Editor, *The Australian*

ANOMALIES IN SUPERANNUATION BENEFITS FOR LONG-SERVING MEMBERS OF THE AUSTRALIAN DEFENCE FORCE AND CALCULATION OF SUPERANNUATION TAXATION SURCHARGE

Year 1997 Information Statements for the Defence Force Retirement and Death Benefits Scheme were accompanied by brief details of the superannuation contributions tax surcharge. These details included a statement that the Notional Surchargeable Contributions Factor (NSCF) had not yet been developed, and this led me to attempt to determine roughly what the employer contributions to my superannuation benefits really were. I was alarmed by the finding that my benefits were negative, and have been for the past sixteen years. Further, I now fear that the method which will be used to calculate the surcharge will use an averaging process which will lead to my being taxed on non-existent earnings when instead I should be provided with a tax saving.

The purpose of this letter is to :

a.   explain my calculations and ask that they be analysed by all addressees independently;

b.   ask that superannuation benefits, particularly those for DFRDB, be altered if the thrust of my calculations is correct; and

c.   suggest a fair method of assessing, for tax surcharge purposes, employer superannuation contributions.

MAJOR ANOMALIES

Reduction of Accumulated Benefits as Length of Service Increases

The major anomaly which I noted is that accumulated benefits *reduce* with additional years of service. This can be best explained through use of examples.

In the following examples benefits are expressed in terms of percentage of final annual pay. Official pension rates and life expectancy figures are at Enclosure 1.

Standard annuity tables (Enclosure 2) have been used. A common discount factor of 4% has been applied; given actual interest rates and pay rises over recent years, and that pensions are indexed, this is thought to be conservative, and addressees are invited to use more appropriate figures based on data held by them.

First Example - Change Over a One Year Period

The first example will compare the effects of retiring at age 53 with 35 years service, and at age 54 with 36 years service. Life expectancy (as shown in Enclosure 1, Table 3) would be 20.72 (say 21) years for the first case, and 19.94 (say 20) years for the second.

With a simple calculation, using pension rates and life expectancy as shown in Enclosure 1, but ignoring discounting:

Case A total expected benefit $= 60.25\% \times 21$ $= 1265\%$ of final annual pay

Case B benefit $= 62.75\% \times 20$ $= 1255\%$

Thus, although the member would have contributed 5.5% of his final year's salary (the compulsory DFRDB member contribution), and the Commonwealth should also have contributed, the benefit has reduced: the expected increase in benefits over the life expectancy period (20 years x 2.5% higher pension rate per year = 50%) is less than the first year benefit foregone (60.25%).

However, this simplified calculation greatly understates the anomaly, as discounting of the stream of benefits should also apply. Using a 4% discount factor, Present Values (PVs) for the benefit streams can be calculated as follows:

Case A benefit $= 1.04 \, (\, 60.25\% \times 14.029)$ $= 879\%$

> (The 1.04 is a compounding factor (4% interest for a period of one year) which allows comparison of PVs at the same date -refer Enclosure 2, Table C; and
>
> 14.029 is the annuity factor which allows calculation of an annuity for 21 years - refer Enclosure 2, Table B.)

or
$$(1.04 \times 60.25\% \times 1) \quad + \quad (60.25\% \times 13.59)$$
$$62.7\% \quad + \quad 818.8\% \qquad = 881\%$$

The two components represent :

a. the PV of the initial year's pension compounded to the *end* of that year, and

b. the PV of the remaining stream of pension benefits (ie for only 20 years).

Case B benefit $= 62.75\% \times 13.59$ $\qquad = \quad 853\%$.

In other words, instead of the Present Value of the benefit increasing by the 5.5% member contribution and an employer contribution (say about equal to twice the member contribution) it actually declines by about 28% of final salary. Thus, in a single year the employer is actually deducting over 40% of a year's salary from the employee's accumulated investment (which includes a notional employer benefit for the final year).

Clearly, the increment to pension provided as a consequence of the extra year's service is not nearly sufficient to compensate for the reduction in the expected period of entitlement.

Second Example - Change Over a Five Year Period

A second example uses a five year difference from age 49 (30 years service) to age 54 (35 years service). Relevant life expectancies are 24 and 20.

Case A benefit $= (1.217 \times 51.25\% \times 4.452) \quad + \quad (51.25\% \times 13.134)$
for first five years $\qquad$ for next 19 years
$$278\% \quad + \quad 673\% \qquad = \quad 951\%$$

Case B benefit $= \qquad 62.75\% \times 13.59 \qquad = \quad 853\%$
Case B extra costs (employee contributions)
$$1.217 \times 5.5\% \times 4.452 \qquad = \quad 30\%$$
Case B net benefits $\qquad = \quad 823\%$

In this example, not only has the employer provided no contribution to superannuation over the five year period, but it has also deducted the equivalent of about 130% of one year's salary from the employee's nominal accrued superannuation investment (including recent employee contributions). Assuming the employer should also have provided benefits over the five year period, the effective deduction is about two years' salary.

Third Example - Change Over a Ten Year Period

The third example uses a ten year difference from age 44 (25 years service) to age 54 (35 years service). Relevant life expectancies are 28 and 20. The effect of the reduction of 3% from the earlier retirement pension (for commissioned officers only) due to the notional retiring age rule will not be taken into account.

Case A benefit = (1.480 x 8.111 x 42.5%) + (42.5% x 12.659)
          for first ten years   for next 18 years
             510%   +   538%   = 1048%

Case B benefit =   62.75% x 13.590 = 853%
Case B extra cost =   1.480 x 8.111 x 5.5%   = 66%
Case B net benefit   = 787%

In this example, not only has the employer provided no contribution to superannuation over the ten year period, but it has also deducted about the equivalent of two and a half years' salary from the employee's nominal investment. Assuming that the employer's contribution to the investment should have been about twice the member's contribution, the employer's total deduction from the investment is equal to about four years' salary.

Fourth Example - Change Over a Fifteen Year Period

The fourth example uses a fifteen year difference from age 39 (20 years service) to age 54 (35 years service). Relevant life expectancies are 33 and 20. The effect of the 3% notional retiring age reduction for officers will again not be taken into account.

Case A benefit = (1.801 x 35% x 11.118) + (35% x 12.659)
          for first 15 years   for next 18 years
            701%   +   443%   = 1144%

Case B benefit = 62.75% x 13.590   = 853%
Case B extra cost = 5.5% x 11.118 x 1.801   = 110% .
Case B net benefit   = 743%

In this example, not only has the employer provided no contribution to superannuation over the fifteen year period, but it has also deducted about the equivalent of four years' salary from the employee's superannuation benefit. Assuming that the employer's contribution to the investment should have been about twice the member's contribution, the employer's total deduction from the investment is equal to about six years' salary.

Summary of Examples

These examples show that from the time a member is first entitled to a DFRDB benefit (after 20 years' service) the employer pays no contribution whatsoever to the member's superannuation investment. Further, the employer actually removes extremely large amounts of money from the investment; for a wing commander serving to age retirement this deduction is about $400 000.

Non Payment of Pension for Final Months of Service

A further anomaly from fair practice is that no pension is paid for the period of service following the last anniversary of enlistment. Thus a member can serve for a longer period but receive a smaller total pension benefit. For example, a member who joined in January but served to October just before Compulsory Age Retirement would be entitled to about $30 000 *less* than a colleague who retired nine months earlier but otherwise had an identical career. It would be appropriate to compensate the longer serving member with a retrospective payment of pension, plus an amount to compensate for the loss of the employee and employer contributions for the relevant period. Such an amendment would remove the need for members to attempt to arrange retirement dates to coincide with full years of employment.

DISCUSSION ON THE MAJOR ANOMALY

The conclusion from the examples given is that long-serving Service personnel have been forced to belong to a scheme which purports to be a superannuation scheme but which actually reduces accrued superannuation benefits by enormous amounts.

One probable reason for this is that at the time the scheme was devised pension percentages were reduced to compensate for the effects of promotion. However, after 20 years service many personnel (perhaps the majority) have reached their final rank. For these members, the reduction is inappropriate. The appropriate approach would have been to retain higher pension percentages, but limit the final salary on which pensions could be calculated. An appropriate level would have been wing commander (equivalent) rank, for that is the rank most officers are likely to hold after 20 years' service, and the rank at which most officers entitled to a pension would resign.

It should also be noted that as a consequence of extreme reductions in the size of some areas of the ADF over the last decade, promotion prospects for many categories and musterings have been enormously reduced. For example, over that period the number of group captain positions flowing from the supply category has been approximately halved. Because of these reduced promotion prospects, which are dramatic in some categories and musterings, and the use of final salary as the determinant of pension, the Commonwealth has in effect unilaterally changed the terms of the superannuation contract it entered into with many of its employees, much to the detriment of those employees.

As the length of service reduces, the period of pension benefits decreases and the interest on the nominal investment increases. Consequently, the annual increment to pension rates should continually increase. This does not happen for most commissioned officers. For officers the notional retiring age reduction of 3% per year has the effect of increasing for several years the amount by which pensions are increased for each additional year of service; this additional amount rises each year to about 1.3% of final salary for each additional year of service. This is demonstrated in the following table:

Age	Years of Service	Base Pension Rate	Reduction %	Actual Pension Rate	Increment as % of Final Salary	
38	20	35	21	27.65		
39	21	36.5	18	29.93	2.28	
43	25	42.5	6	39.95	2.64	
44	26	44.0	3	42.68	2.73	
45	27	45.75	0	45.75	3.07	
46	28	47.5	0	47.5		1.75
47	29	49.25	0	49.25		1.75.

Thus, for most officers the total pension rate increment at age 45 is about 3% rather than the 1.75% shown at Enclosure 1. However, once notional retiring age is reached the size of the total increment *falls* by 1.3%. The higher increment to the pension percentage should have been continued after notional retiring age; this would have increased pension rates at Compulsory Retirement Age by about 15%, and thus would have produced a far less unfair result: the difference in Present Value would have been about 15% x 13.59 x $70 000 = $143 000.

COMPARISON WITH MSBS

A comparison of DFRDB and MSBS benefits provides an additional indication of the unfairness inherent in the DFRDB scheme.

In 1992 members had to elect whether to transfer to MSBS or remain with DFRDB. Before the election had to be made, members were provided with indicative comparisons of the benefits of the two schemes. These indications were inaccurate, but did point to severe anomalies. For example, comparisons for my personal circumstances indicated that:

a.   if I retired two years before Compulsory Retirement Age (CRA) the benefits were about equal;

b.   if I retired one year before CRA, the MSBS benefit was better by about $8000; and

c.   if I retired at CRA, the MSBS benefit was better by about $30 000 (ie the difference varied by the massive amount of $22000 in a single year). Information I have just received from Comsuper (dated 23 Dec 97) indicated that the actual difference at CRA is now about $77 000, more than twice the amount which I was advised in 1992 was likely.

The differences, and the rapid change in them, indicate a severe anomaly in at least one of the schemes - DFRDB paying too little, or MSBS paying too much.

The anomaly is not with MSBS. Indeed, MSBS is also unfair to long-serving members; this is because the annual increment to the employer benefit remains at 28% for about 17 years when commonsense indicates that it should continually increase because of the compounding of the notional superannuation investment of each member. I consider this limit of 28% was imposed to compensate for the effect of promotions (as for DFRDB); it is grossly unfair on those members (the majority) who do not receive promotion in the relevant period. The degree of unfairness increases with years of service because of the compounding effect.

Thus, the anomaly lies with DFRDB. While MSBS each year increases the employer benefit by 28% of final salary (say $20 000), and increases the member benefit by the additional contribution (say $4 000) and the interest on accumulated funds (say 5% of $200 000 = $10 000 by CRA for most commissioned officers), DFRDB actually *decreases* the benefit (by, say, $20 000 - refer to Example 1); the difference is thus about $20 000 + $4 000 + $10 000 + $20 000 = $54 000 per year! Unfortunately, this decrease is not readily identifiable because the DFRDB benefit is expressed only as a pension rather than as a lump sum or as a Present Value of the pension (which is really an indexed annuity).

SURCHARGE CALCULATIONS

The above calculations indicate that for long-serving members the Commonwealth might provide a benefit in the years in which promotion occurs, but definitely does not do so in other years. It would be unfair to base taxation on averaged figures such that members not receiving benefits were taxed on non-existent benefits in order to allow taxation reductions for others who received substantial benefits.

I therefore propose that the nominal employer contributions be determined through a process of annual calculation of the Present Value of expected benefits. This should be very simple, and would concurrently provide to each member a more realistic summary of changes to his/her superannuation than the summary currently provided.

Information provided would include:

a.   Present Value of current entitlement (PVNOW);

b.   Last Year's stated Present Value (LYPV);

c.   Present Value of LYPV   (PVLY)   (compounded using actual interest rates for year);

d.   Adjusted Present Value of PVLY   (APVLY)   (Adjustments made to reflect changes to external factors such as expected interest rates);

e.   Member's contribution during year (MC); and

f.   Employer's contribution (EC)   (including contributions due to promotions and pay rises in excess of CPI) calculated by the following formula:

$$EC = PVNOW - APVLY - MC.$$

The current format of the Information Statement records the increases to future benefits, but does not record the benefit just foregone by not resigning in the previous year. It therefore presents a biased and misleading picture of changes to superannuation benefits. Comsuper should amend the format to provide a balanced report, and the proposed data would facilitate this.

Consequently, I ask that for analysis purposes Comsuper provide the other addressees with details of my wage rates, contributions, entitlements, etc since 1983, so that all agencies can determine a 15 year history of my superannuation entitlements and increments as an example of the type of report which could be provided annually to all members and to the ATO.   These histories could be created either in the format I have described or in an enhanced format if possible.   For each year the 1988 Present Value of the entitlements should also be shown.

PROPOSALS TO OVERCOME THE ANOMALIES

Increase to Percentage of Final Pay

The above calculations indicate clearly that the rate of increase of pension with years of service is inadequate to overcome the shortening of the period of retirement. However, increasing the rates across the board might produce unacceptably high pensions for high ranking officers whose pay rises due to promotion had already compensated for the lowering of pension rates (which had actually occurred as a compensation for the effect of promotion).

I therefore propose that, for ranks up to wing commander, current pension rates be supplemented (by amounts to be decided, but probably in the order of 1.5 percentage points per year) for every year of service since the last promotion.   This would bring some justice and end the anomaly whereby members promoted shortly before resignation receive superannuation windfalls in comparison to their non-promoted colleagues.   Members already retired should also receive the supplement, at least from 1998.

This increase should be sufficient to compensate for the interest on the large nominal accumulated superannuation investments of long-serving members. Rates should be such that the Present Value of benefits would always increase annually by at least three times members' contributions (ie the employer's contribution would be at least twice members' contribution). This would bring DFRDB more in line with other schemes: for the Commonwealth Superannuation Scheme (CSS) long-serving members are entitled to employer contributions equal to *three* times members' contributions; I believe that when I joined the RAAF the then DFRB scheme (which preceded the DFRDB scheme) was allocated employer contributions equal to three times members' contributions; and under MSBS, for long serving members, employer benefits are more than double member benefits. The use of Present Value recording would ensure that this principle was applied.

Release from Scheme

Since it is unfair to force members to belong to a scheme which reduces their benefits, members should be permitted to retrospectively withdraw from the scheme from dates of members' choosing (or automatically from the 20 year point), with the entitlements being rolled over.

From the date of exit members should be allowed to join other schemes (MSBS seems a logical choice, but perhaps a Public Service scheme would be applicable as this could be continued if members transferred to the Public Service). The employer would contribute to the second scheme. For simplicity, such a scheme could merely invest annual contributions as is done for the member component of MSBS and for the productivity benefit; this would again overcome the anomalies caused by promotion.

This option seems extremely fair. All members would be treated similarly with respect to DFRDB entitlements (with no reduction of those entitlements with additional service), and from the date of entry to other schemes all members would be treated similarly to other members joining those schemes at the same time. One exception would be that transferees to MSBS would not be entitled to the reengagement allowance, but it is unlikely that complaints would be raised about this.

For members already retired, it should be fairly simple to determine a change in entitlements.

Transfer to MSBS

When members were forced to elect to stay with DFRDB or transfer to MSBS they were informed that the new scheme was cost neutral, ie extra benefits to members with less than 20 years' service would be matched by reductions to benefits for members with more than 20 years service. Naturally many members were persuaded by this information to remain with DFRDB. As the information seems to have been incorrect, members should be given another option to transfer. The non-detriment provisions of the transfer from DFRB to DFRDB about 1972 were far preferable to the once only election of the DFRDB to MSBS transfer.

It is well publicised that other parties, including ArFFA, have made requests for members to be given another opportunity to transfer.

Implementation would be extremely simple: it could be effected by a simple directive from the Minister, with its mechanics based on the 1992 transfers.

Change MSBS Employer Benefit Percentages

The staggered increments to the MSBS employer benefit (0-7 years, 18%; 8-20 years 23%, more than 20 years 28%) is illogical and extremely detrimental to long-serving members. Increments should rise at least annually to take into account the interest being earned on accumulated investments (even if those investments are nominal through choice of the employer). The salary on which the benefits apply could be limited to that for wing commander rank to preclude anomalies due to promotion, with a non-detriment provision for higher ranked members.

Recommendations and Comment

The second proposal (retrospective release from DFRDB, and enrolment in another scheme) is preferred to the first (increase of DFRDB percentages) because of the second proposal's obvious fairness and because of its lack of a need to calculate significant changes to the DFRDB pension rates.

The third proposal (transfer to MSBS) should also be allowed, on moral grounds as members were not correctly advised before making the 1992 election. However, it is unlikely that any members would choose this option over the second proposal.

The fourth proposal (changes to MSBS employer benefits) is independent of the other proposals. It should be implemented to overcome an obvious injustice. Further, it should be implemented quickly to assist members considering transferring to MSBS.

The proposal to compensate members for their service between the final anniversary of their engagement and their discharge date should also be effected to overcome an obvious injustice.

CONCLUSION

Calculations have shown that DFRDB benefits to long-serving members are grossly inadequate, with benefits actually being reduced with extra service, and that some adjustment is required to MSBS benefits, particularly for very long- serving members. Proper investigation into this by professional staff with access to accurate data, and ministerial action to effect changes, are essential to end severe injustice.

Also, the apparent anomalies with DFRDB raise fears that the superannuation surcharge for taxation purposes might not be fairly calculated. A method based on annual calculation of changes to the Present Value of expected benefits would provide appropriate figures for calculation of taxation obligations.

The current format of DFRDB Information Statements is misleading as it gives the impression that benefits are increasing when they are instead decreasing markedly. A format including Present Value data would help overcome this problem.

REQUESTS

The **Minister for Defence Industry, Science and Personnel** is requested to :
a.   immediately authorise members who elected to remain with DFRDB to transfer to MSBS should they so desire;
b.   organise investigations into perceived anomalies in both the DFRDB and MSBS schemes which are detrimental to long-serving members;
c.   following the investigations, effect necessary changes to DFRDB and MSBS.

ComSuper is requested to :
a.   carry out actuarial studies into the perceived anomalies and report the findings to the Minister for Defence Industry, Science and Personnel and to me; and
b.   amend Information Statements to show Present Value data.

The **Insurance and Superannuation Commission** is requested to:
a.   carry out actuarial studies into the perceived anomalies in the DFRDB and MSBS schemes, and report the findings to the Minister for Defence Industry, Science and Personnel and to me; and
b.   comment on :
(1)   the propriety of the Commonwealth's requirement that Service personnel be members of DFRDB when that scheme provides negative benefit,
(2)   avenues of legal action to overcome the reduction of benefits with increasing service, and
(3)   this letter's proposals to overcome the injustices of the DFRDB and MSBS schemes.

The **Australian Taxation Office** is requested to:

a. carry out actuarial studies into the perceived anomalies in the DFRDB and MSBS schemes and report the findings to the Minister for Defence Industry, Science and Personnel and to me; and

b. comment on:

(1)   the method proposed in this letter for determining the superannuation surcharge, and

(2)   whether reductions to the Present Value of superannuation benefits in future and past years can be used as a deduction from income for taxation purposes.

R.J.SALMOND
Wing Commander

Enclosures:

1. Extract from Comsuper Booklet Titled *Retirement Benefits*

      Table 1:   Percentage of Retirement Pay Given Years of Service
      Table 2   Life Expectancy

2. Present Value and Future Value Tables

      Table A: Present Value of 1
      Table B   Present Value of Annuity of 1
      Table C: Future Value of 1

EXTRACT FROM
COMSUPER DFRDB BOOKLET
TITLED
RETIREMENT BENEFITS

Table 1: Percentage of retirement pay given years of service

Total number years of effective service	Percentage of pay at date of retirement	Total number of years of effective service	Percentage of pay at date of retirement
15	30.00	28	47.50
16	31.00	29	49.25
17	32.00	30	51.25
18	33.00	31	53.25
19	34.00	32	55.50
20	35.00	33	57.75
21	36.50	34	60.25
22	38.00	35	62.75
23	39.50	36	65.25
24	41.00	37	67.75
25	42.50	38	70.50
26	44.00	39	73.50
27	45.75	40	76.50
		(or more)	

Table 2: Commutation factor

Date of eligibility for retirement pay

1 July 1994 to 30 June 1995	4.60
1 July 1995 to 30 June 1996	4.65
etc	
1 July 2002 and later dates	5.00

Table 3: Life expectancy

Age (in years) at date election received	Factor		Age (in years) at date election received	Factor	
	male	female		male	female
31	40.18	45.53	46	26.51	31.48
32	39.25	44.57	47	25.65	30.58
33	38.31	43.61	48	24.80	29.69
34	37.38	42.65	49	23.96	28.80
35	36.45	41.70	50	23.13	27.92
36	35.51	40.75	51	22.31	27.05
37	34.59	39.81	52	21.51	26.18
38	33.67	38.86	53	20.72	25.32
39	32.75	37.92	54	19.94	24.47
40	31.84	36.99	55	19.18	23.63
41	30.93	36.06	56	18.43	22.79
42	30.03	35.13	57	17.70	21.96
43	29.14	34.21	58	16.99	21.13
44	28.25	33.29	59	16.29	20.32
45	27.38	32.38	60	15.60	19.51

PRESENT VALUE AND FUTURE VALUE TABLES

Table A Present value of 1

Periods	1%	2%	3%	4%	5%	6%
1	0.990	0.980	0.971	0.962	0.952	0.943
2	0.980	0.961	0.943	0.925	0.907	0.890
3	0.971	0.942	0.915	0.889	0.864	0.840
4	0.961	0.924	0.888	0.855	0.823	0.792
5	0.951	0.906	0.863	0.822	0.784	0.747
6	0.942	0.888	0.837	0.790	0.746	0.705
7	0.933	0.871	0.813	0.760	0.711	0.665
8	0.923	0.853	0.789	0.731	0.677	0.627
9	0.914	0.837	0.766	0.703	0.645	0.592
10	0.905	0.820	0.744	0.676	0.614	0.558
11	0.896	0.804	0.722	0.650	0.585	0.527
12	0.887	0.788	0.701	0.625	0.557	0.497
13	0.879	0.773	0.681	0.601	0.530	0.469
14	0.870	0.758	0.661	0.577	0.505	0.442
15	0.861	0.743	0.642	0.555	0.481	0.417

Table B Present value of annuity of 1

Periods	1%	2%	3%	4%	5%	6%
1	0.990	0.980	0.971	0.962	0.952	0.943
2	1.970	1.942	1.913	1.886	1.859	1.833
3	2.941	2.884	2.829	2.775	2.723	2.673
4	3.902	3.808	3.717	3.630	3.546	3.465
5	4.853	4.713	4.580	4.452	4.329	4.212
6	5.795	5.601	5.417	5.242	5.076	4.917
7	6.728	6.472	6.230	6.002	5.786	5.582
8	7.652	7.325	7.020	6.733	6.463	6.210
9	8.566	8.162	7.786	7.435	7.108	6.802
10	9.471	8.983	8.530	8.111	7.722	7.360
11	10.368	9.787	9.253	8.760	8.306	7.887
12	11.255	10.575	9.954	9.385	8.863	8.384
13	12.134	11.348	10.635	9.986	9.394	8.853
14	13.004	12.106	11.296	10.563	9.899	9.295
15	13.865	12.849	11.938	11.118	10.380	9.712
16	14.718	13.578	12.561	11.652	10.838	10.106
17	15.562	14.292	13.166	12.166	11.274	10.477
18	16.398	14.992	13.754	12.659	11.690	10.828
19	17.226	15.678	14.324	13.134	12.085	11.158
20	18.046	16.351	14.877	13.590	12.462	11.470
21	18.857	17.011	15.415	14.029	12.821	11.764

Table C Future value of 1

Periods	1%	2%	3%	4%	5%	6%
1	1.010	1.020	1.030	1.040	1.050	1.060
2	1.020	1.040	1.061	1.082	1.102	1.124
3	1.030	1.061	1.093	1.125	1.158	1.191
4	1.041	1.082	1.126	1.170	1.216	1.262
5	1.051	1.104	1.159	1.217	1.276	1.338
6	1.062	1.126	1.194	1.265	1.340	1.419
7	1.072	1.149	1.230	1.316	1.407	1.504
8	1.083	1.172	1.267	1.369	1.477	1.594
9	1.094	1.195	1.305	1.423	1.551	1.689
10	1.105	1.219	1.344	1.480	1.629	1.791
11	1.116	1.243	1.384	1.539	1.710	1.898
12	1.127	1.268	1.426	1.601	1.796	2.012
13	1.138	1.294	1.469	1.665	1.886	2.133
14	1.149	1.319	1.513	1.732	1.980	2.261
15	1.161	1.346	1.558	1.801	2.079	2.397

5 Saville Close
MELBA ACT 2615

Tel: 6265 7575   3 January 2001

Administrative Appeals Tribunal

**INCORRECT CALCULATION OF SUPERANNUATION SURCHARGE LEVY
NOTIONAL SURCHARGEABLE CONTRIBUTION FACTORS (NSCFs) RELATED
TO DEFENCE FORCE RETIREMENT AND DEATH BENEFIT SCHEME (DFRDB)
AND
FAILURE OF GOVERNMENT DEPARTMENTS TO EXERCISE A DUTY OF CARE
TO AUSTRALIAN DEFENCE FORCE PERSONNEL IN RESPECT TO DEFENCE
FORCE RETIREMENT AND DEATH BENEFIT SCHEME**

References: (Copies are enclosed.)

A.   Letter Salmond to Minister for Defence Industry, Science and Personnel; Comsuper;
      Insurance and Superannuation Commission; and Australian Taxation Office dated 12
      January 1998
B.   Fax Comsuper (M.Carberry) to Defence (L.O'Toole), dated 5 February 1998
C.   Letter Salmond to Australian Government Actuary dated 6 March 1998
D.   Letter Salmond to Minister for Defence Industry, Science and Personnel; and
      Treasurer dated 19 March 1998.
E.   Letter Comsuper (R110505, Mary Miller) to Salmond dated 11 September 1998
F.   Letter Salmond to Australian Taxation Office dated 18 June 2000
G.   Letter ATO (Leo Bator/ Paul Morrow) to Salmond dated 10 August 2000
H.   Letter Salmond to The Trustee Comsuper dated 22 August 2000
I.   Letter Comsuper to Salmond dated 24 August 2000
J.   Letter ATO (Leo Bator/ Paul Morrow) to Salmond dated 7 September 2000
K.   Letter Comsuper (Mary Miller) to Salmond dated 20 October 2000
L.   Letter Salmond to Australian Government Actuary dated 10 November 2000
M.   Letter Australian Government Actuary to Salmond dated 20 November 2000
N.   Letter Comsuper to Salmond dated 19 December 2000
O.   Letter Salmond to Comsuper dated 22 December 2000.

1.   I was referred to the AAT by the Superannuation Complaints Tribunal (Ms Luketic,
Tel 13 14 34) on 12 Dec 00.

2.   My complaint is that through a combination of negligence and incompetence by the
Department of Defence, Australian Tax Office, and Australian Government Actuary, DFRDB
benefits are anomalous and Superannuation Surcharge Levy taxes are being incorrectly
calculated. In particular:

a.   many (perhaps most) long serving members of the ADF covered by the DFRDB
scheme receive no employer superannuation contributions (or suffer negative contributions)
for service in excess of 20 years;

b.   the calculation of notional employer superannuation contributions by the Australian
Government Actuary is ridiculous, and the results bear little resemblance to realistic notional
employer contributions (the mistake is probably one of the worst in Australian actuarial

history); and

c.   the calculation of adjusted income for determination of Superannuation Surcharge Levy double counts employer superannuation contributions (once as notional contributions, and once as payments).

3.   Some of these mistakes are now in legislation, and consequently AAT has no direct control over them. However, I hope that AAT will determine that the mistakes arose through a failure of the named organisations to exercise a duty of care to ADF members, and will be able to compel these organisations to provide accurate advice to Government.

4.   In respect to the calculation of notional employer superannuation contributions, I consider that the Australian Government Actuary's Office has acted contrary to Government regulation, and I therefore ask the AAT to compel it to revise its method of calculation. I emphasise that I am not complaining about the Superannuation Surcharge Levy, but merely against its calculation for DFRDB members which is contrary to Government intention as well as regulation.

5.   The mistakes affect thousands of people, and involve millions of dollars. However, my personal case is important in its own right and provides an excellent example of the effects of the mistakes.

Background

6.   I first tried to resolve these problems three years ago.

7.   I joined the RAAF in 1963 and was compulsorily age retired in February 1999. In January 1998, in preparation for my discharge, I attempted to predict my liability for Superannuation Surcharge Levy. I assumed that this would be based on the yearly changes to the present value of my employer's superannuation (DFRDB) obligation to me. This assumption agrees precisely with Superannuation Contribution Ruling (SCR) 97/1 Clauses 3.1.2 and 3.1.5, of which I was then unaware.

8.   Superannuation Surcharge Levy tables had not then been published, so I attempted to calculate my obligation by roughly calculating the present value of my superannuation entitlements. My calculations (Reference A) very surprisingly indicated that for me the change in present value had been negative in each of the past 18 years. In other words, Defence's superannuation obligation to me had not continually increased as expected but had continually reduced. I sought confirmation of this finding, but all relevant agencies negligently refused to analyse my calculations.

9.   As a consequence of my findings I feared the Australian Government Actuary would use incorrect assumptions to calculate NSCF factors, so I approached it. However, on 11 Mar 98 it advised me that, as a consequence of a request to it from Department of Defence, it could not respond to me 'as a single Government response was appropriate'. It seems that Defence was unethically opposing investigation of my findings.

10.   Throughout 1998 I attempted to have the relevant authorities take an interest in the matter, but to no avail. I took no further action until I received Taxation bills for $6246 in mid 2000.

11.   I appealed to the ATO but it refused to investigate my arguments. It referred me to Comsuper and the Superannuation Complaints Tribunal. Comsuper referred me to the Australian Government Actuary which also refused to investigate my findings. It also refused, unless it was paid, to calculate present values to prove or disprove my arguments; both Comsuper and Department of Defence refused to sponsor such a calculation.

12.   On 30 Nov 00, following ATO's advice, I then approached the Superannuation Complaints Tribunal which replied that it could not address DFRDB matters. It referred me to the AAT.

Reasoning

13.   Most of my reasoning is provided in the references. Only basic arguments are provided in this letter. Because the taxation anomalies stem from the DFRDB anomalies, I will begin by discussing DFRDB.

Negative employer superannuation contributions

14.   Defence misleads all DFRDB members into believing that they are receiving a superannuation benefit from their employer. My calculations showed this is not so. Once the superannuation entitlement is created after 20 years service it continually declines unless promotion occurs.

15.   I suspect that the anomaly occurs because length-of-service adjustments to entitlement rates were calculated on an expectation that members would be promoted. However, most members are not promoted after 20 years service.

16.   Because DFRDB benefits are determined by final salary, the growth in total benefits over time (measured by present values) is represented not by a smooth curve but by a sawtooth one: the benefits rise enormously in the years that promotions occur, but in other years rise little or even decline. This anomaly particularly benefits senior officers who are promoted several times in their last years of service, but denies benefits to members who serve for long periods without promotion. For example, I estimate that if LTGEN Cosgrove is a member of DFRDB his superannuation entitlements recently rose by about $2 million over a ten-month period, while mine decreased over an 18-year period.

17.   Knowledge of the anomaly is being deliberately withheld from service personnel. On 5 Feb 98 Comsuper faxed Defence: 'Our response would be to say that [to amend information statements to show present value data] would be hard to justify, particularly when it is considered that a majority of members are likely to find it confusing'. Perhaps the information is also being withheld from Government, which is (at least morally) in contravention of its own Superannuation Guarantee legislation.

18.   When it first becomes available after 20 years service, the DFRDB entitlement is generous. However it is not simply a superannuation entitlement. Rather, it combines a superannuation entitlement with a reenlistment benefit (provided separately under MSBS) which financially 'forces' members to remain in the ADF until they have 20 years service, and a retrenchment benefit in recognition of losses which will occur because of compulsory age retirement.

19.   However, the fact that the benefit is generous provides no justification for either providing no further superannuation benefit for the remainder of a member's service or, especially, reducing the entitlement already accrued. Clearly the members affected should be compensated, including retrospectively.

20.   A further justification for compensation is that the ADF staff reductions over the past decade caused many, perhaps most, members in non-combat related positions to retire at one rank below that they had expected to. This was in effect a unilateral decision by the employer to dramatically reduce superannuation benefits to those members.

21.   I propose two alternative compensation schemes which are based on current related superannuation schemes and are therefore objective.

22.   The first (non-preferred) option is based on the PSS scheme. All members could be:

a.   regarded (for DFRDB purposes) as retiring on reaching 20 years service, with the benefits being compulsorily invested until actual retirement; and

b.   then enrolled in the PSS scheme until actual retirement.

23.   The second (preferred) alternative is based on the MSBS scheme. All DFRDB beneficiaries not promoted after 20 years service could be provided with a lump sum employer benefit for service in excess of 20 years. The rate used should be the MSBS rate (28% per annum). Non detriment provisions should apply so that no person promoted after 20 years service would be disadvantaged.

24.   Under the second option all members not promoted to at least brigadier (e) level should also have their employee contributions made after 20 years service returned with interest. As these contributions were compulsory but provided no benefit, effectively they were stolen from the members. The return of contributions is consistent with the MSBS scheme.

25.   The second option is preferred because of its simplicity to administer, particularly for members already retired.

26.   To lessen administrative effort and cost to Government of the second option, while still compensating members worst affected, the compensation could apply only from the 21 years service or 22 years service points. (About 40% of DFRDB beneficiaries retire before reaching 21 years service, and about 60% before 22 years service. (Source: Australian Government Actuary report 30 Jun 99 Table C4)) This reduction could arguably be justified by the generosity of the DFRDB scheme at the 20 years service point. Extending the exemption even further (eg to the 25 years service point by which about 80% of beneficiaries have retired) would be less costly and still largely compensate those most affected, but justification would be difficult. The costs of using different 'exemption start points' for compensation could be easily estimated by the Australian Government Actuary.

27.   Compensation for members already retired could be staged over several years for cash flow reasons.

28.   The important principle to be remembered here is that the cost is relatively unimportant. The Government has an obligation to return money wrongfully taken from members under false pretences, and an obligation to pay superannuation entitlements it led employees to believe they were receiving.

Incorrect calculation of notional employer contributions

29.   The Australian Government Actuary claims the notional employer contribution has been determined in accordance with Government direction. This I dispute. Superannuation Contributions Ruling 97/1 (SCR 97/1) states:

'3.1   General Approach

3.1.2 It is intended that the NSCF be calculated as the present value of employer provided benefits accruing in the year...

3.1.5 The normal cost of benefits accruing in the year is defined as the difference between the actuarial value of accrued benefits at the end of the year and at the beginning of the year...'

The Australian Government Actuary made no attempt whatsoever to calculate present values. In my case, for the two years in question the present value change to my entitlements was

negative in each year, but the Australian Government Actuary calculated it to be about $50 000.

30.   The Australian Government Actuary claims that this anomaly is created by use of an actuarial method. That statement is nonsense. The appropriate actuarial method is to directly calculate present values. Present value calculations are extremely simple in this case as they are fully determined by:

a.   the pension entitlements at the start and end of the year (which are already provided annually to each member),

b.   the age of the member (which determines life expectancy, and which is known), and

c.   assumptions as to future inflation and discount rate (which are made by the Australian Government Actuary regardless of the actuarial method chosen).

Minor variations due to such things as death benefits and reversionary pensions could be easily catered for.

31.   Instead of using this simple, precise method, the Australian Government Actuary took several years to produce tables with thousands of elements most of which produce monstrously incorrect values. It is beneficial to examine his flawed methodology.

32.   Clearly the Australian Government Actuary did not understand his task. That was to determine present value changes of entitlements of individual members in order to determine the members' individual taxation obligations. Instead, he looked at the total cost of Defence's superannuation obligations and tried to apportion it among individual members. His method was analogous to the Tax Office determining income tax liabilities not by looking at individual earnings, but by looking at total earnings in each state and then attributing individual earnings on the basis of age and state of residence.

33.   Worse, the Australian Government Actuary's apportionment rules did not include the most important factor – promotion.

34.   The results were farcical. For example, these purport that LTGEN Cosgrove's recent increase in government-contributed superannuation entitlements was about $80 000 (36% of salary) rather than $2 million, but purport I gained about $25 000 per annum when in fact I suffered a loss.

35.   The Australian Government Actuary's NSCF tables are therefore clearly incorrect, and useless for the purpose for which they were created. The method used could surely not be classed as an actuarial one.

36.   A representative of the Australian Government Actuary advised on 23 Nov 00 that in any actuarial studies of this type 'there will be some losers and some winners'. This would not be so if an appropriate actuarial study were used.

37.   As the calculations do not determine present value changes as required by the regulations, the Australian Government Actuary's claim that he performed his calculations in accordance with Government direction is false. The statement is also misleading in another sense: the Government took advice on the method to be used from a committee chaired by the Australian Government Actuary!

38.   A final point about the current method of calculation is significant. The method is consistent in that officers on high salaries have their employer contributions greatly underestimated so that they are undertaxed in relation to the Government's intent. The

'subsidy' to them is met by overtaxing low income earners. A cynical person would suspect that this effect was not accidental.

Incorrect calculation of adjusted income

39.   For Superannuation Surcharge Levy purposes, my current income is 'adjusted' upwards by notional PSS superannuation contributions (ie an accrual accounting adjustment). However, it is not adjusted downwards for DFRDB income (ie a traditional accounting adjustment has continued to apply) even though that income was previously counted as notional contributions. This is double counting; it is almost certainly contrary to Government intentions.

40.   The mistake probably occurred because those who drafted the legislation did not take into account the fact that retired service personnel would receive superannuation benefits before retiring from the workforce. The draftees therefore accidentally misled Government and failed in their duty of care to those taxpayers who have consequently suffered from the mistake.

41.   When I advised the ATO of this error, its response (7 Sep 00) indicated that it could not understand the simple concept involved.

42.   The error should be corrected by not including superannuation receipts as part of adjusted income.

Duty of Care

43.   Service personnel are not permitted to belong to a strong industrial organisation; instead, the Department of Defence is obligated to ensure that its ADF employees are treated fairly. However, although Defence has been made aware of the anomalies, it has not only failed in its duty of care to its ADF employees to be forthright with them and to bring the anomalies to the Government's attention, but has actually attempted to suppress relevant information. Its behaviour has been abysmal.

44.   Comsuper has a duty of care to fully explain to members the changes in their superannuation entitlements. It suppression of present value information is equally abysmal.

45.   The Australian Government Actuary has a duty of care to all its stakeholders to perform its calculations properly. Its initial mistake was woeful, but its current attempt to hide that mistake is unforgivable.

46.   The ATO probably drafted the legislation related to Superannuation Surcharge Levy, including the procedures for determining adjusted income. If so it was incompetent. However, its failure to now admit its error is also unforgivable.

47.   All these organisations have a duty of care to Service personnel in relation to superannuation and related tax policy. All have failed badly to exercise that duty.

Primary requests to AAT

48.   I ask the AAT to:

a.   compel the Australian Government Actuary to use an appropriate method to calculate notional employer superannuation contributions,

b.   compel Comsuper to provide present value data on annual superannuation information statements, and

c.   compel the Department of Defence to exercise a duty of care to its ADF employees to properly analyse ADF conditions of service and report honestly to both Government and employees on the results of those analyses.

Secondary requests to AAT

49.   While the AAT is not able to overturn legislation, I ask it to:

a.   compel the ATO to provide competent advice to Government on the adjustment of income for Superannuation Surcharge Levy purposes, and

b.   compel the Department of Defence to recommend, to Government, changes to DFRDB legislation to compensate long serving members (including those already retired) for:

    (1)   the money compulsorily taken from them under the guise that it was associated with a superannuation scheme, and

    (2)   the failure of their employer to supply them with superannuation benefits even though it misled them into believing it was providing benefits.

Yours faithfully

R.J.SALMOND

Enclosures:

Refer to References