PENSIONS AND YOUR TAX

Your Editor has been following debate on the new arrangements for superannuation and it is clear that there is still some confusion about the affect of the new changes. Many more knowledgeable persons than the Editor, including financial advisers and government officials, are unclear as to whether the arrangements are in fact equitable across all of the Australian population, and are also unsure about the practical implications of the new system to individual taxpayers.

The Association is not in a position to respond to every member's particular questions nor to provide advice about their personal circumstance, and therefore advises caution for all. It recommends that individuals seek professional advice about their own financial situation. Members are also reminded of information provided in the last edition of Camaraderie *as well as the* Money Matters *and* ComSuper *articles that follow in this edition.*

Nevertheless, and with a note of caution that broad brush statements or information (even if well intended) might be misleading, the following is an amateur's attempt to explain the situation !

Most members will now be aware of the changes to superannuation which are expected to take effect on 1 July 2007. The passage of the required legislation which will implement the changes is expected soon following the agreement of the Opposition not to vote against it. Much has been written about a perceived inequity for pensioners of untaxed superannuation funds (such as DFRDB and other Government superannuation schemes). This relates to the fact that, <u>for those over 60</u>:

- pensions received from <u>taxed superannuation funds</u> will <u>not</u> be included as income for taxation purposes;
- pensions from <u>untaxed superannuation funds</u> however <u>will</u> be included as income for taxation purposes, however taxpayers will receive a <u>taxation offset</u> [(1)] of 10 per cent.

So, a $20,000 pension from a taxed fund <u>will not</u> be assessed as income; however if it is paid from an untaxed fund it <u>will</u> be included as taxable income, but a $2,000 taxation offset will then be available – that is, the taxpayer's total tax bill (based of course on all assessable income) will be reduced by $2,000. The total taxation payable will therefore depend on the taxpayer's total taxable income (which may consist of pension/s and other income such as salary, dividends and the like), less any taxation offsets. The essential point therefore is that a pension from a taxed fund does <u>not</u> form part of a taxpayer's total taxable income; whilst a pension from an untaxed fund <u>does</u> form part of taxable income (but will also provide the taxpayer with a tax offset).

It <u>may</u> therefore be reasonable for some to <u>assume</u> that the 10 per cent offset does not "equate" to the same benefit had the taxpayer been receiving the pension from a taxed fund. However, this assumption does not address the fact that it was partly because the Government's contribution to the pension was untaxed (and unfunded), that the pension is as large as it is in the first place. Had the member and employer been contributing into a taxed superannuation fund, the resultant pension would have been smaller and it may not be indexed (and also note that defined benefit funds – such as DFRDB, PSS, CSS etc - are rapidly disappearing due to their cost).

Note also that another disadvantage <u>may</u> accrue for some as social benefits are determined by a taxpayers' (taxable) income, which will be less for a taxpayer receiving a pension from a taxed fund then if the taxpayer received a comparable pension from an untaxed fund.

It seems clear that the above matters warrant closer examination and reconsideration by the Government. Many individuals and organisations are lobbying Government on issues and a plethora of views and opinions have been offered.

The Association's View

These matters are complex, open to wide discussion (and views) and will probably take a long time to resolve. The RDFWA suggests that not until members have their taxation liability assessed can they draw any conclusions about how the new arrangements will affect their particular situation.

What is clear is that because of the 10% tax offset and the reduced taxation rates, most pensioners will pay (significantly) reduced tax after 1 July 2007. Even if the offset was to be increased (to say 15%), it would have little practical effect on most of our members as it would mainly benefit only those with relatively large pensions (who will in any case receive considerable benefit from the 10% offset). As most defence pensioners will receive a net benefit from the offset, the RDFWA has not lobbied to increase the offset of 10 %.

Instead, the RDFWA is pursuing [(2)] other more perceived inequities in the Simple Super proposals, eg the adoption of age 60 before people can access any of the new benefits, despite compulsory retirement for some military at 55; and the treatment of those forced to stop working altogether because of permanent invalidity, etc. In the latter case the new arrangements mean that such pensioners continue paying full tax on their invalidity pension until they turn 60.

There is a push by some to re-open the DFRB-to-DFRDB transition process and to have DFRDB classified as a "funded" or "partially funded" (ie taxed) fund, but indications from Government are that this matter will not be considered in the current round of superannuation reform. The Government argues that military pensions consist of both taxed and untaxed components and the 10% offset is the best method of providing equitable benefit to all recipients.

Finally, there seems to be some uncertainty about the tax treatment after 1 July 2007 of that component of a military pension that derives from

a member's additional personal contributions to superannuation schemes such as MSBS. The taxed components may include these contributions (as well as any productivity components) and thus that part of the military pension derived from the member's contributions should also generate a tax offset. It is understood that ComSuper is examining this matter.

Further Actions

The RDFWA and the Superannuated Commonwealth Officers Association (SCOA) continue to keep watching briefs on these matters, and will provide further information if and when it becomes available. One issue that the Editor is seeking advice on (from his local member) is the status of parliamentarian's superannuation funds and whether they will be treated as other public sector schemes. Again, members will be provided with information when it is received.

(1) *The ATO website states that "Tax offsets directly reduce the amount of tax you must pay. They are not the same as deductions, which are taken off your income before your tax is worked out. With a tax offset, we (ie the ATO) work out the tax due on your taxable income then reduce it by the total amount of your tax offsets".*

(2) *On 30 January the RDFWA made an appearance to the Senate Economics Committee on certain matters relating to the new arrangements.*

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Editor