- 1 FEB 2018

Minister for Revenue and Financial Services
Minister for Women
Minister Assisting the Prime Minister for the Public Service

The Hon Kelly O'Dwyer MP

24 JAN 2018

Ref: MC17-009437

The Hon Karen Andrews MP
Assistant Minister for Vocational Education and Skills
Member for McPherson
PO Box 409
VARSITY LAKES QLD 4227

Dear Assistant Minister Karen

Thank you for your personal representations on behalf of Mr William Adams concerning the taxation of Commonwealth Superannuation Scheme (CSS) pensions.

As I noted in my previous response of 13 November 2017, some defined benefit superannuation schemes — including many public sector schemes — involve no employer contributions being made until the person is ready to retire, which means no contributions or earnings tax has been paid on the benefit. To remove the tax on these benefits would mean that members of these untaxed schemes would pay no tax at all on this part of their superannuation.

Nevertheless, most retirees in untaxed schemes pay less tax on their employer-funded superannuation benefits than they would on ordinary income. Pensions from an untaxed scheme are taxed at marginal rates but receive a tax offset of 10 per cent, where the recipient is aged 60 or above, for annual amounts up to $100,000.

The recent superannuation taxation reform package included the introduction of the $1.6 million transfer balance cap to make superannuation tax concessions fairer. Defined benefit (DB) pensions presented a challenge for the transfer balance cap as they do not have an account balance and are unable to be commuted back to the accumulation phase. In place of the account balance, DB pensions will be valued using a factor of 16. The valuation factor of 16 was recommended by the Australian Government Actuary who took into account a number of factors including the benefit of simplicity.

As a result, annual DB amounts over $100,000 will be subject to additional taxation to replicate the effect of the $1.6 million transfer balance cap. For unfunded pensions, such as the CSS, the 10 per cent offset will cease at $100,000. Untaxed components over $100,000 p.a. will therefore be taxed at full marginal rates.

These arrangements ensure that a similar level of tax is paid on benefits received from taxed and untaxed schemes.

I hope this information will be of assistance to Mr Adams.

Yours sincerely

Kelly O'Dwyer

CSS unaudited financial information for 2015–16

	$ '000
Value of Fund as at 1 July 2015	**3,768,774**
Inflows	
Changes in net market value of investments	69,811
Interest	890
Member contributions	71,403
Employer contributions	19,682
Low income superannuation contributions	6
Government co-contributions	53
Net appropriation from Consolidated Revenue Fund	3,699,888
Outflows[1]	
Benefits paid	(4,295,986)
Transfers to the Public Sector Superannuation Scheme	(861)
Income tax expense	(3,087)
Value of the Fund as at 30 June 2016	**3,330,573**

Assets and liabilities as at 30 June 2016	
Investments[2]	3,299,587
Cash at bank	43,110
Amounts to be appropriated from Consolidated Revenue Fund	103
Other receivables	213
Benefits payable	(8,587)
Other payables	(861)
Tax liabilities	(2,992)
Net assets as at 30 June 2016	**3,330,573**

1. The expenses of CSS are met in the ARIA Investments Trust and accordingly no administration or investment expenses appear here.
2. The value of investments shown below reconciles with the total Fund values shown on page 6 as follows:

Default Fund	2,972,430
Cash Investment Option	319,996
Total Fund	**3,292,426**
Add/(less)	
Investments backing the operational risk reserve	11,618
Allowance for cost of disposal	(4,457)
	3,299,587

The assets of CSS are invested in the ARIA Investments Trust (AIT), where they are pooled with the investments of other Government superannuation funds – the Public Sector Superannuation Scheme (PSS), the Public Sector Superannuation Scheme accumulation plan (PSSap), Australian Defence Force Superannuation (ADF Super) and the Military Superannuation and Benefits Scheme (MilitarySuper) – in order to deliver an efficient investment process. The AIT invests in multiple specialist investment funds and portfolios.

The AIT receives income such as dividends, interest, trust distributions and gains and losses on sale and incurs administration and management expenses including expenses that would otherwise be incurred by CSS.

The operating surplus or deficit generated by the AIT is reflected in daily unit prices released by the AIT for its unitholders including CSS, and daily earning rates based on the unit prices are published on the CSS website. If you would like to see a copy of the CSS audited financial statements for this year and the report from the auditor, please refer to our **Annual Report to Parliament** (which is published and tabled in the Parliament in November) at **csc.gov.au**, send an email to **members@css.gov.au**, call us on **1300 000 277** or write to CSS, PO Box 2252, Canberra ACT 2601.

HOW the CSS and PSS work

By Anne Willenborg, Annette Barbetti and Trevor Nock

Extracted from SCOA SuperTime Newsletter May 2014 and reproduced with the kind permission of the publishers SCOA Federal Council

We are regularly contacted by members asking about the functions and features of the CSS and PSS schemes, in particular about the pension, the spouse pension, also known as the reversionary pension, and how the schemes are funded and why their pensions are taxed.

We thought it would be useful to give you a summary style account of the basic workings of the two schemes.

The following is not meant to be a legal document and not financial advice, because SCOA is not licensed to provide financial advice.

It is merely meant as a guide to the very basic functions of the CSS and PSS.

The Commonwealth Superannuation Scheme (CSS)

The Commonwealth Superannuation Scheme (CSS) was established under the Superannuation Act 1976 "to provide superannuation services and products to eligible employees of the Australian government and participating employers".

CSS pension - there are two types

The CSS is a so-called hybrid scheme, meaning it is a combination of two types of funds, a defined benefit fund and an accumulation fund. When you retire as a CSS member, you will of course receive your indexed defined benefit pension, but in addition, you can choose to receive a non-indexed pension or a lump sum payout of your contributions plus any earnings.

Indexed pension

In very simple terms, your defined benefit pension is calculated using a formula based on your final salary, your length of contribution and your age when you retire. Your defined benefit pension is paid out of the Consolidated Revenue Fund, into which your employer made contributions on your behalf while you were working in the public service.

Your pension is paid as long as you live and is indexed by the CPI. If you pre-decease your spouse/partner he/she, if eligible will receive 67% of your pension, also for life and also indexed by the CPI.

However, when you retire, you have the option to reduce your own pension to 93% of the full amount, which will give your surviving spouse a higher pension of 85% of your pension.

Your pension is taxed, albeit with a 10% offset for those aged 60 and over.

Non - indexed pension

Whilst your employer made contributions to the Consolidated Revenue Fund on your behalf, under the scheme rules you also had to make member contributions as well.

A small part of your employer's contributions, the so-called productivity component, together with your contributions, were paid to what is known as the Commonwealth Superannuation Corporation and invested on your behalf.

This part of your benefit can be taken as either a lump sum or additional, non indexed pension, the non-indexed pension is also worked out according to a formula and paid for life. Your surviving, eligible spouse/partner receives 67% (or 85% see above) of your pension.

Whether you choose the lump sum or the non-indexed pension, these are tax free for those aged 60 and over as they are funded by money that has already been taxed.

Why is your defined benefit pension taxed?

Many CSS members are not aware that contributions are made to the Consolidated Revenue Fund on their behalf during their employment in the public service.

The size of the contributions is determined by actuarial calculations based on the number of current pension receipts, their age and life expectancy and the size of their pension. Over the years, this has been between 22% to 26% of salary. The money currently being paid to the Consolidated Revenue Fund by employers on behalf of CSS contributing members is used to pay for those who have already retired.

The employer contributions made to the Consolidated Revenue Fund were not taxed. If these contributions had been paid to a taxed superannuation fund, they would have been taxed, and you would not have to pay tax on your pension once you reach age60.

SCOA does not believe that it is fair that CSS pensioners should pay tax on their pension just because their employer contributions, which were considered part of your 'package', were paid to Consolidated Revenue rather than a taxed superannuation fund.

SCOA has been lobbying for several years to have this gross disadvantage overturned, so far without any success. However, we will continue our campaign and believe that we are making some progress.

The Public Sector Superannuation Scheme (PSS)

If you thought the CSS was complicated, let's take a look at the PSS. It doesn't get any easier or simpler!

The Public Sector Superannuation Scheme (PSS) was established under the Superannuation Act 1990 "to provide superannuation services and products to eligible employees of the Australian government and participating employers".

So far, so good. It was established when the CSS was closed to new members, and in addition to being the compulsory superannuation fund for permanent government employees (this was in the days before "choice of fund"), as opposed to the CSS, the PSS also allowed employees on part time or short term contracts to join.

Your PSS pension

Your PSS pension generally consists of three components including contributions made by you and your employer to the Consolidated Revenue Fund as well as the employer financial component payable at the time you retire and claim your pension.

Depending on the circumstances, A PSS retirement benefit can be taken as a CPI indexed pension, or a lump sum amount, or a combination of both.

As a PSS member, you may make a contribution equivalent to a minimum 2% of your after tax income. You can contribute more if you wish (up to a maximum of 10%), which will increase your 'accrued benefit multiple', one of the figures used to calculate your pension.

Your "productivity component" is part of the fortnightly contributions made by your employer on your behalf.

The formula used to calculate your final benefit is based on your contribution rate, your average final salary (last three years) and length of membership, known collectively as your "accrued benefit multiple"

Finally, this is the most significance difference between the CSS and the PSS, there is your employer financed component. This is paid by your employer and determined when you leave the PSS and claim your benefit. Its value is the remaining balance after your member and productivity components (plus investment earnings, as applicable) are deducted from your total lump sum benefit. In other words, it is the amount of money required to pay for your defined benefit pension for the rest of your life.

What is the role of the Futures Fund?

The CSS was closed to new members in 1990; the PSS followed in suit in 2005. As a result, the number of *contributing members* is diminishing and therefore the funds being paid to the Consolidated Revenue Fund, as described above, are also diminishing.

The Future Fund was established in 2006 to make sure the government of the day was able to meet its "*unfunded liability*". This is the amount of funds required to pay for every PSS and CSS pension in the next forty years or so. Under the legislation, the funds in the Futures Fund cannot be accessed until either the year 2020 or until the Fund has accumulated at least $140 billion. As at 31 December 2013, the Future Fund had $96.56 billion in funds under management.

ComSuper

As we wrote in the February 2014 issue of SuperTime, ComSuper is the government agency which is responsible for the *administration* of the CSS and PSS schemes. If you have access to the Internet, ComSuper has a section on their website set aside for CSS and PSS pensioners called "pensioner services online".

Call ComSuper to get an access number which enables you to log on to your own pension account where you change your payment details; update your address, check your pension payment history and view and print your indexation advice letters and much more.

If you would rather speak to someone about some aspects of your pension, you can call ComSuper on 1300 001 777.

Source: *css.gov.au; pss.gov.au; comsuper.gov.au*