DEFENCE FORCE WELFARE ASSOCIATION
A member of the Alliance of Defence Service Organisations
Patron-in-Chief: His Excellency Mr Michael Bryce AM AE

DEFENCE FORCE WELFARE ASSOCIATION
INPUT TO THE TAX FORUM
TAXATION OF MILITARY SUPERANNUATION PENSIONS

3 October 2011

OBJECTIVE

That "taxed" and "untaxed" Commonwealth superannuation schemes receive identical treatment so that their members are treated equally for their:

1. *Income tax liability, and*

2. *Access to government benefits such as the Age pension and the Commonwealth Seniors Health Card (CSHC).*

BACKGROUND

DFRDB[1] and MSBS[2] military superannuation schemes are deemed as "untaxed". Military superannuation pensions paid to beneficiaries are therefore taxable in the hands of each beneficiary.

Military superannuation pensioners aged over 60 are entitled to a nominal 10% tax offset, but additional income is taxed at the individual's marginal tax rates.

The Defence Force Welfare Association asserts that the Commonwealth's taxation treatment of military superannuation schemes is wrong in principle and in practice, to the point of discriminating against members and former members of the Australian Defence Force.

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[1] The Defence Force Retirement and Death Benefits Scheme opened to ADF members in 1972. It replaced the earlier DFRB scheme. It closed to new members in 1991. DFRDB is a "defined benefits" scheme. DFRDB has 4,246 contributors (i.e. still serving in the ADF) as well as 9 "preserved" members and 56,981 pensioners (30 June 2010. See Commissioner for Superannuation 2009-10 Annual Report p115)

[2] The Military Superannuation and Benefits Scheme replaced DFRDB in 1991. MSBS is the current scheme for all ADF members except the remaining 4,246 DFRDB contributors (see Note 1). MSBS is a "hybrid" scheme. It contains elements of both defined *benefits* and defined *contributions* (accumulation) schemes. MSBS has 54,525 contributors (i.e. still serving in the ADF) as well as 76,430 "preserved" members and 7,684 pensioners (30 June 2010. See Commissioner for Superannuation 2009-10 Annual Report p115)

DISCUSSION

Different Treatment of "taxed" and "untaxed" Superannuation Schemes

Australian pensioners funding their retirement from accumulation (defined contributions) pension funds are deemed to have been members of "taxed" schemes. Their superannuation pension is tax free. Any additional income is then taxed from a zero base. In other words, income from their superannuation pension is ignored for income tax purposes.

Taxed and untaxed income, and assets held in accumulation funds, are treated differently in means tests for certain government benefits such as the Age pension and the Commonwealth Seniors Health Card. Income from "taxed" superannuation schemes is treated far more favourably than income from "untaxed" schemes such as DFRDB and MSBS.

This means that military superannuation pensioners and their families are likely to be ineligible for certain government benefits even if their household income is the same as, or less than, eligible accumulation fund superannuation pensioners and their families. That's wrong.

No Offsetting Benefits for Military Superannuation Pensioners

Contrary to myth, military superannuation pensioners receive no universal taxation or "in kind" benefit that is not available to all other Australians. Military superannuation pensioners do not receive free medical or dental care, free housing, free rides with the RAAF, or other perks. Their unequal taxation treatment is not offset by any benefit that is peculiar to the military.

Why are DFRDB and MSBS "untaxed" Schemes?

The distinction between "taxed" and "untaxed" Commonwealth superannuation schemes is artificial and anomalous. The only people to suffer from it are the members of "untaxed" Commonwealth schemes.

Note that:

- The Commonwealth as employer *chooses* not to fund either DFRDB or MSBS up front (as all other Australian employers are required to do).
- Contributors – sailors, soldiers and airmen & women – have no say in their employer's choice not to fund DFRDB and MSBS up front.
- No superannuation schemes were taxed until 1988.
- Prior to 1988 there was no discrimination between funds. Now there is.
- The Commonwealth by convention does not pay tax to itself.

This all means that the Commonwealth could not collect the normal 15% contributions tax now levied on other superannuation funds. That's why DFRDB and MSBS are "untaxed" schemes.

DFWA does not know why the then Treasurer created the anomalous "taxed" and "untaxed" distinction some five years ago. The Commonwealth has foregone no contribution tax benefit because it is the Commonwealth that chooses not to pay its employer contribution to itself, up front.

Indeed, the Commonwealth has benefitted up front in two ways; it receives long term interest free "loans" from DFRDB contributors (see below) and does not pay anything up front itself.

Compulsory Contributions

Members of the ADF were and are *compelled* to contribute to their military superannuation scheme from their gross (pre-tax) salary. DFRDB contributors compulsorily paid 5.5%. MSBS contributors compulsorily pay 5.0%. MSBS members can now voluntarily pay more, thanks to the recent salary sacrifice reforms. (In neither scheme does the Commonwealth contribute anything up front.)

The point here is that ADF people have never had a choice; they are required to contribute to their government-mandated military superannuation scheme. Contributions to "taxed" schemes were only recently permitted, but these must be in addition to the compulsory DFRDB or MSBS contribution.

Effective Compulsory Contribution Rate

Individual DFRDB contributors pay their compulsory contribution from their gross (pre-tax) military salary. This means that the effective compulsory contribution rate from a DFRDB contributor's disposable income is not 5.5% but more like 8% or higher depending on the individual contributor's rank/salary and marginal tax rate.

Interest-Free "Loans" to Government

All DFRDB compulsory contributions are paid to consolidated revenue. Benefits are paid from consolidated revenue. This means that DFRDB contributors effectively make a long-term interest-free "loan" to the government.

Note here that DFRDB contributors who leave the ADF with less than 20 years service receive no employer (government) superannuation benefit. They merely get their contributions back, without interest. The government is the sole beneficiary from these individuals' compulsory contributions.

Cost Inefficient Way for Government to Meet its Liability

Conversely, paying superannuation pensions as they fall due directly from consolidated revenue is the most costly way for the Government to meet its liability. It has acknowledged this in the formation of the future fund. However in the meantime military (and other Commonwealth) superannuants indirectly pay the cost of this policy decision with the artificial categorisation of their funds as “untaxed” and subjecting these superannuants to taxation of their payments as well as discounting the regular indexing of their superannuation pensions to reduce government budget costs. The end result is that these superannuation pensions reduce in value over time.

Acknowledgement of Offsets

The Defence Force Welfare Association is not aware of any acknowledgement by any government of the help given by DFRDB contributors’ interest-free “loans” to offsetting the cost of DFRDB pensions.

Given that the 4,246 serving DFRDB members compulsorily contributed $22M to consolidated revenue in 2009-10, it is not unreasonable to say that the extant 56,981 DFRDB pensioners perhaps contributed some $300M in today’s dollars when they were serving. Add the hundreds(?) of thousands of servicemen and women who merely got their money back because they served for less than 20 years, as well as the many thousands of DFRDB pensioners who are no longer with us, and the “loans” to government over the life of the DFRDB scheme – 40 years in 2012 – are huge.

In addition, the government benefitted even more from the 1976 transfer of well over $100M (1976 dollars) from the earlier DFRB scheme to consolidated revenue.

And that’s before calculating the massive financial benefit to government from the compound interest effect of all those compulsory DFRDB contributor “loans” and the DFRB transfer.

Where has any government acknowledged these significant offsets?

Administration Savings

Reclassification of the military superannuation schemes to a “taxed” or equivalent status will reduce or eliminate taxation-related administration by COMSUPER, and reduce compliance overheads now borne by the Australian Taxation Office. Reduced administration means reduced costs. The savings are likely to be small but tangible.

Less tangibly but still importantly, the administration burden on individual military superannuation pensioners will also reduce because many (most?) will no longer need to submit annual income tax returns.

Financial Implications

The Defence Force Welfare Association would welcome an honest and objective cost-benefit assessment of its proposal. The assessment should include all the elements outlined above, including those that successive governments have chosen to overlook or ignore.

CONCLUSION

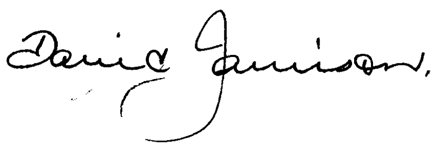
Serving and former Australian Defence Force members are now significantly disadvantaged when compared with the overwhelming number of Australians who enjoy accumulation ("taxed") superannuation schemes.

Taxation of military superannuation pensions is one of those disadvantages. This tax is wrong in principle and in practice.

The Commonwealth has received more than its pound of flesh from its servicepeople up front, and to further penalise military superannuation pensioners by taxing their pension is indefensible.

"Taxed" and "untaxed" Commonwealth superannuation schemes must receive identical treatment so that their members are treated equally for their:

1. Income tax liability, and
2. Access to government benefits such as the Age pension and the Commonwealth Seniors Health Card (CSHC).



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