ELECTRICITY INDUSTRY SUPERANNUATION SCHEME

4 August 2006

General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

May 2006 Federal Budget

'A Plan to Simplify and Streamline Superannuation'

The Electricity Industry Superannuation Scheme (EISS) is a multi-employer scheme providing superannuation benefits to members who work in the electricity supply industry in South Australia. The Board of the Scheme wishes to make a submission on the proposed changes to the superannuation system.

As background, the Scheme provides accumulation and defined benefits (both lump sums and pensions) to about 2,500 members and has around $500 million in assets. It is exempt from SIS and in 2002 its taxation status changed from untaxed to taxed. It is established under an Act of the South Australian Parliament and is not public offer. The Scheme was previously granted Pre July 1988 Funding Credits and there is still a balance available.

Our submission describes the concerns that the Board has with the changes and the impact that these changes will have on the Scheme, the members and the employers who contribute to the Scheme. The key areas covered in our submission relate to:

- Relative taxation of benefits from taxed and untaxed schemes
- Pre July 1988 Funding Credits
- Recognition of pre 1983 service
- Cap on concessionally taxed contributions

Please contact our Executive Officer, Jon Holbrook, on (08) 8271 9161 if you have any queries in relation to this submission.

Yours faithfully

Mark Day
Chairman

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Submission

The Scheme has the following concerns with the proposed changes. In raising these concerns, we have kept in mind that the main aim of the Government's plan is to simplify superannuation.

Taxation of Benefits

We feel there is an issue regarding the equity between the proposed benefits tax from untaxed schemes vs taxed schemes.

For a member over 60, the relative taxation of a pension from an untaxed scheme has improved compared to a member receiving a pension from a taxed scheme.

In the Electricity Industry Superannuation Scheme, members have a choice between taking a benefit as if the Scheme is untaxed or taxed. Our calculations have shown that pension members over 60 may be significantly better off by taking a pension as if the Scheme were untaxed.

For a pension commencing prior to 1 July 2007, the comparison is in the table below. The first column shows the gross pensions required prior to 1 July 2007 to provide equivalent net incomes (assuming that the pension is the only income and ignoring the senior tax offset). The second column shows the net position after 1 July 2007.

	Comparison prior to 1/7/07 $	Difference after 1/7/07 $
Pension from an untaxed scheme		
Gross Pension	52,000	52,000
Tax	-11,730	-11,730
Rebate	0	5,200
Net Pension	40,270	45,470
Pension from an taxed scheme		
Gross Pension	42,659	42,659
Tax	-8,787	0
Rebate	6,398	0
Net Pension	40,270	42,659

Therefore the rational choice for a member under many circumstances is to take an untaxed pension (as allowed under section 159SS of the Tax Act), and for the Scheme to make an election under section 274(7) of the Tax Act that an equivalent amount of contributions are untaxed. Members have this choice under the rules, as part of the privatisation process and the change in the Scheme's tax status.

In order to prevent a significant increase in employer costs, we would need the options currently available under sections 159SS and 274(7) to remain available.

We are therefore looking for confirmation that sections 159SS and 274(7) will remain unaltered.

Pre July 1988 Funding Credits (PJFCs)

We understand that a consultation paper has just been finalised on the new method of determining how PJFCs are to be used.

We would like to express our concern that any changes may leave the Scheme worse off, especially if the changes do not recognise that the accrual of defined benefit liabilities is not necessarily uniform.

For example, the actuarial value of our pension liabilities has recently increased due to increases in life expectancies, greater than expected increases in salaries in the electricity industry, and reductions in the number of members commuting their pension to a lump sum. A significant part of this increase in liabilities relates to benefits accrued before 1988. This needs to be recognised as part of any formula for the use of PJFCs. We feel that the current formula does this in an appropriate and simple manner.

Recognition of Pre 1983 Service

The government is proposing that pre 1983 components (which are largely untaxed now and are completely untaxed under the proposals), will be fixed in dollar terms according to an unknown formula at an unknown date.

This is inequitable for members with defined benefits, as benefits accrue as a multiple of salary. It is difficult to say now in dollar terms how much of a final retirement benefit has accrued prior to July 1983.

It also raises two other difficulties for our members. Some divisions have a choice of benefit on resignation and retirement. Which choice is the pre 1983 amount to be based on and what happens if they take a lesser or greater benefit?

Also our members have defined benefits that are based on variable member contribution rates, which allow them to catch up on past periods of lower contributions. A member could have contributed at a low rate in the past and then pay a higher rate closer to retirement.

But the catch up in respect of a period of pre 1983 service is only possible if the pre 1983 service is there in the first place. Therefore, there should be some recognition of this in the pre 1983 amount. The current proportional formula (calculated at the time of payment) works well in this regard for defined benefits.

Cap on concessionally taxed contributions

There are a number of problems with the proposed cap on concessionally taxed contributions.

- **it only applies to taxed schemes**
  There is then a possible inequity if the member pays excess tax on a contribution over $50,000 and then subsequently takes an untaxed benefit.

  This inequity is compounded if the member is also subject to the benefit limit of $700,000 from an untaxed scheme, as the excessive contribution will attract tax at the highest marginal tax rate, as will the benefit, leaving very little for the member.

- **the use of notional contributions by defined benefit schemes is inequitable, costly and difficult to administer**
  The superannuation surcharge showed how difficult individual contribution taxes are to administer for defined benefit schemes.

  Due to our variable member contribution rates and the nature of our benefits, we calculated notional surchargeable contributions by getting our actuary (at some cost) to calculate up to 9 notional contribution rates per member per year, as this was the most equitable way of doing it.

  Even then, it is possible (due to the choice of benefits) that a member could be taxed based on the assumption that they will take a particular benefit. If they take a lower benefit, then they have been over-taxed.

  This system also required constant explaining to the members concerned, due to its lack of transparency. This comes at a cost to the Scheme.

- **the removal of the pooling arrangement for defined benefit schemes is inequitable**
  The cost of a member's benefits does not accrue at a uniform rate over their membership. The cost tends to be higher closer to retirement. This is exacerbated when there are variable contribution rates. This could lead to the situation where a member is over the contribution limit one year but under the next, though on average the cost may be well under the limit.

  The current system of deductible contribution limits allows the pooling of individual limits for comparison to defined benefit contributions, after allowance for accumulation contributions.

- **the limit is too low**
  Because members generally find it easier to contribute large amounts to superannuation as they get closer to retirement, $50,000 is too low a limit. We have a number of defined benefit members in their 50's who are salary sacrificing large amounts because they can afford to now, whereas they couldn't earlier when they had children at home and mortgages still outstanding.

- **the tax is levied on the individual but payable by the fund**
  Each fund is then required to adjust benefits on an individual basis.

Essentially this system is Surcharge Mark II. The surcharge was removed by the government to simplify superannuation and make it easier for high income earners to save for retirement (as per the Treasurer's press release at the time). How is the current proposal simplifying superannuation?

Our suggestion is:

1) That the limits on contributions for both taxed and untaxed schemes should be the same;
2) That there be no limit on concessionally taxed benefits from untaxed schemes;
3) That pooling of contribution limits for defined benefit schemes be allowed, and that the schemes then determine how any excessive contribution tax is to be offset against benefits;
4) That the limit be set at least $100,000, to allow members who are salary sacrificing amounts later in life to catch up on lower earlier contributions. The other option is that a lifetime limit be set, which members can then fund as it best suits them;
5) That notional contributions not be required, but instead that a rate of 9% (being the minimum possible) be used for all members;
6) That any additional tax be levied on the member, but with the option to request their superannuation fund to pay it.

This simplifies the administration, as well as removing the inequities between taxed and untaxed schemes.