

The following documents have been posted in response to concerns raised by a number of members as to how their pension related entitlements have been calculated by Energy Industry Superannuation Scheme and other concerns they have had with the Scheme.

Taxation Experience of the Electricity Industry Superannuation Scheme (EISS) 1 July 2000-30 June 2007

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About the author: Ray is a retired academic and is a superannuant of the South Australian Superannuation Scheme. During retirement he has been involved in representing the interests of members of public sector defined benefit pension schemes at State and Federal levels. A substantial interest that Ray has had is the taxation status of the State Pension Scheme, and consequences for members should the scheme cease its constitutional protection. To acquire technical superannuation knowledge Ray enrolled in, and completed, the Diploma of Superannuation Management which is offered by the *Association of Superannuation Funds of Australia (ASFA)* in cooperation with Macquarie University. He was the national prize-winner for two units of the Diploma including the unit *Defined Benefit Funds*.

Please note:, Ray does not claim to be a recognized authority on the tax consequences of a superannuation fund ceasing constitutional protection and what follows should be viewed as a scholarly document, the merit of which readers should judge for themselves. It has been written for the purpose of assisting people to understand the effects of a change in taxation status on their pensions.

Ray via the ASU provided the Chairman of the Electricity Industry Superannuation Scheme (EISS) Board with an equivalent version of the document and an invitation to point out any significant errors it contained. Ray also asked the EISS Chairman to indicate if he had any objection to the document being made available to interested persons. In the interests of balance the response that we have now received from EISS can be found at...

1. Introduction

The substantial matter with which the paper deals is the controversial and unusual method that EISS uses to recalculate its pensions following changes in the tax arrangements applying to the Scheme which had effect from 1 July 2000.

The concern about the EISS method of recalculating pensions is based on the possibility that it has had the effect of delivering a net saving to employers that could, and should, have been passed to members.

If changes in taxation arrangements have seen a net savings pass to employers, instead of members, this is a very important matter. A basic principle of Australia's superannuation savings system is that a superannuation fund must operate in the best interests of members. As far as accrued benefits are concerned an employer is only entitled to expect that it will not be required to make additional contributions over and

above those it has agreed to make. For the case of a defined benefit fund the contributions that an employer has agreed to make are those needed to fund the defined benefit.

2. Taxation Changes Affecting EISS

Until 30 June 2000 the Electricity Industry Superannuation Scheme was a constitutionally protected scheme. This meant that it did not pay tax on its income. Most superannuation schemes had been paying tax on their income since 1 July 1988. The main taxes payable were a 15% contributions tax on employer contributions and a tax of up to 15% on investment earnings. Constitutionally protected schemes are also referred to as 'untaxed sources' while schemes that pay tax on their income are referred to as 'taxed sources'.

When benefits are paid to members from untaxed sources they are subject to higher rates of tax than those paid from taxed sources. This is necessary to ensure that people receiving their superannuation benefits from untaxed sources end up paying a comparable amount of tax as people getting their superannuation benefits from taxed sources.

Where the benefit was a pension, those receiving their pensions from taxed sources, and retiring after 1 July 1988, received a reduced pension to compensate employers for the effect that the taxes introduced on 1 July 1988 had on the fund assets. To compensate members for this they were able to claim a 15% tax offset on their pensions. People receiving pensions from untaxed sources did not have their pensions reduced but nor could they claim the 15% tax offset.

The net effect for most members of taxed funds was that they ended up with substantially higher after-tax incomes than would have been the case if their fund had continued as an untaxed fund. The reason for this is that pensions were always reduced by less than 15%. Of this less than 15% of the pension lost, 15-30% would have been lost as tax anyway and so the net loss was usually no more than 10%. This loss was compensated by a 15% tax offset, producing the result that most members had a net gain of more than 5% of their original gross pension. This explains why the pension reductions were non-controversial.

To the best of the writer's knowledge EISS is the only Australian fund that has changed from untaxed source to a taxed source, with the members receiving no improvement in the after-tax value of their pensions.

Following superannuation reforms which took effect on 1 July 2007 taxed source pensions paid to people aged 60 or more are tax-free; while people receiving untaxed source pensions can claim a 10% tax offset on their pension. **These reforms of 2007 have made no difference to the tax payable by funds.**

At 30 June 2000 constitutional protection of EISS ceased and it commenced paying tax on its income received from 1 July 2000. It was also required to pay tax on the assets it held at 30 June 2000.

In order to ensure that the requirement to pay tax from 1 July 2000 did not increase employer costs, requiring them to make contributions greater than they would have been required to make, had the tax changes not occurred; all EISS gross benefits were

subject to reduction from what they would have been if constitutional protection had not ceased. **The allowed extent for these reductions was the extent needed to avoid or reduce an increase in employer costs arising from the tax changes. The reductions have been claimed by the Trustee to provide no advantage to employers.**¹

Members of EISS receiving Lump Sum Benefits seem to be quite satisfied with their reduced benefit but the reduction of pensions has been controversial. The reason for the controversy is that pension reductions have often been higher than 15%, i.e. higher than the maximum superannuation tax rate. Some members have also noticed that if they take their pension as a lump sum, i.e. if they commute the pension, the percentage reduction for taxation is much smaller than the reduction that is made to the pension, if they take their benefit in that form.

The method that EISS uses to calculate pension reductions makes use of *personal income tax rates* to achieve the result that the reduced (post-privatisation or taxed source) pension has exactly the same after-tax value as the original (pre-privatisation or untaxed source) pension. Taxation rates applicable to superannuation fund income play no part in the recalculation of the pension. This, in itself, is controversial and leads to the obvious question: **how does the Trustee know that the reductions just avoid or reduce an increase in tax costs for the employers and are not creating an advantage for the employers?**

Requests by members to have the EISS trustee set out detailed calculations to prove that these large pension reductions are not delivering an advantage to employers have been unsuccessful. The purpose of this paper is to provide sufficient detail about taxes actually paid by EISS since 1 July 2000 to see if the taxes paid are consistent with the extent of pension reductions that EISS is making.

3. EISS pensions and the Electricity Corporations Act 1994

Reducing a pension on which a person and his/her spouse will be dependent for life is no small matter and so it is not surprising to know that these reductions are explicitly provided for in the Electricity Corporations Act, 1994 (Schedule 1, Part F, Clause 11). This provision was made in anticipation of the privatization of ETSA. The relevant sub-clauses of Clause 11 are reproduced below.

11—Treasurer may vary Rules in relation to taxation

- (1) *The Treasurer may, after consultation with the trustee of the Scheme, insert into the Rules a rule or rules relating to changes in benefits for members and employer costs in relation to those benefits, following the Scheme's loss of constitutional protection.*
- (2) *A rule inserted by the Treasurer may—*
 - (a) *prescribe a decrease in the level of gross benefits; or*
 - (b) *require benefits to be paid on an untaxed basis or partly on an untaxed basis; or*
 - (c) *make provisions of the kind referred to in both paragraphs (a) and (b),*

in order to avoid or reduce an increase in employer costs caused by changes in the incidence of taxation as a result of the Scheme's loss of constitutional protection.

- (3) *Subject to subclause (4), the change in benefits effected by a rule made under this clause must not result in the level of net benefits to which a member, or a person in respect of a member, is entitled being less than the level of net benefits to which he or she would have been entitled if the Scheme had not lost constitutional protection.*
- (4) *The level of net benefits to which a member, or a person in respect of a member, is entitled may be reduced below the level permitted by subclause (3) to avoid or reduce an increase in employer costs attributable to tax under the Superannuation Contributions Tax (Assessment and Collection) Act 1997 of the Commonwealth in relation to the member.*

Sub-clause (1) tells us that the Treasurer may, for reasons related to taxation; vary the EISS rules by inserting rules 'relating to changes in benefits for members and employer costs in relation to those benefits'.

Sub-clause (2) tells us that pensions (all benefits) may only be reduced to the extent needed to avoid or reduce an increase in the employer's cost arising from changes in the incidence of taxation following the fund's loss of constitutional protection. The use of the words; 'avoid or reduce an increase' in this clause tell us that the employer costs might increase, but cannot decrease.

Sub-clause (3) tells us that the reductions authorized under sub-clause (2) must never have the effect of reducing a pension's after-tax value even if this would see an increase in the employer's costs.

Sub-clause (4) has only been provided because it is referred to in sub-clause (3). It deals with the superannuation surcharge and has no relevance to the matter under discussion.

Sub-clauses (1) and (2) make it necessary for the fund Trustee to take account of the amount of tax the fund became liable to pay in respect of its pension benefits when it changed to a taxed fund. This does not appear to have been done. All pensions are reduced to the point allowable under sub-clause (3) ***having no regard for whether this reduction exceeds the employer's tax cost.***

Pension reductions are being made as if sub-clauses (1) and (2) do not exist; when they would appear to be of fundamental importance. The reductions are being made as if only sub-clause (3) needs to be complied with. But sub-clause (3) would appear to be merely a 'no-detriment' provision, which is used to check that a pension reduction does not see a member end up worse off. Sub-clause (3) only needs to be used, and only should be used, after sub-clauses (1) and (2) have been given their proper expression.

The South Australian State Treasurer has obtained an opinion from the Crown Solicitor that the pension reduction formula is valid and complies with the provisions of Clause 11 of the Electricity Corporations Act 1994.² The opinion includes the qualification that the reduction formula is valid **'after taking account of the increased employer costs that had to be offset'**. With the qualification, this is a correct and useful opinion because it focuses attention on the fact that the matter turns

on whether reductions just offset employer tax costs (and are therefore valid) or whether they go further (and are therefore invalid).

4. Indications that the EISS Pension Reduction Method Is Valid Because it Only Recovers the Employer Tax Costs Arising From Loss of Constitutional Protection

Members have made requests of the EISS Trustee and of the State Treasurer to obtain a detailed explanation of why it is necessary to reduce pensions by 17% and more when the maximum rate of tax payable by a fund on its income is only 15%. These requests have made clear the members' concern that the reductions are providing an advantage to employers that they, the members, were entitled to receive.

As a result of these requests members have been provided with a copy of a document entitled:

EXPLANATORY MEMORANDUM: "AMENDMENTS TO THE RULES OF THE ELECTRICITY INDUSTRY SUPERANNUATION SCHEME, REDUCTIONS OF BENEFITS ON ACCOUNT OF TAXATION"

The author of this document is a Mr. Allan Archer (now deceased) referred to below in connection with the January, 1998 report on the taxation status of South Australia's superannuation schemes. The explanatory memorandum was dated 27 June, 2002 and the Treasurer inserted the rules for pension reductions into the EISS rules on 28 June, 2002. The document contained no detailed discussion of the pension reduction formula and no explanation for why pensions were to be reduced by more than 15% even though most other benefits would be reduced by less than 15% and, in many instances, by much less than this.

The document refers to *the scheme actuary* having done calculations on the tax that would have to be paid, but the South Australian Department of Treasury and Finance *does not hold copies* of the actuary's worksheets and can only supply a copy of the Explanatory Memorandum.²

5. Indications that EISS Pension Reduction Method is Invalid Because it Goes Beyond Recovery of the Employer Tax Cost Arising From Loss of Constitutional Protection

a) Experience of other schemes: public sector pension schemes in NSW are taxed sources and these pensions were reduced to avoid an increase in employer costs arising from the taxes on superannuation fund income introduced on 1 July 1988. The reductions involved only the employer-funded component of the pension and this component was reduced by less than the 15%, in proportion to the fraction of the pension recipient's service completed before 1 July 1988.³

For example, if we assume that the employer component of the NSW pensions was 80% the maximum extent of reduction of any pension is $15 \times 0.8 = 12\%$. If a person had half his/her fund membership completed before 1 July 1988 the reduction would have been about 6%.

b) Reports to the SA Department of Treasury and Finance: in January, 1998 (before EISS ceased constitutional protection) the SA Department of Treasury and

Finance received a report on the taxation status of the state's superannuation schemes. This report advised that a large financial advantage would be obtained by the state government if the State Pension Scheme ceased constitutional protection. The method outlined for adjusting pensions to deliver this advantage was the same method that EISS is now using.

Referring to the large gains to be made in this way the January, 1998 Report states:

"The Government may need to cope with demands from members of the pension scheme that they, as well as the Government, should share in the gains achieved. An important part of the response would be that these people are still members of schemes which have been closed because of their generosity, and yet their benefits have been continued. Thus they should have little to complain about if the advantage of applying the PJFC [pre-July 1988 Funding Credit] is not passed through to them, so long as they are not detrimentally affected. A critical point is that the benefit reductions should be such as to remove the windfall gains, but not to the extent of causing detriment to any members."(p. 63)⁴

Note: pre-July 1988 Funding Credit is discussed in detail below.

A co-author of the January 1998 Report was Mr. Allan Archer, referred to in Section 2 as the author of an *explanatory memorandum* on the rule changes. Mr. Archer was the actuary who provided advice, to the EISS Trustee and to the State Treasurer, on the benefit reduction formulae, to be used by EISS following its loss of constitutional protection.

In 2004 the SA Department of Treasury and Finance received another report on taxation status of the state's superannuation schemes. This also concluded that large savings could be obtained by ceasing constitutional protection for the State pension Scheme and applying reductions to pensions in the way that had been done by EISS. In this report we read:

*"In the Lump Sum Scheme/Pension Scheme there is a net tax advantage in moving from an untaxed environment to a taxed environment. These advantages could be used to increase members' benefits and/or reduce employer costs. If members' benefits are maintained at current levels (after allowing for tax effects), then savings in the order of \$450 million are estimated for the employer."*⁵

This 2004 report acknowledges that in other states, members' benefits had been improved with employer costs being maintained constant.

c) A 'First Principles' calculation of the expected effect of tax on pensions

We consider the case of a member for whom the following applies;

- a) Retired in 2002 after 42 years service
- b) Made 'Undeducted Contributions' of \$35,490
- c) Pre-privatisation (untaxed source) pension value was \$38,760
- d) Post-privatisation (taxed source) pension value was \$32,110

We assume that the amount needed to fund the untaxed source pension was \$500,000 but it does not matter what the actual amount was because our interest is in the tax

cost as a percentage of the pension value rather than as a dollar-amount. This percentage is largely independent of the pension value.

We will assume that the \$500,000 is paid into an untaxed fund just before it ceases constitutional protection. The tax payable on the \$500,000 upon loss of constitutional protection is calculated as follows.

Calculation step 1: the pensioner's 42 years of service is divided into 23 years of pre-1 July 1983 service and 19 years of post-30 June 1983 service.

Calculation step 2: a pre-1 July 1983 component of the pension value is calculated as:

$$23/42 \times \$500,000 = \$273,810. \text{ *No tax is payable on this amount.*}$$

Calculation step 3: a post-30 June 1983 component of the pension value is calculated as:

$$\begin{aligned} \text{Total pension value} - \text{Undeducted Contributions} - \text{pre-1 July 1983 component} \\ = \$500,000 - \$35,490 - \$273,810 \\ = \$190,700. \text{ *This is subject to tax at the rate of 15\%. The tax payable is:}* \end{aligned}$$

$$\$190,700 \times 0.15 = \$28,605. \text{ *This is 5.7\% of the pension value of \$500,000}*}$$

Calculation step 4: after payment of the tax calculated at step 3 the amount remaining to fund the taxed source pension is:

$$\$500,000 - \$28,605 = \mathbf{\$471,395}$$

The amount required to fund a pre-privatisation pension of \$38,760 was \$500,000 and so the amount calculated at step 4 (\$471,395) should be capable of funding fund a post-privatisation pension of:

$$\$38,760 \times 471,395/500,000 = \mathbf{\$36,542}$$

The calculations above are based on a member's actual experience and the member was paid a post-privatisation pension of only \$32,110, this being a reduction of 17.2% (from \$38,760 to \$32,110) and far more than the 5.7% tax which the above calculation suggests would have been paid on the assets backing the original pension.

Note: the date used in the above calculation is 1 July 1983 and not 1 July 1988. This is because taxes became payable on lump sums assigned to fund members from 1 July 1983. Funds did not commence paying tax on fund income until 1 July 1988.

The advantage the employer has obtained here can have a dollar value assigned to it as follows:

- The tax cost of changing the pension from an untaxed source pension to a taxed source pension was \$28,605 and this was 5.7% of the value of the assets needed to fund the original pension
- Having lost 5.7% of the assets backing the pension to tax, the employer was entitled to see the pension reduced by this percentage to offset the tax cost
- The pension was reduced, not by 5.7%, but by 17.2% and the value of this reduction is $\$28,605 \times 17.2/5.7 = \$86,317$

- **The pension has been reduced as if \$86,317 tax was required to be paid when only \$28,605 had to be paid. The advantage to the employer is \$57,712.**

Note: the calculation immediately above is based on the amount of assets backing the pension being \$500,000. If the actual amount is different (which it probably will be) the calculated, dollar-amount advantage to the employer will be different in proportion, but still very substantial.

d) Tax payable on the lump sum obtained by commuting an EISS pension

If the person whose details were used in the calculation above had opted to commute 100% of the pre-privatisation (untaxed source) it would have provided a gross lump sum of about \$404,400. This would have been reduced for tax reasons (the same tax reasons the pension was reduced) to about \$381,500. This is a reduction of \$22,900 which, expressed as a fraction of the original lump sum, is $22,900/404,400 = 0.057$ (5.7%).

- It is now appropriate to consider the actual taxation experience of EISS following its loss of constitutional protection.

6. Actual Taxation Experience of EISS

The writer has examined the EISS Annual Reports from 2000 through to 2007. These reports cover the entire period from the loss of constitutional protection on 1-7-2000 until 30 June 2007. The EISS fund was fully funded at December 2005. The Figures in Table 1 are for the entire fund i.e. lump sum, pension, RG and accumulation sub-schemes combined. The values for *Changes in net assets before tax*, *Income Tax Expense* and *Assets Held* are taken from Financial Statements of the corresponding Annual Reports. The other numbers in Table 1 have been calculated.

Table 1

	Years ending 30 June 2000 - 2007								
	2000	2001	2002	2003	2004	2005	2006	2007	Total
Change in net assets before tax (\$M)	-32.3	50.8	36.1	47.9	80.1	97.3	91.3	109	480.2
Income Tax Expense (\$M)	0	0	9.0*	1.5	2.4	0.3	8.6	9.9	31.7
Income tax expense as a % of change in net assets before tax.	0	0	24.9	3.1	3.0	0.003	9.4	9.1	7.1**
Assets Held (\$M)	116.7	167.5	194.5	240.8	318.5	415.5	498.2	597.3	n/a
Cumulative cost of tax(\$M) (see Note)	0	0	9.9	12.5	16.4	18.4	27.9	41.2	n/a
Cumulative cost of tax expressed as a % of assets held	0	0	5.1	5.2	5.1	4.4	5.6	6.9	n/a

* This amount of \$9 million includes the tax that was paid on the assets held by the fund at 1-7-2000. That amount of tax was \$6.2 million. The balance of \$2.8 million was, presumably, the tax paid on contributions and investment income for the two years ending 30 June 2001 and 2002.

**This figure is an average of the values for the years ending 30 June 2001 until 30 June 2007. Tax did not become payable until 1 July 2000.

Note: *Cumulative cost of taxation* values provide an estimate of the extra money that would have been held in the fund if it had not had to pay tax. The estimate has been made by starting from the left of the table and multiplying the income tax expense (row 4 of the table) by 1.1. This number expresses an investment return of 10% p.a.

Proceeding across the table, each year's income expense is added to the accumulated expense as at the previous year and the calculation repeated. Using an investment

return of 10% is conservative in this context because the average return for 2001-2007 was less than 10%.

From Table 1 we see that the total Income Tax Expense up until 30 June, 2007 is \$31.7 million. Had the fund remained as an untaxed fund, this money would have stayed in the fund and earned interest. Assuming an interest rate of 10% p.a. this would have seen an extra \$41.2 million accumulating (refer to the Note *Cumulative cost of taxation values* in Table 1 above for an explanation of how this figure is obtained). So, if the fund had remained as an untaxed fund the assets held in the untaxed fund at 30 June 2007 would equal:

Assets in the taxed fund at 30-6-2007 + \$41.2 million
= \$597.3 million + \$41.2 million
= \$638.5 million (6.9% more than \$597.3 million, the amount held in the taxed fund)

So, an untaxed fund, to which employers had made the same contributions as they made to the taxed fund, would only hold an extra 6.9% in assets but the untaxed fund would have to pay pensions that were 17% greater. There would not be enough money in the untaxed fund to pay these pensions, which indicates that employers have been making smaller contributions to the taxed fund than they would have had to make to the untaxed fund.

This conclusion is not affected by the fact that the figures in Table 1 are for all the EISS sub-schemes rather than for just the pension sub-scheme. If anything the rate of tax payable on the assets held in the pension sub-scheme will be less than for the combined schemes. This is because, of all the sub-schemes, the pension sub-scheme has the greatest proportion of older members and therefore the greatest proportion of its benefits accruing before 1 July 1988. Contributions made to fund such benefits are not subject to tax as explained in *Section 7. Why has EISS paid so little tax on its 2001-2007 income?*

Before this analysis was carried out, the belief that pensions had been reduced by more than the tax cost was based on experience elsewhere, indirect calculations and knowledge of the tax payable on a commuted pension. **Now the EISS fund experience itself, is seen to support the conclusion that pension reductions have gone beyond the mere offsetting of tax costs and have delivered a substantial saving to employers.**

The fund experience is quite inconsistent with the 'Explanatory Memorandum' on which the Trustee and State Treasurer appear to have relied.

7. Why has EISS paid so little tax on its 2001-2007 income?

It is well known that superannuation funds have, since 1 July 1988, been liable to pay a 15% contributions tax on employer contributions and up to 15% tax on investment earnings. On this basis one might expect the effect of tax on the EISS to be much greater than the observed 6.9% shown in Table 1.

The main reason why the amount of tax paid by EISS over the period 2001-2007 is nowhere near the 17% or more by which pensions were reduced is that the fund has made use of a Pre-1 July 1988 Funding Credit (PJFC) to reduce its taxable income.

What is a pre-1 July 1988 Funding Credit?

Superannuation funds that were not fully funded at 1 July 1988 (the date on which superannuation funds became obliged to pay tax on fund income) were assigned a pre-1 July 1988 funding credit (PJFC). This was an amount that could be used as the fund was brought up to full funding *to ensure that the fund did not have to pay the 15% contributions tax on the contributions that could be attributed to membership of the fund completed before 1 July 1988.*

The initial PJFC amount assigned to each fund is adjusted annually to reflect:

- a) the amount of the PJFC utilized that year and
- b) changes in wages growth that had occurred during the year.

For EISS the initial amount of the PJFC was \$258.3 million and none was utilized until 30 June 2001. By 30 June 2001 indexation of the initial amount had seen it increase to \$435.6 million. The 2005 Annual Report summarises the change in the EISS PJFC amount from 30/6/2001 to 30/6/2005 as shown in Table 2.

Utilisation of the PJFC ceased at 30/6/2005 and it is expected that none of the balance of \$267.9 million at that date will be able to be used, due to legislative changes made by the Federal Government.

Table 2: PJFC amounts 2001-2005 (\$M)

Year	Opening PJFC Balance	Add Indexation	Less PJFC Used	Closing PJFC Balance
2001	258.3	177.3(Note)	46.2	389.4
2002	389.4	17.9	50.3	357.0
2003	357.0	22.1	48.2	330.9
2004	330.9	15.2	47.8	298.4
2005	298.4	15.8	46.3	267.9
		Total PJFC used	238.8	

Note: The large indexation amount for 2001 reflects the fact that it is indexation for the period 1988-2001. The total vested benefits amount for all the EISS schemes at 30/6/2001 was \$298 million

The likely reason that the PJFC amount at 30/6/2001 of \$258.3 million + \$177.3 million = \$435.6 million is far greater than this, is that it includes the pre-1 July 1988 credits associated with the fund membership of the EISS retired pension scheme members, who were transferred to the State Pension Scheme prior to 30 June 2001.

The PJFC associated with the fund membership of these people was not transferred to the State Pension Scheme but was retained by EISS.

Utilisation of the PJFC has the effect of reducing the amount of the contributions made that are subject to the 15% contributions tax. For example, by using \$46.2 million of the PJFC in the year ending 30 June 2001 EISS was able to receive \$46.2 million in employer contributions without having to pay the 15% contribution tax on

those contributions. The EISS Annual Report for the year ended 30 June 2001 shows that employer contributions totalled \$56.9 million. The effect of PJFC utilization would have been that *EISS had to pay the 15% contributions tax on no more than \$56.9 - \$46.2 = \$10.7 million.*

Details of employer contributions and PJFC utilization for the entire period from loss of constitutional protection at 30-6-2000 until 30-6-2007 are set out in Table 3. For the years ending 30 June 2001, 2002 figures are available for the different sub-schemes of EISS {Pension Scheme, (PS); Lump Sum Scheme, (LS); Retirement Gratuities Scheme, (RG) and Accumulation Scheme, (Accum)}. After 2002 the Annual Reports *do not provide separate financial details* for the different EISS sub-schemes. The employer contributions values have been taken from the Statements of Changes in Net Asset included in each Annual Report. The PJFC figures are taken from the Notes to Financial Statements of the 2005 Annual Report.

Table 3

Employer contributions for year ending 30/6	PS(\$M)	LS(\$M)	RG(\$M)	Accum (\$M)	Total(\$M)	PJFC utilized (\$M)
2001	26.0	19.7	9.3	1.9	56.9	46.2
2002	21.5	22.3	9.7	2.4	55.9	50.3
2003	56.2				56.2	48.2
2004	60.4				60.4	47.8
2005	56.4				56.4	46.3
2006	31.5				31.5	0
2007	42.3				42.3	0
Total					359.6	238.8

From Table 3 we see that, from the time of the loss of constitutional protection on 30-6-2000 until 30-6-2007, the employer contributions to the EISS for all sub-schemes totalled \$359.6 million.

The Trustee utilized \$238.8 million of the scheme's PJFC amount. The effect of this is that, of the \$359.6 million employer contributions received by the fund, tax was payable on no more than:

$$\$359.6 \text{ million} - \$238.8 \text{ million} = \$120.8 \text{ million.}$$

The tax payable on this amount of contributions is:

$$0.15 \times \$120.8 = \$18.1 \text{ million.}$$

So EISS paid no more than \$18.1 million in tax on contributions of \$359.6 million. This is an effective contributions tax rate of no more than $18.1/359.6 = 0.050$ (5%).

Once again we are unable to see in the experience of EISS a reason why it was necessary for pensions to be reduced by 17% (and more) in order to protect employers from an increase in their costs; compared to what the costs would have been if EISS had not ceased its constitutional protection effective from 1 July 2000.

8. Summary

The taxation experience of EISS is that the effect of taxation following its loss of constitutional protection is consistent with employers having gained an advantage from the benefit reduction method applied to pensions; rather than just having covered their tax costs.

In the face of some very persuasive evidence to the contrary, the only basis members have been given for accepting that their pension reductions are valid, i.e. do not go beyond recovering employer tax costs arising from loss of constitutional protection, is an '*explanatory memorandum*' written by an actuary unfortunately now deceased.

Sources

1. EISS Annual Report to the Treasurer for the year ending 30 June 2003. Notes to and Forming Part of the Financial Statements, **Note 5. Income Tax**
2. Letter to the Hon Bob Such, MP from the State Treasurer, the Hon Kevin Foley, MP, 23 June 2008
3. SAS Trustee Corporation
4. Allan Archer and Tony Cole *Study of the Taxation Status of the SA Government Superannuation Funds*, January 1988, p 63.
5. Martin Stevenson *Review of Taxation Status of the SA Government Superannuation Funds*, 23 December 2004, p 7.

3 November 2008

Mr Andy Dennard
Secretary
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Dear Andy

We refer to your letter of 14 October 2008 attaching a copy of a paper prepared by Mr Ray Hickman.

We consider that a large number of the arguments and conclusions drawn by Mr Hickman are erroneous. We have summarised our key areas of concern below:

- 1) When Mr Archer (the actuary) provided advice to the Treasurer on the changes to superannuation benefits following the privatization of the industry and hence the Scheme, we understand that he did so on a scheme-wide basis. We have a Queen's Counsel opinion that confirms this was the correct approach for the Treasurer to adopt.

Consequently, we acknowledge that there are 'unders' and 'overs' as the benefit reduction formula applies to particular individual members and the corresponding employer costs. The Board has publicly discussed this with members previously.

The way the benefit reduction is calculated on a taxed pension may mean that the cost of a Division 3 taxed pension may be lower than the cost of a Division 3 untaxed pension. However, it is not the Board's job to determine whether the condition relating to employer costs under clause 11(2) of Part F of Schedule 1 of the EC Act is or has been satisfied – this was a matter for the Treasurer to determine at the time of making the rule amendments. Regardless of whether the Board considers the rules to be equitable, the role of the Board is to apply the rules. The rules require that pensioners receive the same benefit after income tax without regard to how this impacts on employer costs.

Members are able to apply to the Board to have their benefits paid as though they were being taken as an untaxed pension, as if the Scheme remained constitutionally protected. If members take a pension on an untaxed basis the cost is as it would have been pre-privatisation and, importantly, such pensioners are left in the same net position as pre-privatisation.

- 2) Irrespective of point 1), the Board's duty to comply with the rules governing the Scheme is a paramount duty and does affect the scope of the Board's other duties as a trustee.

The Board has power to vary the rules of the Scheme, but if a variation will increase employers' contributions or employers' liability it can only be made with the consent of employers. The Board has no capacity acting on its own to make variations to the rules that impact adversely on employer liability.

A change to the benefit reduction formula as suggested by Mr Hickman will have the effect of increasing employer liability. The Board has asked the employers whether they would support altering the benefit reduction formula so that a 15% cap applies to the reduction on pensions; all employers have stated that they will not approve such a rule change.

- 3) Over the years, the Board has sought extensive advice about the benefit reduction formula and the application of the rules. Last year the Board obtained the opinion of Philip McNamara QC. All advice has supported the Board's conduct in connection with the application of the benefit reduction formula. It is misleading to suggest that, in applying the benefit reduction formula as set out in the Scheme rules, the Board is not acting in accordance with its fiduciary obligations. This also extends to any allegation that the Board has failed to satisfy its obligations because it has not carried out investigations into the cost analysis undertaken by or on behalf of the Treasurer when making the relevant rule amendments in June 2002.

In view of the above, whilst Mr Hickman's paper may be useful for your purposes in lobbying the State Government for changes to the EC Act, the Board remains bound by the rules unless and until such a change is effected. Any suggestion made by you or Mr Hickman to the effect that the Board is able to do more is erroneous and misleading and potentially damaging to the Board.

Yours sincerely



Mark Day
Chairman



Superannuation
Complaints
Tribunal

Registration of Complaint Form

Please Read the Following Carefully Before Lodging a Complaint

This form can be used to lodge a complaint against a Superannuation Fund Trustee, a Retirement Savings Account (RSA) provider or a Life Company which has offered an annuity or provided insurance under an RSA. All of these are referred to in this form as the 'Fund'.

ITEM 1: HAVE YOU MADE A FORMAL, WRITTEN COMPLAINT TO YOUR FUND'S COMPLAINTS OFFICER?

- Yes** Attach a copy of your letter of complaint (if you have kept a copy). **Go to Item 2**
- No** You must make a formal, written complaint to your Fund's Complaints Officer before the Tribunal can assist you. [Note that **time limits apply** to certain complaints; contact the Tribunal on 1300 780 808 for details.]

Item 2: Has the Fund responded to your complaint?

- Yes** The Fund has responded to my complaint but I am not satisfied with the Fund's response. Please attach a copy of the Fund's response and **Go to Item 3**
- No** Has 90 days passed since the Fund received my complaint?
 - Yes** **Go to Item 3**
 - No** The Fund has 90 days within which to respond to your complaint. [Note that **time limits apply** to certain complaints; contact the Tribunal on 1300 780 808 for details.]

Item 3:

Please complete this Registration of Complaint form and send it, together with the copy of your letter of complaint to the Trustee and a copy of the Fund's response, to:

Superannuation Complaints Tribunal
Locked Bag 3060
GPO MELBOURNE VIC 3001

Website www.sct.gov.au
Telephone **1300 780 808**
Facsimile **03 8635 5588**

Personal Details of the Complainant (please print)

NAME:
(Mr/Mrs/Ms/Dr) (Family Name) (Given Names)

SEX: (circle) Male/ Female DATE OF BIRTH:/...../19..... OPTIONAL: (circle) Do you speak a language other than English at home? YES / NO

ADDRESS:
(No.) (Street)

.....
(City/ Suburb) (State) (Postcode)

PHONE: (.....)..... (.....).....
(daytime contact) (Fax)

IF YOUR COMPLAINT IS ON BEHALF OF ANOTHER PERSON

NAME OF PERSON:..... RELATIONSHIP TO YOU (eg. child): DATE OF BIRTH:/...../19.....

**Superannuation Complaints Tribunal
REGISTRATION OF COMPLAINT**

Fund Details (please print)

FUND NAME:		
MEMBER'S NAME (if not complainant)	MEMBER/ POLICY NO.:	
DATE OF MEMBER'S DEATH: (if deceased)	YOUR RELATIONSHIP TO THE MEMBER:	
(if member is not complainant) (eg. parent, spouse, executor)		
FUND ADDRESS:		
(No.)	(Street)	
.....		
(City/ Suburb)	(State)	(Postcode)
CONTACT PERSON:		
PHONE (include STD): (.....)	(Name)	(Position)

If you wish to have someone else act on your behalf please provide the following details for that person. The Tribunal has discretion under section 23 of the *Superannuation (Resolution of Complaints) Act 1993* to approve representation, if it considers it necessary in all the circumstances. The Tribunal will inform you of its decision. Please note that the Tribunal is not empowered to award costs in relation to any fees arising as a result of representation. In other words, you will have to bear the costs of your representation.

NAME:	(Mr/Mrs/Ms/Dr)	(Family Name)	(Given Names)
ADDRESS:			
(No.)	(Street)		
.....			
(City/ Suburb)	(State)	(Postcode)	
PHONE: (.....)		(.....)
(include STD)	(Daytime contact)		(Fax)
RELATIONSHIP TO COMPLAINANT:			
(eg. spouse, solicitor)			
REASON FOR WANTING SOMEONE TO ACT ON YOUR BEHALF:			
.....			
.....			
.....			

If your complaint relates to the payment of a death benefit, please provide the name(s) of any other person(s) who may request to be made a party to the complaint (N.B. they will need to make separate request(s) in writing).

Name(s):
.....

SECTION A: If you are making a complaint about a disability benefit because of Total & Permanent Disablement (T & PD) you must complete this section.

Please provide:

1. The date you last physically worked:/...../.....
2. The date you permanently ceased employment (that is, the date of termination):/...../.....
3. The reason for your termination (for example resignation or retrenchment).....
4. Did you permanently cease employment because of the condition which caused you to make a claim for T & PD benefit? (Please circle) Yes / No
5. Have you received any Worker's Compensation payments? Yes / No If 'Yes', payments commenced on:/...../..... and ceased on:/...../.....
6. A copy of your claim for a TPD benefit. OR IF NO COPY AVAILABLE The date you made the claim:...../...../.....

7. A copy of the Fund's first decision to reject your claim for a TPD benefit.

8. A copy of your letter requesting the Trustee to review the decision (ie letter of complaint/notice of dispute).

9. A copy of the Fund's second decision to reject your claim.

In relation to questions 5, 6, 7 and 8, if you cannot provide copies of the documents please provide dates.

Comments (for example, if you cannot answer one or more of the above questions please explain):.....

.....

SECTION B: Please complete the following section for all complaints (if insufficient space, please attach additional pages)

1. The matter I am complaining about is in the following area:

- | | |
|--------------------------------------|--|
| Disability Benefit | Failure to Provide Information / Wrong Information |
| Death Benefit | Superannuation Surcharge |
| Payment Calculation/ Account Balance | Other (Please specify): |
| Fees and Charges | |

2. Amount of the benefit/Amount in dispute: \$.....

3. What is the Fund's decision(s) or action(s) you are not satisfied with?

.....

4. Please state why you believe that your Fund's decision is unfair or unreasonable:

.....

.....

.....

.....

.....

5. What is the loss (if any) you claim you have suffered?

.....

.....

.....

6. What is the resolution you seek?

.....

.....

.....

7. Please add any other relevant comments:

.....

.....

.....

.....

8. If your complaint relates to the sale, management or variation of an annuity policy, please provide the date of commencement of the policy:/...../.....

9. If your complaint concerns a policy with a Life Company and the complaint is about the conduct of the Life Company and/or its representative before the policy commenced or you were admitted to the fund, please provide the commencement date of the policy:/...../.....

10. Is there any other person or organisation you are aware of who may be affected by the outcome of your complaint? If yes, please identify them and explain how they may be affected.

Name (etc).....

.....

.....

The above is a description of my complaint. I give my permission for copies of this information, and any attachments which I enclose, to be given to my Fund or its representatives or any other party to the complaint whether or not that party is currently joined as a party to the complaint.

..... (Print Name) (Signature) (Dated)

NOTE: The form must be signed personally by the Complainant named on the form.