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66. As the history below shows, there was discussion between the EISS Board, Treasury and Mercer on the tax offset rules from 2000 onwards. The Scheme's loss of constitutional protection was an item at a number of board meetings during this period as shown below.

67. In this context, a letter was sent on 7 June 2002 on the EISS Board's behalf supporting the rule changes. The EISS Board continued after this date to review the changes, and the impact on the Scheme.

History of the creation of the rules

68. The points raised above are based on the history of the creation of the tax offset rules, and the thinking that went into them as far as the EISS Board is aware. Much of this is encapsulated in correspondence between Mercer, State Treasury, and the EISS Board between 2000 and 2002. The history of this correspondence, and the EISS Board's consideration of the issue, is shown below.

2 July 2000	The Treasurer wrote to the EISS Board advising that his intention was to remove the Scheme's constitutional protection, and to introduce rules to reduce benefits for the effect of the tax changes.[7]
5 July 2000	The Under-Treasurer wrote to the EISS Board advising Treasury's intention for the tax offset, i.e. that it would be 15% of the post 1983 portion of lump sums. No comment was made on pensions.[8]
10 July 2000	Mercer provided advice to the EISS Board on the Under Treasurer's proposed approach to reducing benefits for contribution tax. Also discusses the effect of the reduction on employer costs (i.e. that the change would increase employer costs unless a PJFC[9] is granted).[10]
19 July 2000	The EISS Board resolved that: *In view of:* a) *the stated intention of the Commonwealth to tax the scheme as from 1 July 2000* b) *the stated intention of the State Treasurer to make a rule change to:* - *reduce the gross amount of any benefit which is paid after 30 June 2000 wholly or partly as an eligible termination payment (ETP) by an amount equal to 15% of the post June 1983 component of the ETP which would have been paid had the reduction had not been made and* - *direct that the post June 1983 component of the ETP payable following the reduction in the gross benefit should be paid as a taxed benefit:* *The EISS Board will pay benefits as from 1 July 2000 as though the scheme was taxed. The gross amount of each ETP which is paid after 30 June 2000 will be reduced by an amount equal to 15% of the untaxed element of the post June 1983 component of the ETP which would have been made had the reduction not been made. However, where a cash benefit applies to a member under age 55, a lesser reduction will be applied so that the member will not be disadvantaged.*
9 August 2000	Mercer provided advice to the EISS Board concerning the tax offset for benefits for members under 55.[11]
16 August 2000	The EISS Board resolved that: 1. *The letter be received* (i.e. the 9 Aug 2000 letter from Mercer) 2. *The benefit reduction for a member under age 55 will be calculated as if the member were taking in cash his/her maximum cashable entitlement*

[7] Attachment 4
[8] Attachment 5
[9] See below for explanation
[10] Attachment 6
[11] Attachment 7

	3. *The Secretary advise the Treasurer of 2 above*
29 May 2002	At the EISS Board meeting: *The Fund Secretary Mr Neill tabled a letter dated 27 May 2002 from APRA advising that a Pre July 1988 Funding Credit (PJFC[12]) of $256,300,000 had been granted.* *The Scheme Actuary Mr Archer advised that this level of funding credit should be significantly more than can be used. However in case there is scope in future to use more than this level of credit, an application could be made for an extra credit arising from the predecessor of the RG Scheme.* *IT WAS RESOLVED TO:* 1. *SUBMIT TO APRA AN APPLICATION FOR A PRE-JULY 1988 FUNDING CREDIT IN RESPECT OF THE OLD RETIRING AND GRATUITIES SCHEME.* 2. *AUTHORISE TWO EISS BOARD MEMBERS TO SIGN THIS APPLICATION.* *Mr Archer suggested that an ad hoc sub-committee be formed so as to allow EISS Board consultation regarding the work being performed on behalf of the Treasurer on the taxation reductions to benefits. Trustees Messrs Barrett, Fleetwood & Young were appointed to this sub-committee.* *Mr Young queried whether the funding credits would benefit the employers or the members. Mr Archer's response was that to the extent to which the use of the funding credits could be anticipated in the current actuarial valuation, they would be to the benefit of the members. However if later on an employer was able to make greater use of the credits (e.g. through adjusting the timing of employer contributions), the benefit of the extra credit would fall to that employer.*
June 2002[13]	Mercer, in its capacity as adviser to the State Government, provided a report to the Under Treasurer on rule changes for lump sum benefits. This provides the actuary's opinion that the changes do not reduce benefits, nor do they reduce employer costs. Also argues that the maximum practical benefit reduction on lump sums is 15%. Note: this advice did not discuss the tax offset on pensions.
7 June 2002	The Fund Secretary wrote to the Under-Treasurer stating that: *The EISS Board advises that it supports and recommends the proposed rule changes that have been developed by Mr Allan Archer of Mercers.*[14]
26 June 2002	The minutes of the EISS Board meeting show that the EISS Board continued to consider the effects on members of the tax offset rules, and specifically the impact of the PJFC. Advice was sought from the Scheme's tax adviser, as follows: *Mr Archer explained the workings of the tax reductions to benefits with the aid of slide copies. However, the EISS Board remained confused about this complex issue, and the Chairman asked that this explanation be given again at the July meeting, to provide more time for EISS Board members to consider the material provided. The EISS Board requested that the Scheme's Tax Adviser be briefed of the matter, and asked to attend the July meeting.*
28 June 2002	The Treasurer provided the EISS Board with the final rule changes (inserting rules 29, 30 and 31 of Division 1, plus the changes to Division 5) including an

[12] See below for explanation

[13] This report is dated June 2002 on the cover, but 5 September 2002 on page 23. It is unclear when the Board received a copy, as it was advice to the Treasurer.

[14] There is no formal resolution approving this letter that appears in the Board minutes for this period. This had no material impact on the outcome.

	explanatory memorandum
31 July 2002	The minutes of the EISS Board meeting show: *The EISS Board members noted the letter from the Treasurer, dated 28 June 2002 confirming the amendments to the EISS Rules inserted to deal with the benefit reductions, and the Explanatory Memorandum relating to the amendments.* *Mr Archer then presented some slides summarising the issues.* *Finally, the EISS Board members noted an email dated 12 July 2002 dealing with the opinion of the Scheme's Tax Agent (KPMG partner, Mr Peter Siebels) regarding the amendments, and received Mr Siebels' comments on this matter.*

Pre-July 1988 Funding Credits (PJFCs)

69. A PJFC is a Pre-July 1988 Funding Credit. This allows employer contributions in respect of the unfunded liability for pre-1988 benefits to be untaxed for a taxed fund. This was a large part of the actuarial analysis on rules 29 – 31.

70. The PJFC of $258m shown in the extract from the minutes of May 2002 is far more than would be expected to ever be able to be used by the Scheme. Also, this does not represent the value of the PJFC to the Scheme. This amount allows $258m worth of contributions to be non-taxable. That is, the maximum value of the PJFC to the Scheme is the tax on $258m worth of contributions, or 15% of $258m, i.e. $38m.

71. The value of PJFCs allowed for in the actuarial analysis in the explanatory memorandum for the tax offset rules is $25m. That is, the Scheme was assumed to claim $166m worth of employer contributions against its PJFC (15% of $166m is $25m).

72. In 2003-2005, the value of the tax saved by the PJFCs claimed to date was around $20m. In 2005/06 no PJFCs were claimed, and following the 2007 tax changes, the Scheme has stopped claiming PJFCs.

73. The value therefore to the Scheme of actual PJFCs claimed was less than was estimated in the actuarial analysis for the tax offset rules.

74. PJFCs have been allowed for on a scheme-wide basis in the calculation of the "employer cost test". The nature of the credit makes it difficult for this amount to be allowed for on an individual member-by-member basis.

Summary

75. The tax offset rules were introduced because the Scheme's loss of constitutional protection imposed a tax liability on the Scheme. Without the application of the tax offset, this would have increased employer costs and provided increased net benefits to members.

76. The tax offset rules were inserted by the Treasurer into the Scheme rules in June 2002 pursuant to his powers under clause 11 of the EC Act, following consultation with the EISS Board.

77. The tax offset rules required that members' net (after tax) benefits from a taxed fund must be equal to those from an untaxed fund, under three major assumptions regarding the payment of benefits and based on tax rates set out in the schedule to Division 1 of the Scheme Rules.

78. The actuarial analysis in the explanatory memorandum is that the reductions imposed by the rule changes, as well as the use of the Scheme's PJFC, are sufficient to meet the cost of the extra tax liability caused by the Scheme's loss of constitutional protection. That is, on a scheme-wide basis, employer costs are unchanged.

79. There was significant consultation between Treasury, Mercer and the EISS Board on the tax offset rules between 2000 and 2002.