PSS 100% LUMP SUM VERSUS 100% PENSION

When a PSS member retires, he or she will need to choose whether to take 100% of the benefits as a lump sum, to convert all to a pension or to take a combination (with at least 50% of the lump sum being converted to a pension).

The choice to take the whole benefit as a lump sum may seem obvious in some cases, for example where a sizeable mortgage remains **BUT how much do you give up in taking that lump sum?**

The total (lump sum) benefit from the scheme is calculated by multiplying the Final Average Salary (FAS) by the Accrued Benefit Multiple (ABM). The growth of the ABM depends on the chosen contribution rate. The FAS is usually the average of superannuation salaries on the last three birthdays. (The FAS on a redundancy, though, is calculated slightly differently).

The PSS pension is then calculated directly from the lump sum by applying a Pension Conversion Factor based on age at claiming.

Note that the Pension Conversion Factors (PCF) used in the PSS are:

Age	PCF	Age	PCF	Age	PCF
55	12.0	61	10.8	67	9.6
56	11.8	62	10.6	68	9.4
57	11.6	63	10.4	69	9.2
58	11.4	64	10.2	70	9.0
59	11.2	65	10.0	71	8.8
60	11.0	66	9.8	72	8.6

If we analyze the following example, we can get a better idea of the values of PSS pensions and lump sums in general. As well, because of the different tax treatments on the two payment options, we should look at the net figures.

PSS benefits comprise two tax components: Tax-free and Taxable. The Taxable Component comprises two elements: Taxed and Untaxed. The tax treatment of each of these is different. The Tax-free Component is, as the name suggests, free of tax regardless of how the benefit is taken. For those between preservation age and 60, if the benefit is a pension, the Taxed element of the Taxable Component is taxed at the marginal tax rate (MTR), less a 15% tax offset. This is tax-free for those over 60.

Example

Jo has an ABM of 7.00 and a FAS of $75,000 at age 60. Her lump sum entitlement is 7 x $75,000 or $525,000.

If she converts all of this to a pension she will receive a CPI-indexed pension of $47,727 per annum using the age 60 Pension Conversion Factor of 11, (see the table in the previous column).

Alternatively, she could elect to take the $525,000 as a lump sum or at least $23,863 per annum as a pension and the remainder ($262,500) as a lump sum.

The Untaxed element of the Taxable Component is taxed at MTR. Where the pension recipient is aged 60 or more, this element receives a 10% tax offset (capped at $10,625 per annum). From 1 July 2017, the tax concessions on your defined benefit pension are limited to amounts less than $106,250 p.a. For this purpose, any benefits from a tax free and taxed source are considered first followed by benefits from an untaxed source. Any untaxed benefit which then exceeds $106,250 p.a. will not be eligible for a 10% tax offset.

If the member is over 60 and the benefit is paid as a lump sum, the Taxed element of the Taxable Component is tax-free. For those over preservation age but under 60, the Taxed element of the Taxable Component is tax free up to the low rate cap (LRC), which is currently $225,000 (2021-22). Any excess Taxed element is taxed at 17% (includes Medicare Levy).

For those over age 60, the Untaxed element of the Taxable Component is taxed at 17% up to the Untaxed plan cap of $1,615,000 (2021-22). Any excess is taxed at 47%. For those between Preservation Age and 59, the Untaxed element is taxed at 32% unless some LRC remains when that part of the Untaxed element will be taxed at 17% . Again, once the Untaxed plan cap of

Jo's example will make this clearer. For this example, we have assumed a component split of Jo's PSS benefit of 25% Tax-free, 15% Taxed Taxable and 60% Untaxed Taxable. An estimate of the actual component split of a PSS benefit can be obtained only from ComSuper (CSC) and the final amounts are not known until the date the payment is made. In this example, the components will therefore be:

Tax Components	100%	100%
Tax-free	$131,250	$11,932
Taxed element of Taxable Component	$78,750	$7,159
Untaxed element of Taxable Component	$315,000	$28,636
Total	$525,000	$47,727

If Jo was under 60:

On a 100% pension and with no other taxable income or deductions, Jo would pay no tax on the $11,932 and normal income tax on the remainder ($35,795) less a 15% tax offset on $7,159. Her tax liability would then be MTR on $35,795 ($3,343) minus 15% tax offset on $7,159 ($1,074) minus a Low Income Tax Offset ($700) minus a Low and Middle Income Tax Offset ($255) or $2,029 plus Medicare Levy at 2% of $35,795 ($716) for net tax of $2,030. Jo's net annual pension would therefore be $45,697.

On a 100% lump sum, Jo would pay no tax on the $131,250 (Tax-free component), no tax on $78,750 (Taxed Taxable under LRC), 17% tax on $146,250 (rest of LRC on the Untaxed Taxable element) and 32% on $168,750 (remainder of the Untaxed Taxable element). Tax payable on the 100% lump sum would, therefore, be $0 + $0 + $24,863 + $54,000 or $78,863 for a net payout of $446,137.

If Jo is 60 (or older):

On a 100% pension, Jo would pay no tax on the $11,932 and the $7,159 and normal income tax on the remainder less a 10% tax offset. Her tax liability would then be $0 + $0 + $1,983 - $2,864 or $0 (noting that a tax offset cannot result in a credit to you, nor reduce your Medicare Levy obligation). Her net annual pension would therefore be $47,727 less Medicare of 2% of $35,795 ($716) or $47,011. On a 100% lump sum, Jo would pay no tax on the $131,250 (Tax-free component), no tax on the $78,750 (Taxed Taxable) and 17% tax on the $315,000 (Untaxed Taxable element). Therefore, tax payable on Jo's lump sum would be $53,550 for a net payout of $471,450.

SO, should you take the lump sum or the pension?

At 60, Jo's net lump sum would be $471,450 and this needs to be compared with the "value" of a net CPI-indexed pension of $47,011 per annum.

There are a number of ways to value this pension but the Family Law legislation provides ready access to factors designed to be a "fair" value of the benefits. These are called the PSS "Scheme Value" Pension Valuation Factors which, for ages 55 to 72, are shown in the table below.

For a female aged 60, such as Jo, the Pension Valuation Factor is 17.5677 so that a CPI indexed pension from the PSS of $47,011 would be worth about $825,875.

As can be seen from the Pension Conversion Factors used in the PSS shown on the previous page, the PSS "Scheme Value" Pension Valuation Factors are higher for both genders at all ages so, unless the retiree is in very poor health, the results will be similar for all.

It should also be remembered that these factors include the value of a reversionary benefit paid to a spouse in the event of a member pensioner's death based on an average age difference. Where a member pensioner has a spouse with a greater age difference or has no spouse, the values will differ slightly but not enough to negate the argument.

Based on these numbers, our recommendation is always to take the 100% PSS pension if at all possible

Age	Male	Female	Age	Male	Female	Age	Male	Female
55	18.3635	19.3283	61	15.9670	17.1885	67	13.2826	14.7322
56	17.9889	18.9932	62	15.5363	16.8001	68	12.8152	14.2948
57	17.6037	18.6499	63	15.0977	16.4031	69	12.3446	13.8498
58	17.2083	18.2983	64	14.6527	15.9975	70	11.8716	13.3975
59	16.8034	17.9377	65	14.2016	15.5837	71	11.3968	12.9385
60	16.3895	17.5677	66	13.7448	15.1619	72	10.9208	12.4735