SMSF Owners' Alliance
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SMSFOA Members' Newsletter

#6 /2014

Dear Members

The Interim Report of the Financial System Inquiry (FSI) released last week covers a lot of ground and throws up questions of interest to SMSF owners.

- Do high income earners get an unfair advantage from superannuation tax concessions?
- Are the high operating costs of small SMSFs a problem and should there be limits on who can set up an SMSF?
- Should borrowing by SMSFs to make geared investments be banned in future?
- Should retirees be forced to take out retirement income products (annuities)?

The FSI report also raised broader questions of relevance to SMSFs, including whether dividend imputation and negative gearing should be continued. These issues will also fold into the forthcoming Taxation White Paper which we should hear more about in the second half of this year.

Our response to the observations and questions posed by the FSI need to be lodged by 26 August which is a tight deadline. We would appreciate member views on the key points and any other issues in the Interim Report that you may find of interest or concern. The report can be found at: www.fsi.gov.au

You may recall that SMSFOA made a substantial submission to the FSI. Since the release of the interim report, we have also attended briefing sessions given by the FSI Chairman, David Murray and panel members Craig Dunn and Carolyn Hewson.

Please let us know your thoughts – email us at info@smsfoa.org.au

In the meantime….

Do high income earners get an unfair advantage from superannuation tax concessions?

The FSI report refers to the cost to the budget of superannuation tax concessions and notes that the majority of tax concessions go to high income earners (read SMSF members). It says some 'stakeholders' have questioned whether this is equitable. It is disappointing that the FSI has so uncritically picked up these claims which are not well founded. In our follow-up submission we will point out, yet again, the fallacy that super tax concessions are an unsustainable cost to the budget that benefit the 'rich'. We'll point out, yet again, that people who earn more actually pay more tax and therefore get a greater dollar benefit from any tax concession. We'll point out, yet again, that higher income earners pay the lion's share of income tax and that the majority of Australians don't pay any net tax. We'll point out, yet again, that full income tax is paid on contributions above the voluntary contributions limits.

Should we be concerned about the cost of running an SMSF and should access to them be limited?

The report notes that SMSFs with low balances cost more to run than the fees charged by APRA-regulated funds. We know from Rice Warner's work (quoted in the FSI report and available on our website under the 'Reports' tab) that SMSFs with fund balances lower than $200k are more expensive to run. Between $200k and $500k SMSFs are competitive with the large managed funds if the trustees take on some of the administration and investment management themselves. Over $500k SMSFs are significantly cheaper to run.

It may not be sensible for someone with a low super balance and with limited opportunity to grow their fund to set up an SMSF, particularly in the latter stages of their working lives. However, people who have the opportunity and ability to grow their SMSFs, who want to make their own investment choices and who don't wish to pay the heavy fees charged by the major funds (of which the FSI report was very critical) may find it attractive to set up an SMSF and take control of their super savings even if it costs them more until they build their fund to a more efficient size.

The ethos of self-managed superannuation is that people take on the responsibility for managing their own retirement savings and we believe this is a healthy attitude. We will not easily be persuaded that limiting access to self-managed super could be justified.

Should direct borrowing be banned in future?

By 'direct borrowing', the FSI means limited recourse borrowing arrangements (LRBAs) to fund asset purchases, generally real property. We understand it is not intended to apply to embedded borrowing via financial instruments such as instalment warrants.

Concern has been expressed by the RBA and others about SMSFs borrowing to invest in property, in particular residential property promoted by developers. Clearly it is not desirable in terms of spreading portfolio risk for SMSFs to be established to hold a single, highly geared property asset, though it can be a way to build assets, particularly when voluntary contribution limits are set too low.

The FSI notes that that a relatively small (3.7%) but growing proportion of SMSFs engage in this type of investment.

In comments on this issue to date, SMSFOA has agreed that leveraging an SMSF to invest in one highly geared property asset is not generally seen as a sound investment approach. We have also referred to the relatively low (3.5%) proportion of total SMSF assets held in residential property. We've pointed that other policy options exist, such as influencing lenders to apply stricter credit controls and more effective regulation of property promoters and financial advisers.

We'll give further thought to this issue.

Should retirees be forced to take out retirement income products (annuities)?

SMSFOA's answer to this question is a strong No! Annuities are a tool that some SMSF owners may find convenient but we will strongly resist the suggestion floated in the FSI report that they should be made mandatory. SMSF owners should be able to manage their retirement income streams as they judge best, consistent with the philosophy of independence and self-reliance that underlies the concept of self-managed superannuation.

That said, we agree with the FSI report that not enough attention has been given to managing the post-retirement phase of superannuation and there is scope to develop more and better retirement income strategies and products.

We'd welcome your comments on these and other issues raised in the FSI's interim report.

Lifting the pension age will strengthen super adequacy

We recently produced a research report which showed that the adequacy of the superannuation system in providing adequate retirement incomes would be improved if the retirement age is deferred for five years to 70 as proposed in the budget. If people work 5 years longer and spend 5 years less in retirement, they will have saved more during their working lives and will spend less while in retirement.

They will still have to make voluntary contributions above the SG amount to come close to self-sufficiency in retirement but the gap between what people will need to have saved during their working lives and what they actually will have saved would be narrowed.

Our media release was picked up by The Australian and Sky Business News. You can find the research report and media release on our website – www.smsfoa.org.au

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