

SMSFOA Members' Newsletter

#1 /2015

Dear Members

Welcome to the first Members' Newsletter of what promises to be an eventful year.

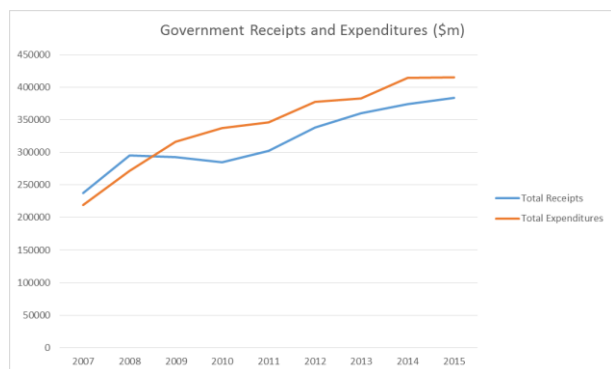
Pre-budget submission

Our first action of the year was to make a pre-Budget submission to Treasury ahead of the May federal budget.

It continued the main theme of the pre-Budget submissions we made in the past two years, namely:

The Government does not have a revenue problem. It has a spending problem.

Revenues continue to rise year on year. However, spending continues to rise ahead of revenue, although there has been a flattening out of the rate of increase as a result of the spending cuts in last year's Budget.



The Government attempted to do more in the 2014 Budget to redress this imbalance, but was frustrated in some of its spending cuts by the Opposition and the minor parties in the Senate.

In the face of this resistance, the Government should not be tempted to fiddle with superannuation in the Budget. Changes to the system should only be considered as part of a global review of the long-term stability of the system. The impending Taxation White Paper is the most appropriate forum for a review and not the next Budget. The recommendations of the White Paper, which should cover long-term structural reform of the tax system, should not be pre-empted by Budget measures based on the perceived need to raise revenue to deal with an over-spending problem.

Our submission goes on to dispel some of the common myths about SMSFs, including that super is an unfair tax break, super tax concessions cost the Budget too much, they cost are expensive to run, they fuel house prices and they are overly cautious investors.

The submission is on our website: <http://www.smsfoa.org.au/advocacy.html>

We also take the opportunity in our pre-Budget submission to comment on a couple of recommendations of the Financial System Inquiry (the Murray Report).

Dividend Imputation

While the FSI Report questions whether dividend imputation should continue, we believe it is a fair and sensible system. Its original motivation to prevent the double taxation of company profits remains valid.

Many SMSFs rely on tax free dividends from blue chip companies to provide a reliable source of income to their fund to support retirement pensions.

Equity in superannuation

Both the FSI's Interim and Final Reports claimed the system of tax concessions for superannuation contributions is unfair because the larger share (around 56%) of concessions goes to the top 20% of income earners. They ignored the obvious point made by SMSFOA: the top 20% of income earners also pay the most income tax (64%). It's not surprising that higher income earners get a larger benefit from any tax concession or tax cut simply because they pay more tax in the first place.

To claim this is unfair is to advocate even higher taxes for the minority of Australians who already pay the majority of tax revenue.

Gearing

Although borrowing by SMSFs is not a matter for the Budget, we pointed out that it is still done on a relatively small scale and more can be done to control it, rather than banning it outright. A limit – say 50% - might be placed on how much a fund can borrow relative to the asset covered by the loan as well as the total assets of the fund. Also, credit lending could be restrained and ASIC should take tough action against property spruikers.

While few SMSF trustees opt to use borrowed funds, we think that option should be open to them in keeping with their responsibility to build fund assets to generate an adequate and reliable retirement income.

Taxation White Paper

The big event of 2015 is likely to be the Taxation White Paper. We understand the first step will be the release of a high-level Treasury discussion paper in the near future. It's planned that a Green Paper and then a final White Paper will follow during the course of the year.

It will then be up to the Government to decide whether to implement recommendations contained in the White Paper. These are expected to address fundamental aspects of Australia's tax system – including the taxation of superannuation.

The Government will receive the White Paper recommendations as it heads into an election year in 2016 so there will be a question mark over the Government's appetite for fundamental and controversial change to the tax system. The politics of tax reform are never easy.

Shareholders Association Strategy Seminars

The Australian Shareholders Association is running a seminar in all capital cities in February/March on the theme of how to get the most out of your SMSF. The seminars cover strategies for the pre-retirement, converting to pension and pension phases of self-managed funds.

Book your spot here: <https://www.australianshareholders.com.au/smsf-seminars>

SMSFs remain in the cross hairs

The latest thinly-veiled attack on SMSFs comes from a Federal Court judge who says tax concessions for superannuation allow the wealthy to avoid tax. We could not let this through to the keeper and prepared a response for the Australian Financial Review which carried the judge's comments in a front-page story on 21 January.

Here's what we sent to the AFR – let's see if they publish it:

Those in glass houses...

Last week the AFR reported that Justice Richard Edmonds of the Federal Court gave a speech in Adelaide where he stated the superannuation system had become "totally skewed in favour of the wealthy because of the opportunity for tax avoidance."

Justice Edmonds was reported as saying: "I daresay if the ordinary man in the street had any knowledgeable notion of what certain sections of the community are getting away with in this regard, any semblance of consensus would disappear."

I daresay if the ordinary person in the street had knowledge of the generous superannuation for Federal Court judges they might view Justice Edmonds' comments in a sceptical light.

Federal Court judges are paid a salary of \$412,550 plus a car, first class travel and other allowances.

Under the Judges' Pensions Scheme, Federal Court judges receive a non-contributory pension of 60% of their judicial salary on reaching the age of 60 and having served 10 years. The same applies to judges on the High Court, the Family Court and other high judicial officials.

The Department of Finance website spells out what 'non-contributory' means: "The Scheme is unfunded and no assets are held. Benefits are financed from Consolidated Revenue as they become due for payment. Judges and retired judges do not contribute to the Scheme and the Commonwealth meets the costs of benefits."

It couldn't be plainer; 100% of the superannuation enjoyed by Federal Court judges is paid for by the taxpayer and the judges don't contribute a cent.

When Justice Edmonds clocks up 10 years' service in May 2015, he will be entitled on retirement to a pension of \$247,530 tax free (as adjusted from time to time by the Remuneration Tribunal).

He would need at least \$2.6 million in superannuation to fund an equivalent pension for an average life expectancy. His pension is wholly taxpayer funded and continues no matter how long he lives; for the rest of us retirement income comes from our super savings with no risk protection against longevity. Only one in 27 SMSF members has an account balance of more than \$2 million.

If he is fortunate to spend 25 years in retirement, Justice Edmonds could receive over \$9 million in pension payments if the Remuneration Tribunal grant inflation increases over time. All funded by the taxpayer.

Perhaps Justice Edmonds is right. The ordinary man in the street might not see this as fair and reasonable.

If judges had to contribute to their own super it would surely not compromise the independence of the judiciary.

It's fair to assume that in his Adelaide speech, Justice Edmonds had self-managed superannuation funds in mind.

They are an obvious target because SMSFs have much higher balances than the APRA-regulated retail and industry funds. On average the account balance of an SMSF member is half a million dollars. The average balance of an account held in a retail or industry fund is less than \$30,000.

The conclusion that should be drawn from these numbers is not that the SMSF members have avoided tax to build their savings. It is that self-managed funds are the only type of fund actually achieving the main objective of the system – to encourage people to be financially independent in retirement and not have to rely on a taxpayer-funded pension.

As to Justice Edmonds' claim that the superannuation system has been totally skewed in favour of the wealthy because of the opportunity for tax avoidance, a couple of points need to be made.

The same tax rules apply to members of self-managed funds as apply to members of the large APRA-regulated funds. Everybody gets the same deal.

The amount of money that can be channelled into super is limited by caps on voluntary contributions. Larger non-concessional contributions can be made from income on which tax has already been paid.

The level of auditor qualified tax returns for self-managed funds is low - around 2% compared to around 15% in the general taxpaying population. The ATO has commented on the good compliance performance of self-managed funds.

While it's true that people on higher incomes get a larger dollar benefit from super tax concessions, they pay more income tax in the first place – and still pay more in tax even after the tax concession. The Financial System Inquiry reports pointed out that the top 20% of taxpayers get around 56% of the super tax concessions, yet failed to acknowledge that the same 20% pay 64% of all income tax collected.

Most of the funds in super are from an individual's own savings. The tax concession amounts to only about 10% of their total super savings. Giving a tax concession is a better deal for the Government than paying out 100% of the Age Pension.

When it comes to being a burden on the system, those who have saved and sacrificed to support themselves in retirement, even with tax incentives along the way, are more like saints and not the tax avoiding sinners they are made out to be.

Online media

Earlier this month SMSFOA was given a good run in *SMSF Adviser*, an online newsletter specialising in informed comment on SMSFs. Our article drew some very positive comment on the *SMSF Adviser* blog.

SMSF Adviser is a good forum for intelligent comment on SMSFs – you can sign up for your free daily edition here:

<http://www.smsfadvisoneronline.com.au/>

In defence of a well-functioning, successful sector

Wednesday 14 January 2015 Columnist: Duncan Fairweather



Where problems are perceived to exist with the SMSF sector, its important policy decisions are based on reality and hard facts, not ideology and hearsay.

The seemingly inexorable rise of self-managed funds is the most striking dynamic of Australia's superannuation system. More so because the rise of self-managed superannuation has been driven by the choice and determination of individuals rather than by government policy direction.

Self-managed funds are the only funds realising the vision set for Australia's superannuation system – to enable people to make themselves financially independent in retirement and avoid reliance on the age pension.

Generally SMSF members are achieving this goal while the members of the large industry and retail funds are not. The average balance in a self-managed fund account is over \$500,000 compared with average account balances in industry and retail funds of less than \$30,000.

The higher balances in SMSFs result from people maximising their concessional and non-concessional contributions and from the returns generated by their assets. Yet self-managed superannuation is not just for those paid higher. ATO statistics show that 66 per cent of SMSF members are on incomes of less than \$80,000.

One important outcome of self-managed superannuation is enabling a generation of Australians to fund their retirement and old age within their own lifetime, instead of leaving a pension tab on the table for the next generation to pick up.

The fact that a million Australians, with more joining every day, are willing and capable of taking charge of their retirement savings, and doing a good job of it, is to be applauded.

However, it seems success breeds envy and draws criticism.

You'll hear it said that self-managed funds are driving up property values, distorting capital allocation, investing too conservatively, investing recklessly, straining the Budget, getting an unfair tax advantage and are costly to run.

We challenge each of these claims as they are often driven by ideology, or self-interest or are just plain wrong.

Take the claim that SMSFs are used to gain an unfair tax advantage.

Members of self-managed funds are subject to exactly the same tax rules as members of pooled super funds.

Critics are quick to point out the top 20 per cent of income earners get the lion's share of super tax concessions but they don't always acknowledge that the top 20 per cent also pay the lion's share of income tax. They get 57 per cent of the tax concession but pay 64 per cent of income tax. So, as you would expect, the value of their super tax break is proportionate to the amount of tax they pay, and actually a bit lower.

Or take the claim that super tax concessions are an unsustainable drain on the Budget.

Tax incentives to save for retirement are sensible policy because in the long run it's cheaper than paying out the age pension. If super tax incentives are reduced, less will be saved, fewer people will be financially independent and more will have to rely on a full or part taxpayer funded pension.

Are SMSFs too costly to run? It's true that a relatively low account balance in a self-managed fund will cost more to administer than one held in a pooled super fund. But above around \$100,000, costs are comparable or much lower. Two-thirds of self-managed funds have an operating expense ratio to assets of less than 1 per cent and 40 per cent have an expense ratio of less than 0.25 per cent.

It's not just about cost. The main reason people set up self-managed funds is to take control of their savings and more are doing so relatively early in their working lives. They make a commitment to save and as they build their assets, the relative cost of running their fund comes down. They are being helped by the emergence of a range of low-cost, online fund management service providers.

The real cost issue in superannuation is the fees charged by the large industry and retail pooled super funds, which are estimated to have consumed a quarter of these funds' returns in the past decade, a cost borne by their members.

Another common criticism of SMSFs is that they drive up property prices through highly leveraged investment. But no hard evidence is presented to back up this claim. Very low interest rates and an inadequate supply of new housing is likely fuelling property prices more. SMSFs actually put quite a small proportion of their assets into residential property – around 3.5 per cent and this has been steady for five years. They put three times as much into commercial property, often linked to the owners' business.

Some people, on dubious advice, may be starting an SMSF to borrow to buy a residential property. Having one highly leveraged asset is clearly not a sensible strategy. To the extent that it is occurring it should be managed through better advice, credit restraint by lenders and regulation of property promoters.

In pondering the report of David Murray's Financial System Inquiry and, in due course, the forthcoming tax white paper, the government should reflect on the singular success of self-managed funds in achieving the objectives of the superannuation system, appreciate the motivation of people who set them up and recognise the social and economic benefits they deliver.

Duncan Fairweather, executive director of the SMSF Owners' Alliance

The rise and rise of self-managed super

The ATO has released its latest annual report on self-managed superannuation funds.

The report relates to the 2012-13 financial year so the figures are dated though they remain the latest available firm numbers on the performance of the SMSF sector. The ATO also publishes more up-to-date figures in their quarterly SMSF series, based on estimates.

The 2012-13 annual report notes that the average SMSF return on assets that year was 10.5%, the fourth year of positive performance following the GFC.

It noted some interesting demographics.

- As more younger people set up SMSFs, the median age of members dropped below 50 for the first time
- The gender balance was closer – with 47% of SMSF members being women
- For the first time, pension payments exceeded contributions.

The last point is a reflection of baby boomers entering retirement and perhaps lower caps on contributions.

The 2012-13 annual report with accompanying data tables can be found here:

https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2012-2013/?page=3#Executive_summary

SMSF Adviser has published commentary on the key points by Aaron Dunn of *The SMSF Academy*:

<http://www.smsfadviseonline.com.au/columns/item/300-10-big-things-from-the-ato-s-smsf-statistics>

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