SMSF Owners' Alliance
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SMSFOA Members' Newsletter

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Dear Members

Superannuation tax breaks are in the political firing line again.

Over the past couple of weeks, there's been a chorus of claims that super tax breaks are too generous, benefit the rich unfairly and should be wound back.

This is the usual refrain of left-wing think tanks like the Australia Institute and the Grattan Institute. This time they have some unlikely allies including broadcaster Alan Jones, financier 'Aussie John' Symond and former NSW Premier Nick Greiner. Mr Greiner went so far as to urge the Abbott Government to break an election promise and attack super during its first term.

Finance Minister Mathias Cormann was unmoved, telling Sky News:

"The Government took a very clear policy to the last election and that is that we would not make any unexpected, adverse changes to superannuation policy and taxation arrangements. We stand by that commitment. We will be having a national conversation in the context of the tax white paper review process about how our tax policy settings might be able to be improved over the medium to long term. That will ultimately lead to some policy positions we take to the next election. But from where we sit right now, in this term of Government, we will stick to the commitments we made in the lead up to the last election and that is not to make any adverse, unexpected changes to superannuation." – Sky News 21 February 2015

Those who want to see super tax incentives cut back rest their argument on two claims: first, that it's a big cost to the federal budget and second that the benefit of the tax cuts flows largely to those on higher incomes.

From the outset, SMSFOA has challenged the often repeated claim that superannuation tax concessions cost the budget over $30 billion rising to $50 billion. This claim is based on Treasury's annual *Tax Expenditure Statement(TES)* which attempts to measure the cost of taxes that are not collected and are regarded as an expense to the budget.

We have debated the validity of the TES numbers with Treasury who have acknowledged it is wrong to simply add two components given in the TES – tax not collected on contributions and tax not collected on fund earnings – together to come up with a large number. Yet the media and some commentators consistently do it.

Treasury heavily qualifies the TES number and has pointed out that different, and lower, numbers will result from different conceptual approaches. One major flaw in the TES number is that it doesn't take account of the increase in age pension payments that would be needed if less money flows into superannuation.

At least some media commentators get it right. Below we reproduce excellent articles this week by Professor Judith Sloan in *The Australian*; by economics writer Glenda Korporal in *Business Spectator* and by Robert Carling of the Centre for Independent Studies in the *Australian Financial Review*. All are critical of the TES and its misuse by those who argue that superannuation tax concessions are unfair. They are well worth taking the time to read.

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

What's in a name change?

You may have seen that the SMSF Professionals' Association (SPAA) has changed its name to the SMSF Association (SMSFA).

The CEO, Andrea Slattery, said the rebranding was to reflect her organisation's "all embracing place in the SMSF sector".

However, she confirmed that embrace did not include accepting SMSF trustees as members. *SMSF Adviser* reported:

When asked if trustees would be targeted by SMSFA moving forward, Ms Slattery said "there is no change to what we've always done".

"We do not have trustee members," she said. "We have always represented the industry, we have always represented every community in the sector at an advocacy level [and] at every level, but our memberships are the professionals."

To be a member of SMSFA you must be accredited by another professional body – i.e. an accountant, lawyer or financial planner. As Ms Slattery confirmed, there is no membership category for SMSF trustees and beneficiaries.

In contrast, to be a member of SMSFOA, you must be the trustee or beneficial member of an SMSF or, as we say, an 'owner'.

The acronyms SMSFOA and SMSFA now look similar but the 'O' in SMSFOA remains a vitally important difference.

A busy time on the policy front

Responses to the Financial System Inquiry (Murray Report) are due by the end of March. One issue arising from this report is whether borrowing by SMSFs should be banned. As we said in our FSI and pre-budget submissions, rather than trying to turn back the clock by banning Limited Recourse Borrowing Arrangements, a better way to deal with this issue is by stricter credit controls by lenders and perhaps a cap on leverage of an asset within a fund.

Most of the big issues of significance for SMSF owners, such as putting an end to franked dividends, were deferred to the Taxation White Paper. This in itself has been deferred until after the release of the latest Inter-Generational Report. This makes sense as the Inter-Generational Report will provide the setting in which changes to the superannuation system can be considered in the White Paper.

Meanwhile, SMSFOA is saying the Government should resist calls for super tax changes to be made in the May budget to raise revenue. Here's how *SMSF Adviser* reported our media release:

SMSFOA urges treasurer to ignore calls for super tax

Written by Miranda Brownlee Tuesday, 24 February 2015

The SMSFOA said the government should wait till the upcoming taxation white paper before making any decisions on changes to the superannuation system.

"Changes to the superannuation system have long-term implications for all working Australians and should be considered only when a consensus view on the objectives of the superannuation system has been achieved, as recommended by David Murray's recent Financial System Inquiry," said the SMSFOA.

The white paper, the SMSFOA said, should result in recommendations, based on careful economic analysis of an adequate and sustainable retirement savings system, to carry forward.

"Such a measured and transparent approach is necessary to give certainty to retirement incomes policy and give Australians the confidence to invest their savings throughout their working lives to ensure financial independence in retirement," said the SMSFOA.

On the other hand taxing the earnings of super funds to reduce the Budget deficit, the SMSFOA said, is not the easy solution that some commentators claim it is.

The association said the justification that superannuation tax incentives are a huge cost to the Budget is based on heavily qualified treasury estimates.

"Their second premise that the top 20 per cent of income earners get around 55 per cent of super tax concessions conveniently overlooks that the same top 20 per cent of income earners pay an even larger share, 65 per cent, of income tax," said the SMSFOA.

"The earnings tax idea was tried by the previous government in 2013 and was not implemented by the current government as it was unworkable in practice and wouldn't have raised much revenue."

The SMSFOA said implementing the tax on superannuation income will hurt those who have "done the right thing and saved enough to support themselves in retirement without recourse to a taxpayer funded age pension".

And we got a run on ABC Radio too

SMSFOA's Duncan Fairweather was interviewed on the same topic by Steve Chase on ABC News Radio. To listen go to: http://www.abc.net.au/newsradio/content/s4185942.htm

Now to the commentary pieces – we hope you'll take the time to read them as they are all pertinent to current issues affecting SMSFs.

1. Professor Judith Sloan - 24 February 2015

THE AUSTRALIAN

Superannuation tax system needs to be simplified

Judith Sloan

Contributing Economics Editor

WITHOUT a doubt, the most misleading and damaging figure produced by Treasury is the combined tax expenditure of employer superannuation contributions and superannuation entity earnings — the so-called superannuation tax concessions.

Mind you, there is quite some competition for this title. Take the figure of $46 billion the Treasury highlights as the revenue that isn’t received because the main residence is exempt from capital gains tax. It’s a wonder Treasury doesn’t calculate a figure for the revenue forgone from the failure to tax the imputed rents that owner-occupiers enjoy. (Perhaps I shouldn’t have mentioned that.)

But let me get back to the superannuation tax concessions. How often do we hear gormless commentators trot out figures of close to $30bn that these tax concessions are “costing” the government every year?

And just to show off, these same commentators will quote the slightly lower revenue gain figure of $27bn to acknowledge that people will not make voluntary contributions to superannuation if their contributions and earnings are taxed at their full marginal rates. As Homer Simpson would say, “Doh”. But the clear proposition is that there are billions of dollars lying on the pavement the government should pick up to repair the budget, particularly because these tax concessions favour those on high incomes.

But the real problem is that both the $30bn and the $27bn are complete contrivances that - erroneously use income tax as the benchmark. But because super is a form of savings, the appropriate benchmark is an expenditure tax — in our case, the GST.

In fact, for the 2013 Tax Expenditure Statement, the Treasury came very close to admitting this mistake. Let me quote the grudging concession contained in Appendix A: “There is interest in the question of whether using an expenditure tax benchmark, either in addition to the income tax benchmark or as a replacement, would be appropriate.”

Why the Treasury decided to call these estimates using the expenditure tax benchmark experimental is anyone’s guess. They are no more experimental than the ones provided in the main part of the report which are loaded up with unspecified assumptions.

Using the expenditure tax benchmark, the superannuation tax concessions are estimated to be worth minus $5.8bn in 2012-13. That's right — the figure is negative. The $27bn lying on the pavement has completely disappeared.

Indeed, Henry Ergas has calculated the average tax paid on super is around the 40 per cent mark, which makes it a very expensive option for most people, including those on high incomes. It is interesting that the 2014 Tax Expenditure Statement, which is produced by the revenue section of the Treasury, did not continue the "experiment" of using the expenditure tax benchmark. "Although that exercise has not been repeated for this year's TES, the conceptual points that were discussed last year remain."

Quite. But it doesn't seem to suit the agenda of the Treasury when it comes to changing the taxation of super.

We should not forget former treasurer Wayne Swan was forever tweaking the taxation of super. There are now tight annual caps on concessional contributions ($25,000 for those aged under 50 and $35,000 for others), and this includes the compulsory employer contribution. There is also the excess contributions tax and the 30 per cent tax on fund earnings for those who earn more than $300,000 a year.

As a parting shot, he attempted to impose a tax surcharge on fund earnings above $100,000 a year, although the legislation was never passed. Not only was the idea close to impossible to implement for defined benefit schemes (like the one covering Swan) but the volatility of fund earnings, including intermittent capital gains, made the whole proposal both inefficient and inequitable. It is interesting Swan never took up the advice of the Henry tax review, which proposed contributions to super be taxed at full marginal tax rates minus a fixed rebate, an annual concessional contributions cap and a 50 per cent tax cut on fund earnings, from the current rate of 15 per cent to 7 ½ per cent.

Mind you, there are holes in these ideas too; in particular, there is the difficulty of applying these arrangements to defined benefit schemes, like the one that covered Ken Henry. Moreover, the compliance costs of this arrangement would be very high. At the moment, super funds don't know what their members earn and some people will have several jobs and several funds. There is no doubt the Henry "solution" would be much more complex to administer than the current - arrangements.

If we look overseas to see how super is taxed, we find Australia is around the middle of the pack. When we think of the three phases — contributions, earnings and withdrawals — there are various combinations of full tax rates, concessional tax rates and zero taxes. In Britain, for instance, contributions are taxed at full marginal income tax rates but there are zero taxes on earnings and withdrawals. There is a superficial, albeit misleading, appeal to thinking super in Australia is undertaxed and that the concessions favour those on high incomes too much. But we need to consider the tax-transfer system as a whole and to judge the equity of the sum rather than the parts. We also need to have tax arrangements that are simple and easy to administer.

In point of fact, Australia has one of the most redistributive tax and transfer arrangements among developed economies. The top 1 per cent of income-earners pays nearly 20 per cent of all income tax revenue and the top 10 per cent pays nearly half.

What is often forgotten in this debate is that super is compulsory and super members' funds are locked up for a long time. Perhaps the solution is to make the system voluntary and allow people to opt for a current pay rise if they wish. We can then discuss the taxation of super and the eligibility for the age pension.

2. Glenda Korporaal – 25 February 2015

BusinessSpectator

The super debate must be a sensible one

It's pre-budget season in Canberra -- a time when the government's thoughts turn to revenue raising and kites are readied for flying.

The imminent release of the latest Intergenerational Report has also helped to fuel recent debates on the entitlement to aged pensions and whether our superannuation system is too generous, especially to wealthy retirees.

Of course we know that both sides of politics promised to remove superannuation from the annual budget cycle. So we know there won't be any change to super in the May budget like there was under Labor. Right?

The current government also promised during the election campaign that there would be no unscheduled negative changes to super in the life of this parliament.

And of course politicians do keep their promises. Right?

Assuming all that holds, it is clear that a review of our superannuation system is on the cards later this year. The Intergenerational Report will talk to the implications of demographic changes ahead, to be followed by the Tax White paper which will focus on specifics change to the system.

The question is whether that debate can be held in a clear headed, equitable way which allows all working Australians to plan for their retirement savings through superannuation with some confidence -- and doesn't throw the baby out with the bathwater.

As the government prepares the ground for some changes, there is an element of near hysteria creeping into the debate.

Using superannuation to put money away for retirement -- as everyone is entitled to do -- is in danger of being painted as some evil exercise in tax avoidance costing the government billions in lost revenue. An estimate from the Treasury puts this at more than $32 billion in revenue foregone.

So abolish superannuation and the government budget balance would be some $30bn better off? Of course not. Many would spend the money on day to day living leaving them with little savings on retirement, or turn to other tax-effective investments such as negative gearing.

Australia's compulsory superannuation has generated an unprecedented culture of saving for retirement. Ordinary working people are now more focused on the issue of retirement funding than ever before in our history.

The system has generated an enviable $2 trillion pool of capital which is being invested in shares, property and infrastructure and helped to shield Australian companies from the worst of the share market crash of 2008-09.

It's not perfect but it's a lot better than not having a compulsory retirement system.

If last year's budget debacle over the GP co-payments shows the government anything, any changes to super need to be carefully worked through as part of a sensible long-term package.

Start looking for revenue grabs, or try to turn the debate into a lecture about the age of entitlement, or attacking people for wanting to put extra into their superannuation as they approach retirement, or trying to pit one sector against another, and there will be no sense of shared commitment to the changes.

Yes, let's make sure the rich don't benefit from the tax concessions in the system — but there are already limits on the annual amounts which can be contributed to super both pre and post tax.

Assuming that the poor will always turn to the aged pension for their retirement, the aim of our superannuation should be to keep as many of the "middle class" off the system.

One truism being peddled is that most people who put money into superannuation take it all out once they retire, spend it and go on the pension.

If this is a concern let's have the figures on what does actually happen. A recent study by actuaries Rice Warner, using data from the Australian Prudential Regulation Authority, points out that the average drawdown of pension assets is about 7.7 per cent.

As it notes, the minimum drawdown levels can range from 4 to 14 per cent depending on age, "suggesting that the average pensioner (aka pensioner from a superannuation account not the government) does not draw down significantly more than the minimum required".

Providing better products for retirees to invest in, including annuities, as recommended by the Murray report, is one constructive way to make sure that money saved for retirement is used to fund retirement.

Any changes to the system have to be considered as a whole. Start jacking up the tax rate on the earnings of funds held inside super during the retirement phase and people will take their money out.

As the Financial Services Council points out its pre-budget submission, under the Senior Australians and Pensions Tax Offset a retiree can hold the equivalent of $600,000 in cash without paying tax on earnings. The FSC argues the minimum withdrawal age from super be put up to closer to the pension entitlement age of 65.

The FSC and other super and financial lobby groups need to make sure the debate on our super system is a sensible one aimed at preserving its best elements — not poisoned by vested interests or assuming that anyone putting extra into super is rorting the system.

3. **Robert Carling** – 19 February 2015

FINANCIAL REVIEW

Rorts for the rich are a myth

By Robert Carling

"**We need an informed and balanced debate, not a one-sided campaign wrapped in dodgy data and the new politics of inequality**."

Tax concessions in areas such as superannuation, capital gains and GST are under attack like never before. Those who would slash such concessions say they waste billions in potential tax revenue and distribute benefits 'unfairly'. In this climate, Treasury's recent tax expenditure statement – a key exhibit in the case against concessions – is being used as ammunition for a fresh assault.

Campaigns for good tax reform are one thing, but the campaign against concessions lacks balance. Concessions contain elements of good policy as well as bad and the challenge is to differentiate. Many of the criticised concessions are soundly based and, far from wasting revenue and creating distortions and loopholes, are necessary to remove biases that would otherwise prevent efficient outcomes. Tax expenditure estimates suffer major measurement and conceptual weaknesses. They are at best just one of many inputs to policy deliberation, and at worst rubbery figures based on flawed concepts.

Treasury itself warns tax expenditures can be difficult to quantify; they do not measure the revenue that could be gained by removing concessions (because taxpayers adjust behaviour in response to loss of concessions); they are not additive; and they are only as valid as the benchmark against which they are measured. But these warnings are blithely ignored by critics who can see nothing but 'rorts', 'loopholes' and 'subsidies to the rich'.
By far the most important caveat to the tax expenditure billions concerns the benchmark against which they are measured. Treasury advises TES users that benchmarks "involve judgment, may be contentious and can be arbitrary".

In some cases the benchmark is straightforward. It is clear that GST-free food is a tax expenditure against the benchmark for a broad-based consumption tax. But the benchmark is contentious in the case of income tax concessions such as those for superannuation and capital gains. The enormity of tax expenditures reported for these items is a result of the comprehensive income benchmark that is commonly, but often inappropriately, used.

The notion of comprehensive income tax is that all income regardless of source should normally be taxed at the same rate. This was once generally accepted among tax economists, but the now more widely-accepted principle of optimal taxation says tax policy should take account of the differential economic impacts of taxing different tax bases.

The Henry tax review was at pains to explain that the principle of optimal taxation leads to savings income being taxed at lower rates than labour income (at least when tax on labour income is as high as it is). To do otherwise is to create a systemic bias against saving and investment. The review argued that the tax treatment of superannuation should be assessed against an expenditure (consumption) tax benchmark, under which super fund earnings and contributions (but not end-benefits) would be tax-free. Such limited data as are available suggest that tax expenditure measured this way is a small fraction of that reported.

he consumption tax benchmark seriously undermines, if not destroys, much of the campaign against tax concessions. Many of these concessions are not unjustifiable loopholes at all but a route to more efficient taxation. For example, scrapping the 50 per cent capital gains discount – the most unfairly maligned of all concessions –would score an economic policy own-goal, damaging investment while raising little if any extra revenue.

Dividend imputation and negative gearing have also been challenged, most recently by the financial system inquiry. These are not officially classified as tax expenditures. That should not exempt them from scrutiny, but they exist in the tax structure for good reasons.

A key plank in the critique of concessions is that they are poorly targeted because most of the benefit goes to those with above average incomes. This views tax concessions as if they were social benefits, which largely they are not. The case for taxing saving and investment at reduced rates applies at all income levels, and the concessions ought to apply neutrally. Judgments about distributional effects are most sensibly based on the tax/transfer system as a whole, not component parts of it.

Tax expenditures and concessions more generally should not escape scrutiny in the forthcoming white paper tax review. But we need an informed and balanced debate, not a one-sided campaign wrapped in dodgy data and the new politics of inequality.
Robert Carling is a senior fellow at The Centre for Independent Studies.
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And finally….

The Australian Shareholders' Association magazine *Equity* provided an opportunity for SMSFOA to comment on topical issues, including the FSI proposal to end dividend imputation.

(See next page for Equity Article)

Lights flashing on amber for super savings

By Duncan Fairweather, Executive Director, SMSF Owners' Alliance

In an uncertain world where billions can be knocked off stock markets in a day, investor certainty and confidence are precious commodities.

The one million Australians who run self-managed superannuation funds know they have to cope with the swirling currents of the stock market as best they can.

What they don't want is more uncertainty added by government. Yet we are heading into very uncertain territory for SMSF investors. 2015 is looking like an avenue of flashing amber lights. We face a Budget in May from a government whose efforts to overcome the huge deficit and debt they inherited by cutting spending are being frustrated by an unruly Senate and a cynical Opposition.

Then there's the Murray Report to be dealt with and the Tax White Paper process which will likely throw up fundamental questions about how superannuation is taxed.

The spark for the formation of the SMSF Owners' Alliance two years ago was the risk that the previous government would eye the $500 billion sitting in SMSFs as a handy source of revenue as we could see it clearly wasn't going to be able to deliver its promise to return the budget to surplus.

So it proved. The previous government announcing in 2013 a new tax on super fund earnings that would, effectively, only hit SMSFs. Why only SMSFs? As the 1930s American bank robber 'Slick Willie' Sutton said when asked why he held up banks: "Because that's where the money is."

The average balance in a self-managed fund is about $1 million. The average balance in a retail or industry fund is less than $30,000. The tax didn't go ahead because it would be difficult to collect and because the previous government's time ran out. However, with the current government struggling to get the budget back on track, the temptation for a 'smash and grab' raid on SMSFs remains.

If it happens, it won't be pretty. As 'Slick Willie' also said: "You can't rob a bank on charm and personality." Nor can you nicely rip away people's retirement savings.

You can't influence public policy on charm and personality either. You need good arguments, you need policy capability and you need political punch in Canberra.

The large APRA-regulated retail and industry funds employ highly paid lobbyists to push their case in Canberra. Their brief does not include looking after SMSFs. We must do that ourselves.

The realisation that SMSF trustees and beneficiaries needed an independent and effective voice drove the formation of the SMSF Owners' Alliance two years ago.

Why should shareholders care? Because many of you hold your shares via self-managed funds. The ASX tells us that $159 billion is invested in shares by SMSFs accounting for 13% of the total listed stock value of the ASX.

Nearly two thirds of SMSFs hold listed shares and nearly one third of their assets are invested in shares.

SMSFs will be even more significant share investors in the future – the ASX estimates that by 2035 the $500 billion held in a million self-managed fund accounts today will have swelled to $2,000 billion held in nearly 2.5 million SMSF accounts.

The first flashing amber light for self-managed funds is the Murray Report's questioning of whether Australia's system of dividend imputation should continue...a question the Tax White Paper will examine.

Winding back or eliminating imputation would adversely affect SMSFs which invest heavily in the blue chip companies that issue fully franked dividends. Nine of the top ten ASX-listed companies issue franked dividends.

SMSF owners like these companies because they deliver strong, tax paid dividends that build fund assets in the accumulation phase and generate steady income in the retirement phase. It's a sensible and popular investment option.

Dividend imputation was introduced 28 years ago to end the double taxation of company profits. As well as removing tax on dividends in the hands of shareholders, imputation increased the capital strength of Australian companies by reducing their need for debt funding.

Whatever the economic arguments for and against imputation, the reality is that SMSFs rely heavily on franked dividends and any policy move to abolish or curb them will erode the value of super income, particularly for those in the pension phase looking for steady and dependable returns from their savings.

Not only will the one million Australians with SMSFs be hit. Every working Australian with an account in an APRA-regulated retail or industry fund that invests in companies with franked dividends will find the value of their super savings diminished.

About SMSFOA: The SMSF Owners' Alliance was established two years ago to promote and protect the interests of the one million Australians who have chosen to look after their own financial needs in retirement. SMSFOA makes submissions to government on superannuation policy issues and sits on ATO and ASIC consultative panels. It is often quoted in media stories about SMSFs. For more, visit www.smsfoa.org.au or email info@smsfoa.org.au.