SMSF Owners' Alliance
Limited ABN 96 161 052 464
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SMSFOA Members' Newsletter

#3 /2015

Dear Members

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Policy update

Financial System Inquiry (Murray Report)

As this newsletter is published, we're completing our submission in response to the Final Report of the Financial System Inquiry. It'll be posted to our website shortly.

One of the more interesting recommendations from the FSI is that the politicians should try to reach agreement on the objectives of the superannuation system and then enshrine them in legislation. It seems strange that a $2 trillion pool of funds has been amassed without any over-arching statement as to its purpose. To be fair to its architects, superannuation has come a long way since it was conceived in the 80s as a trade-off for wage increases.

The various reviews of taxation and retirement systems in Australia to date have implicitly accepted the general view that an equitable system in a developed country should allow people in retirement to enjoy a certain standard of living comparable to the one they had during their working lives. It has also been implicit that the Age Pension is intended to be provide a safety net for a minority for whom the superannuation system has not worked though the reality is that the majority of Australians are on either a full or part Age Pension and will be for decades to come according to the Intergenerational Report.

However, defined objectives of an effective retirement system – including the role of the Age Pension – are not yet legislated.

Hopefully, bipartisan agreement on the objectives of our retirement savings system will make it harder for governments to fiddle with superannuation in the future and give people more confidence in placing their savings in superannuation.

SMSFOA recently met the Shadow Treasurer, Chris Bowen MP, following his comment that a bipartisan agreement is possible. It was a useful discussion however we've yet to see whether his definition of a more 'equitable' system will be consistent with the principles we've set out above and lead to more Australians being able to benefit more from superannuation.

Defining the objectives will inevitably involve discussion around limits to superannuation and we will need to be vigilant to ensure the interests of the one million people who have already set up self-managed funds are taken into account. We have referred to the concept of a Reasonable Replacement Rate – generally accepted as two thirds of pre-retirement income – as a fair benchmark for defining a suitable pension objective. We've also said that any changes to the superannuation system in the future should not be to the detriment of people who have saved under the existing rules.

Tax White Paper

Some of the big issues around superannuation were flicked by the FSI to the forthcoming Taxation White Paper. We expect a discussion paper (a Green Paper) will be the first step in this process and we might see it quite soon.

In the meantime, we are working up a comprehensive submission on how we think the superannuation system can be improved to deliver better outcomes.

If you have thoughts on how the superannuation system, and the taxation of it, should work please let us know – send an email to info@smsfoa.org.au

Intergenerational Report

SMSFOA attended the lock-up for the release of the latest Intergenerational Report which provides context for the Taxation White Paper. One of the startling figures from the Report is that by 2055, two thirds of Australians will still be drawing a full or part Age Pension. At the moment, about 70% of Australians are on the Age Pension. In 40 years, that proportion will have fallen only to 67%, though more people will be on a part pension.

This figure starkly underlines the need to maximise the opportunities for Australians to save more via superannuation – to improve the superannuation system, not kill it off, stunt its growth or make it more complex and uncertain.

For a look into the future: http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report

The $32billion myth exploded

It was good to see a senior Treasury official come out and say what we've been saying for the past couple of years – the oft-quoted $32 billion cost of superannuation tax concessions is misleading and can't be used as an argument to reduce the tax breaks on superannuation.

Graham Hand in his online newsletter *Cuffelinks* seized on the statement by the head of Treasury's Revenue Group, Rob Heferen, at an SMSF Association conference and we put out a media release – see below.

In her regular column in The Australian, Professor Judith Sloan of Melbourne University also again lambasted the media and economic commentators who uncritically use the $32 billion number.

We have consistently questioned the credibility of this number because it is used as the starting point for many attacks on the fairness of superannuation, mostly directed at SMSFs.

While admitting that the $32 billion figure should not be taken as a measure of the cost to the Budget of superannuation tax concessions, Treasury should also have noted that it is mathematically incorrect. It's the sum of two measures – tax concessions on contributions and on earnings – which can't be added together. Treasury actually warned against adding the two components then went ahead and did so itself, creating the $32 billion furphy in the first place.

Learn Build Empower Conference 4-6 May 2015

The Australian Shareholders Association is holding a conference in Melbourne from 4-6 May. Streams covered include 'Insights on equities', 'Managing your SMSF', 'Profiting from diversification' and more. Features an excellent range of high calibre speakers including Richard Goyder, CEO, Wesfarmers; Alan Oster, Chief Economist, NAB and Graeme Colley, SMSF Association of Australia.

For more information or to register: https://www.australianshareholders.com.au/conference-2015

Getting the word around

Bacon, Super & Eggs Breakfast

SMSFOA Director Barry McWilliams recently took the opportunity to tell about 150 industry professionals about the Owners' Alliance.

Barry was invited to present at the regular Super Central *Bacon, Super & Eggs* breakfast by SMSFOA member Peter Townsend, Principal of Townsends Business & Corporate Lawyers.

In his well-received PowerPoint presentation, Barry covered the reasons why SMSFOA was set up and our key activities to date.

Thought Leaders' Roundtable

Last week, SMSFOA Chairman Bruce Foy led the discussion at a Thought Leaders' Roundtable organised by SMSFOA and hosted by the Chairman of Private, Portfolio Partners, Hugh MacNally.

The Roundtable drew together some of the best minds in the SMSF sector to discuss the policy challenges facing self-managed funds and how to better promote SMSFOA as a champion for SMSF trustees. SMSFOA's Research Director, Malcolm Clyde, canvassed options for policy changes that might be considered by the forthcoming Taxation White Paper.

Taking part in the discussion were Diana D'Ambra (Australian Shareholders; Association), Stuart Forsyth (McPherson Super), Graham Hand (Cuffelinks), Ian Hardy (Private Portfolio Managers), Louise Lakomey (Crystal Wealth), Peter Lalor (SuperIQ), Claire Mackay (Quantum Financial), Brett Marsh (OneVue), Karl Siegling (Cadence Capital), Peter Townsend (Townsend Lawyers).

It was a useful opportunity to tap into the thinking of successful people in the SMSF space. Thanks to SMSFOA member Ian Hardy for PPM's hosting of this event.

PPM
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Now back to that $32 billion number

On Treasury's admission that it's $32 billion cost of super estimate can't be relied on, we issued this media release:

SMSF Owners' Alliance
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Media Release

Finally it's official - focus on $32 billion cost of superannuation is misleading

28 February 2015

Over two years ago we questioned the publication by Treasury of figures which were interpreted, wrongly, as meaning superannuation tax concessions were a $32 billion cost to the Federal Budget. We have since consistently said **it is not valid to use the aggregate figure of $32 billion in tax concessions as an estimate of the amount of tax the government would save if there were no tax concessions (on superannuation).**

We have also suggested repeatedly that the persistent misuse of this figure by various commentators was distorting a rational debate about superannuation and that Treasury should issue a statement explaining that such use of the figure is misleading.

So we are delighted to hear that a senior Treasury official has now made a clear and unequivocal statement that: ***"When people report things that say this ($32 billion) is a measure of tax expenditure and therefore that's the amount the Government could save if they did something about it, that is untrue." ****

Rob Heferen, Executive Director of Treasury's Revenue Group is reported to have told an SMSF conference this week the annual Tax Expenditure Statement is not a document with a policy message. *"When it is reported in the press...there seems to be an inference that simply because there is a large measured tax expenditure, the Government should do something about it. That is not the case. There is no policy message in the Tax Expenditure Statement."* He went on: *"We are asked to do an audit, so we do. But be wary on the revenue gain estimates. Don't use them, they are too unreliable. On the revenue foregone (estimates), done according to international best practice, that is not a measure of what is saved. Anyone who says this is not reading the fine print - it's not even in fine print, it's in bold print. Every year when we put it out, we get criticism so I wanted to make it clear." **

With this clarification Treasury has made it possible to have a more objective and rational discussion about the purpose, effectiveness and benefits of superannuation and how Australia's retirement savings system can be improved, without undue focus on a large but artificial number.

However, the Tax Expenditure Statement (TES) still does not, for example, explain what savings in Age Pension flow from the existence of the superannuation tax concessions and ignores the reporting of some very large tax concessions such as the income tax concessions for those on lower incomes. A full disclosure of such figures could assist a thorough and objective review of taxation.

That there are tax concessions with regard to superannuation is not in doubt. However, some reported suggestions that superannuation tax concessions may not be of benefit ignores the importance of national savings for the ongoing health of the Australian economy. In his context Dr Ken Henry's comments in his 2009 Report on Australia's future tax system should be noted. He clearly stated that "*income taxation creates a bias against savings*" and "*discriminates against taxpayers who choose to defer consumption and save*" with the result that "*individuals* (savers) *pay a higher lifetime tax bill than people with similar earnings who choose to save less*". In particular he reported that the bias against long-term savings was evident" *for lifetime savings such as superannuation*" and that "*superannuation should receive preferential income tax treatment compared to other savings*".

Like Rob Heferen, Dr Henry also questioned the validity of over-reliance on the reported tax expenditures due, in part, to differences of opinion as to what benchmark should be used. The reported figures depend upon the benchmark used. The Henry Tax Review raised questions about the benchmark used in the Tax Expenditure Statement, by reporting that "*most countries' retirement income systems use an expenditure tax benchmark.*" The TES in contrast uses the "income tax benchmark".

To give Treasury due credit, and to illustrate the problematic nature of this exercise, in last year's report on superannuation tax expenditures they also reported on superannuation tax expenditures using the "expenditure tax benchmark". This resulted in the tax expenditure with regard to the concessional taxation of super earnings swinging from the $16.1 billion it usually reports to <u>minus</u> $5.8 billion (i.e a tax <u>penalty</u> rather than tax <u>concession</u>). Unfortunately, they did not repeat the exercise this year. Despite the problems with the tax expenditure report, Rob Heferen explains that they are obliged to report some of these figures in order to comply with a recommendation in 2007-08 by the National Audit Office.

Treasury have also been consistent in warning that the two superannuation components - tax concessions on contributions and tax concessions on fund earnings - are not additive. (i.e the $32 billion number is definitely wrong) Treasury also notes that "*Readers (of the TES) should exercise care when comparing tax expenditure estimates with direct expenditure estimates.*" The overall point is not that one method is right and another wrong, but that the whole process is inexact and will produce different numbers according to the benchmarks used.

In this context, it is of concern to see the head of Treasury, John Fraser, describe superannuation tax concessions as "*middle class welfare*" and should be debated as part of the Government's attempt to fix the budget.

Mr Fraser rightly points out that "*Australia has spent its way to a structural budget problem. Government payments are growing faster than government revenues and without action this trend will continue.*"

We have been making exactly this point to the previous and present Governments in our past three pre-Budget submissions.

The deficit and debt problem needs to be fixed by reining in current Government spending, not by more taxation on the retirement savings of Australians. When people make savings for their future, they need to be confident that their savings are secure and not available to Governments that have a problem because they can't properly manage their budget. The Government should heed Dr Henry's warning about the problems of the over-taxation of savings.

The Henry Report also emphasised how the *"compounding effect of interest* (income) *has a significant influence on how much superannuation a person can accumulate"* and that "*the taxation of earnings reduces this compounding effect."* A reduction in the tax rates on superannuation fund earnings from 15% would improve the effectiveness of superannuation.

A comment often made in the context of superannuation taxation concessions - repeated in the media this weekend - is that the top 20% of income earners get more than half of the benefit of the concessions. It is rarely mentioned that the same top 20% of income earners also pay 65% of income tax. A comprehensive analysis of who pays tax in Australia and how much they pay, net of welfare and other benefits, would be useful background information and provide an objective reference point for submissions on the Taxation White Paper and in the debate over the fairness of superannuation tax concessions.

We commend the recent observation by the Assistant Treasurer, Josh Frydenberg, that the growth of SMSFs is a good thing and that they are a key source of competition in the superannuation system. He said how keen he was to see Australia have the most efficient, transparent and competitive superannuation system.

In this regard, we agree that an over-arching and, ideally, bipartisan statement of superannuation objectives, as recommended by David Murray's recent Financial System Inquiry, is a sensible step. Such a formal statement of the purpose and objectives of superannuation will make it harder for governments to tinker with the system and will help to engender confidence in what is a lifetime investment for Australians.

We have taken the statements made in the Henry Review, the Cooper Report and other overseas reports as being reasonable objectives for the Government to adopt. i.e.

> By compulsion and tax incentives, support a privately-funded superannuation system that delivers a pension to most Australians that bears a reasonable relationship to each Australian's pre-retirement income; with the Age Pension only being a safety net for a minority of Australians.

We therefore believe that the focus of any review of superannuation, either in the context of the Taxation White Paper or otherwise, should be:

1. Adequacy - setting an appropriate measure for retirement income in relation to preretirement income and making it possible for most Australians to achieve this level of financial independence in their increasingly longer period in retirement;
2. Fairness – what this means, how to measure it and how each alternative system addresses this;
3. Efficiency – as acknowledged by the Financial System Inquiry, improving the competitiveness and efficiency of superannuation investments leads to an improved system for everyone; and
4. Reducing red-tape – such as removing features of the system that have been added in an ad-hoc fashion by various Governments over time and which do not appear to directly help in achieving the principle objective of super but rather increase its complexity.

We will be addressing these issues in our response to the Taxation White Paper process following the release of the Intergenerational Report which will set the scene for shaping the best retirement savings system in the long-term interests of all Australians.

* As quoted in the weekly online newsletter *Cuffelinks*.

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And Professor Sloan weighs in again.

In our February newsletter, we ran an excellent article by Professor Judith Sloan of Melbourne University demolishing the often-repeated claim that the Government could save $32 billion in superannuation tax concessions. Below we reproduce another good article this week by Professor Sloan on the same topic.

THE AUSTRALIAN

OPINION

Super rules favour politicians, not the rich

- by: *Judith Sloan*
- From: *The Australian*
- March 24, 2015 12:00AM

Judith Sloan

Contributing Economics Editor

One of the banes of the existence of the young academic is the repeat tutorial. I always found that I got better after the first tutorial, although anything beyond the fourth tutorial on the same topic in a week was pure torture.

Fast forward a few decades and I feel as though I am giving a repeat tutorial on the topic of superannuation tax concessions. And if I hear again that the government could collect $30 billion if only these concessions were removed, I think I am going to scream.

Just in case you think I am a lone voice in this debate — which I'm not, by the way — consider this opinion from someone who really knows about these things: the head of revenue in the Treasury, Rob Heferen.

"When it is reported in the press ... there seems to be an inference that simply because there is a large measured tax expenditure, the government should do something about it," he says.

"That is not the case. There is no policy message in the tax expenditure statement.

"We are asked to do an audit, so we do. But be wary on the revenue gain estimates. Don't use them, they are too unreliable.

"On the revenue foregone (estimates), that is not a measure of what is saved. Anyone who says this is not reading the fine print, it's not even in fine print, it's in bold print. Every year when we put it out, we get criticism so I wanted to make it clear."

So here we have it from the horse's mouth, so to speak, but the impact of this informed voice of reason has no impact on the rising crescendo of calls to do something about the superannuation tax concessions.

So let me repeat the main (and simplified) features of the taxation of superannuation in Australia. (Sigh from the weary tutor at this point.)

Apart from very high income earners, contributions are taxed at 15 per cent and earnings are taxed at 15 per cent.

There is an annual concessional contributions cap, which includes the employer contribution, of $30,000 a year for those aged under 50 and $35,000 for those over 50.

Withdrawals for members (of taxed schemes) aged 60 and older are tax-free.

In 2012-13, the Labor government halved the tax concession on the superannuation contributions of high income earners, defined as those earning more than $300,000. At the time, it was estimated that this would affect 1.2 per cent of people contributing to superannuation and would save the budget close to $1bn across four years.

I am sometimes asked what I would do to change the taxation of superannuation.

My response is that I would change nothing, partly for the reason of establishing a degree of certainty in a space that has been subject to far too many changes. In any case, any substantial increase in superannuation taxes would simply increase the cost of the age pension down the track.

On the issue of equity, the combination of a low annual (unindexed) concessional contributions cap and the reduced tax concession on the contributions of high income earners has killed off superannuation as a tax haven for wealthy individuals.

It's all very well pointing to individual superannuation accounts with more than $10 million — there are very few of them, by the way — but these accounts have been amassed on the basis of rules that no longer apply. It is simply not possible to accumulate this amount in a tax-preferred way any longer.

Let us return to the cut to the superannuation tax concession for high income earners announced by then treasurer Wayne Swan in the 2012-13 budget, which came into effect in July 2012.

At the time, the then minister for financial services and superannuation, Bill Shorten, swore that the new arrangement would apply to all parliamentarians, including those on the old defined benefit scheme, the Parliamentary Contributions Superannuation Scheme.

The members of this scheme include Tony Abbott, Joe Hockey, Julie Bishop, Wayne Swan, Jenny Macklin, Tanya Plibersek, Anthony Albanese and the list goes on. The scheme was closed in 2004.

The trouble is that the Labor government did absolutely nothing to ensure the cut to the superannuation tax concession for high-income earners did actually apply to members of the PCSS.

It was left to the Coalition government to clean up the mess. The new regulations came into effect in May last year.

Now you may wonder who in parliament earns more than $300,000 a year.

It is the entire ministry, the leader and deputy leader of the opposition, the Speaker and the president of the Senate.

But note that the defined benefit contribution is added to the salary of the member when calculating - eligibility.

Recall also that the PCSS is the mother of all schemes where parliamentarians retire on a maximum of 75 per cent of their highest earnings.

And this pension is indexed to movements in parliamentary salaries.

It would have to be one of the most generous schemes in the entire world. The implied capital value for most retiring parliamentarians is well more than $6m. (So much for that political bellyaching about large superannuation balances.)

Just in case your heart bleeds for more recently elected parliamentarians, think again.

While the rest of the community is expected to make do with a compulsory superannuation contribution of 9.5 per cent, the parliamentarians voted themselves a contribution rate of 15.4 per cent — as you do.

You should also be aware that all commonwealth judges and state higher level office holders who have superannuation contributions paid into a constitutionally protected fund are completely exempt from the reduction in tax concession on the super contributions of high income earners.

So when you hear about superannuation tax concessions favouring the rich, just think about those parliamentarians, judges and other public office holders who think it is just fine that they shouldn't be treated like everyone else.

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