SMSF Owners' Alliance
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Members' Newsletter #4/15

In this edition:

- Negative responses to the Labor plan to tax super earnings in retirement
- SMSFOA says super taxes should be considered in the context of the Tax White Paper
- The proposed tax will catch more people than Labor says because it's not indexed and income will vary according to fund performance
- The Government labels Labor's retirement tax as a revenue grab that will target the middle class

"Rather than piecemeal changes…what's needed now is a clear fix on what needs to be done to both superannuation and the age pension to make them both fiscally sustainable. AFR editorial – 23 April 2015"

A nugget of common sense in the media commentary following Labor's announcement on 22 April that it plans to resurrect its plan to put a 15% tax earnings on superannuation accounts for retired people, lowering the threshold from the $100,000 in earnings proposed in 2013 to just $75,000. This has generally not gone down well with self-funded retirees, including Australia's one million SMSF owners.

As *smsfmagazine* observed:

"The federal opposition's announcement last week that it will introduce new superannuation taxes if it wins power at the next election has been met with a mainly negative response from the SMSF sector.

smsfmagazine reported that:

The SMSF Owners Alliance criticised the policy on several fronts, including the misleading prediction of how many Australians it affected. "The number of people who will have to pay the earnings tax will be more than the number quoted by Labor and will include people with balances far lower than $1.5 million," SMSF Owners Alliance executive director Duncan Fairweather said. "The proposed earnings threshold of $75,000 is not to be indexed for inflation. This means that from year to year, more people will be drawn into this sneaky tax net as their superannuation earnings and their fund earnings grow." Furthermore, the industry lobby group could not see the actual benefit to the superannuation system itself. "This extra tax does nothing to improve superannuation for the many Australians who don't have enough," Fairweather said. "Indeed, due to the extra complexity and cost, this idea would probably lower returns and reduce the chances for all Australians to save enough in their super."

SMSFOA's two media releases picked up on the theme that Labor had jumped the gun by announcing its superannuation tax policy ahead of the forthcoming Taxation White Paper and a potential bipartisan agreement on the objectives of superannuation. See our media release 'Labor

Jumps the Gun on super tax': http://www.smsfoa.org.au/images/Media_releases_2015/150422%20-%20Labor%20Jumps%20the%20Gun%20on%20Super%20Tax.pdf

The idea that ALP's proposal, though purporting to attack the 'rich', does nothing to improve super for everyone else is gaining momentum as reflected in this comment from the leading investment adviser Vanguard:

"The next election will ultimately pass judgement on the Labor proposals and the Government's still-to-come alternative approach. Sadly these long-running policy debates bring along with it the fellow travellers of regulatory uncertainty and legislative risk - both of which can effectively undermine confidence in the entire system.

While the ALP proposal focusses on "How much is enough" at the high account balance end of the market the single biggest challenge facing the system is that far too many people still have far too little in super to fund anything like a comfortable, let alone generous retirement."

We also pointed out that the recycled retirement tax – as with Labor's super tax proposal two years ago – it would hit many more people than Labor estimated and would be practically difficult to administer. See our media release '10 things wrong with Labor's new super tax' - http://www.smsfoa.org.au/images/Media_releases_2015/150424%20-%20Ten%20things%20wrong%20with%20Labors%20new%20superannuation%20earnings%20tax.pdf

Labor's initial tax on superannuation account earnings over $100,000, announced in government in April 2013, was not implemented by Labor and discarded by the incoming Coalition government because it was impractical and costly to collect. The same fate awaits the new proposal to tax earnings over $75,000.

An informed view in the media from former senior ATO official Stuart Forsyth:

"Nothing in superannuation is simple and this policy although it sounds simple would in fact be extremely complex to implement. Costs to implement would be prohibitive both at the Government level and the industry level."

Generally seen as unfair to people who have worked hard and saved for a decent retirement

Letters to the editor and online blogs are awash with comments from that far from being fair, Labor's proposals are unfair to people who have saved hard all their working lives to enjoy a comfortable, not lavish, life in retirement. This letter in the Sydney Morning Herald was a typical response:

The Labor Party – partially supported by the Herald editorial ("Labor's small step on super tax breaks – April 23) – proposes changes to the super of the "wealthy". What does wealthy mean? I have more than $1.5 million in my super and I don't feel wealthy; my wife and I earned and contributed all the money in our super funds; we didn't win Lotto, inherit a pile or pull off some tricky tax deal; we don't have money in trusts or off-shore tax havens; we built our super funds following the appropriate laws and taxes of the time; we both left school at 17, went to work and have paid the appropriate tax every year since; we have saved as hard as we could to buy a house, support our family (with absolutely no family benefits – parts A or B) to build our super and ensure that we can support ourselves; and we do not qualify for any pensions or parts thereof. We have always tried to, and always will, "pull our weight" but we are sick to death of all political parties playing around with the rules of super well after we have any ability to change our plans for our retirement. It is simply not right or just to make retrospective changes to super. Ralf Harding, Rushcutters Bay.

And this from Angela in The Australian's blog on 28 April:

Senior citizens and retirees have been treated disgracefully and I am sorry we cannot oblige the government by dropping dead en-masse before our 65th birthday! Hang on Angela, it ain't a done deal yet.

Grattan Institute thinks Labor's policy is too soft

The Grattan Institute – the think tank pushing the view that superannuation tax incentives are unfair and benefit 'the rich' – said Labor's 'softly softly' policy didn't go far enough. Grattan's CEO John Daley said in the AFR: *"The tax free threshold of $75,000 is too high…a better policy would to set the tax-free threshold at $20,000."*

This is the same level of income as the basic, single, aged pension.

The Grattan Institute was formed in 2008 with funding of $15 million each from the Federal and Victorian governments, $4 million from BHP-Billiton and support from the National Australia Bank and the Myer Foundation.. It has a staff of 28 housed at Melbourne University. Its mission is to examine economic and social issues in the context of 'Australia as a liberal democracy in a globalised economy.'

The Government's response

Treasurer Joe Hockey said he would look at Labor's proposal but noted that the Opposition's usual response to any issue was to tax it.

The Assistant Treasurer, Josh Frydenberg, rejected the idea in this article in The Australian on 28 April:

THE AUSTRALIAN

Josh Frydenberg: Labor's tilt on super unjust

- by: *Josh Frydenberg*
- From: *The Australian*
- April 28, 2015

Last week, Labor proposed two changes to superannuation tax concessions. It was a political solution to a policy problem.

Slugging Australia's super savers is not the answer to the challenge of budget repair. Real structural savings need to be found, including reforming the government's largest single expenditure item, namely pensions.

It is here that Labor's cupboard, in its year of "big ideas", is bare.

But the problem with Labor's proposal is much deeper than this. As Henry Ergas powerfully wrote on these pages yesterday, Labor's claim that its 15 per cent tax on superannuation earnings above $75,000 will likely affect 60,000 retirees with balances over $1.5 million is misleading in the extreme. On Ergas's calculation, 70 per cent of those hit will have balances lower than this, making Labor's proposal a desperate revenue grab that will target the middle class.

This is because super earnings fluctuate widely from year to year as financial markets move up and down. The fact Labor has also not indexed the threshold to take into account the consumer price index will widen the net of those who are affected.

Labor's approach is also unfair. It hurts those retirees who have chosen to sell the family home with the proceeds going into their super. It also will affect people on a pension despite Labor's press release expressly ruling it out. In any given year pensioners may have a large capital gain that takes them over the threshold.

When *Euromoney*'s 2011 treasurer of the year, Wayne Swan, announced a similar cash grab in 2013, applying a 15 per cent tax on earnings to $100,000 and above, Treasury's deputy secretary told Senate estimates "a number of super funds said it would be extraordinarily problematic to do".

Maybe that is why Labor found it easier the first time around to announce its proposal rather than to enact it. On its second attempt, it has allocated more than $200m to the tax office just to implement this measure.

No wonder our national newspapers have editorialised about the policy being "piecemeal and opportunistic", and industry bodies such as the Self-Managed Super Fund Owners' Alliance have described it as "knee-jerk fiddling" that creates more uncertainty.

This is quite ironic given Chris Bowen said he wanted to bring stability to the sector by taking super "out of the annual budget speculation cycle". Yet when Labor was in office and he was assistant treasurer and then treasurer, he was part of a government that increased taxes on super by $9 billion, and introduced new changes virtually every year.

This was despite Kevin Rudd's commitment in November 2007 that super under Labor would not change "one jot, one tittle".

The final blow to Bowen's credibility was on July 31, 2013, when he said: "A Labor government will commit that the tax treatment of superannuation will only be considered for amendment every five years." The commitment lasted all of 48 hours.

Two days later, on August 2, Bowen announced changes to the threshold under which inactive super accounts were transferred to the Australian Taxation Office. It was a $582m revenue measure. You simply cannot trust what Labor says.

In Bowen's book, *Hearts & Minds*, he unequivocally supports concessions for superannuation, calling them justified. He resists them being pared back, saying "the problem with this is that it creates uncertainty for, and concern by, people who are making voluntary contributions to superannuation". Wise words; if only he would heed his own advice.

In response to Labor's constant undermining of super and savings policy, the Coalition pledged not to make any unexpected adverse changes to super during this term. We did this to provide stability and allow for a proper period of review rather than a continuation of

Labor's ad-hoc budget night changes. People are saving for retirement and shouldn't be penalised for doing so.

Retirement income policy, which includes the interaction between the tax, superannuation and aged pension systems, is just too important to be subject to policy on the run. This is why we have a tax white paper process. The goal is to achieve a long-term policy outcome, not a short-term political fix.

Josh Frydenberg is the federal Assistant Treasurer.

And here's the article by leading economist Henry Ergas which to which Josh Frydenberg refers:

Chris Bowen reheats discredited, soak-the-rich super policy

Henry Ergas

Columnist

Sydney

https://plus.google.com/107156584299320274780/

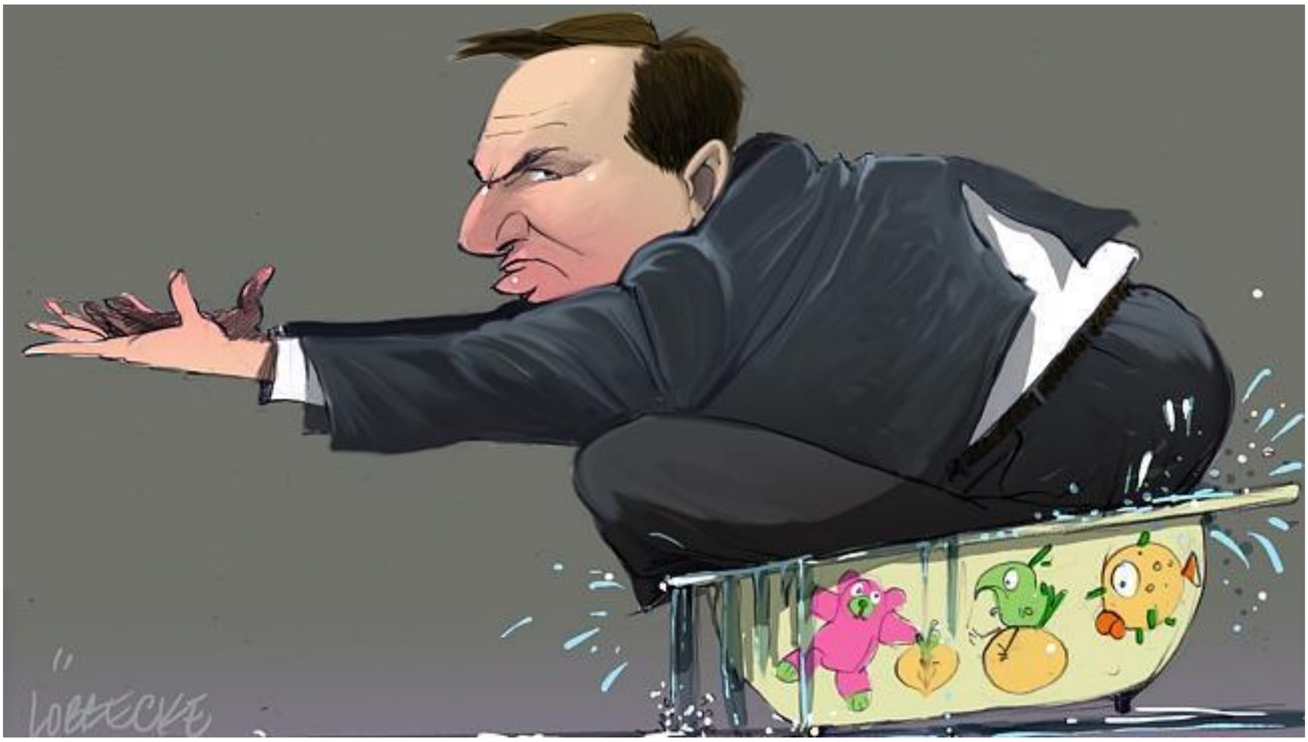
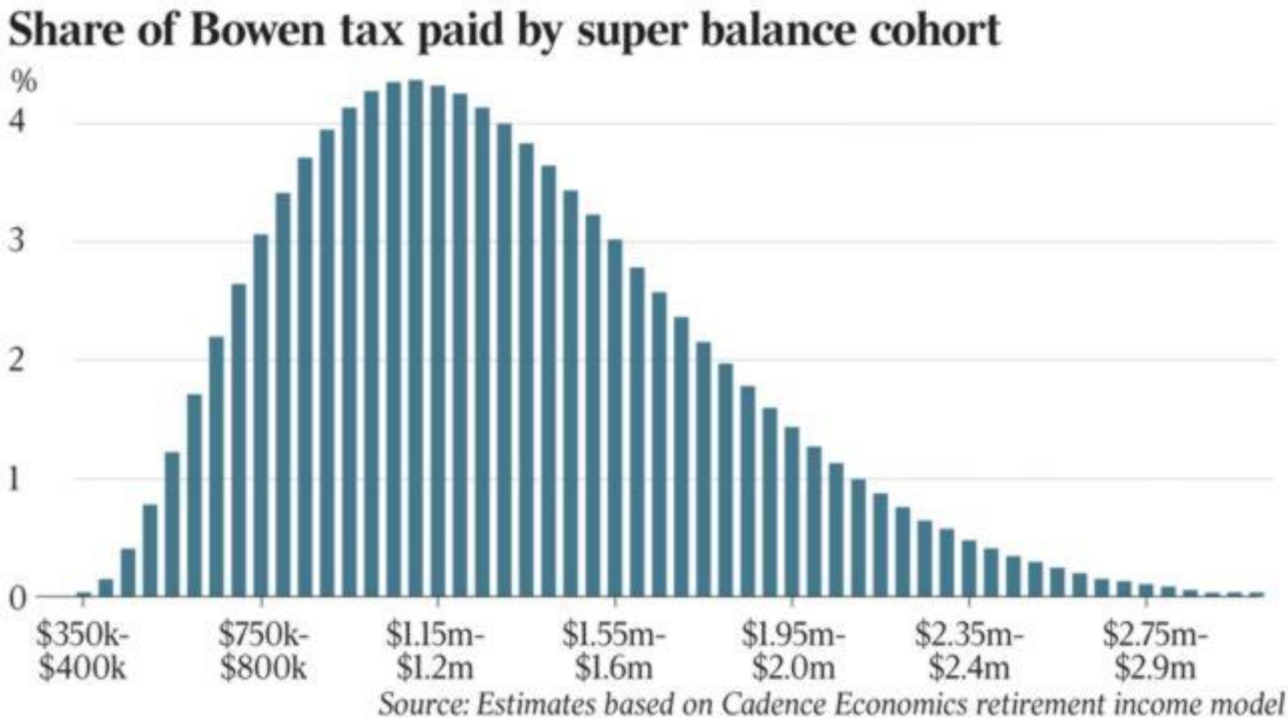


Illustration: Eric Lobbecke *Source:* Supplied



Share of Bowen tax paid by super balance cohort. *Source:* TheAustralian

You can't step into the same river twice. But the bathwater is a different matter. It just gets colder and nastier each time.

If Chris Bowen knows that, it hasn't stopped him diving in. Voters presumably thought they had killed off Wayne Swan's proposal to tax retirees' superannuation income whenever it exceeded $100,000.

Well, the baby may have gone but the bathwater is back, and with an even lower threshold of $75,000. Nor is it alone in returning from the crypt. For the misleading statements are back too. In this case, it's the claim the tax, which Bowen expects to raise $9 billion in a decade, will only hit the 60,000 or so retirees with super balances greater than $1.5 million.

In reality, 70 per cent of the tax's take is likely to come from older Australians whose super balances are below $1.5m. Indeed, accounts with balances of less than $1m would pay nearly a third of the tax, while accounts holding $2m or more would not even contribute 10 per cent of the total.

The difference between these estimates and Bowen's is readily explained. Super accounts, like most other investments, earn incomes that vary greatly: one group of investors with small balances could have a standout year, lifting their income above the threshold, while others with much higher balances suffer large losses.

As a result, figuring out whose ox the tax will gore requires taking that variability into account.

Whether the Parliamentary Budget Office did so in assessing the proposed tax isn't known, as Bowen has refused to release its report.

What is certain, however, is that Bowen, when he says the tax merely affects savers with very large balances, is ignoring that variability entirely. Rather, Bowen assumes that balances secure a fixed 5 per cent return each and every year, so that only accounts with $1.5m or more exceed the threshold. But that assumption is absurd.

Luckily, a model developed by Bob Scealy from Cadence Economics can be used to correct Bowen's mistake. Starting from the initial distribution of super balances, Scealy's model simulates their evolution over time, with the spread in the returns they earn reflecting historical patterns of variability.

That allows an estimate to be derived, for each opening balance, of the probability that its income in any year will exceed the $75,000 threshold, as well as of the amount that can be drawn from the account over the saver's remaining lifetime.

The results suggest that far from generating the bulk of Bowen's $9bn, very large accounts will contribute barely a third. Moreover, as inflation both erodes the threshold in real terms and increases the nominal value of accounts, the likelihood of earnings on even quite small balances exceeding the $75,000 threshold will rise sharply, shifting a rising tax burden on to retirees whose savings are far below the actuarial value of an entitlement to the full age pension (which Mercer estimates at $1m).

Bowen's proposal is therefore not a tax on the rich; rather, it is a tax on the middle class, which is already harshly treated by our retirement income system. And that is all the more the case as the well off are likely to have greater opportunities for switching assets from super to other tax-advantaged forms of savings.

That switching, which is sure to be pervasive, is not just crucial to understanding the tax's incidence; it also means the claimed $9bn net revenue increase, which does not seem to take any switching into account, is likely to be a serious over-estimate.

And other factors could make that over-estimate all the greater. In particular, taxing relatively small balances, even if it is only once or twice in a decade, causes savings to be exhausted more rapidly.

Their owners therefore qualify for the age pension sooner and for more years. Adding to the problems, that effect is especially pronounced as the tax would hit incomes in the occasional very good year (when excess earnings might have been reinvested) without providing any offset in low-earning years.

While quantifying the resulting impacts is complex, a rough estimate is that pension eligibility for initial balances in the $350,000 to $500,000 range could be 5 to 10 per cent greater under the Bowen tax than without it, with broadly similar effects for means-tested age care payments. As those increases in eligibility translate into greater public expenditure, the promised gains in net revenues will melt away. And there will be broader efficiency costs to boot.

For example, non-compulsory savings will be diverted into assets such as owner-occupied housing, further distorting housing markets while increasing our vulnerability to property price bubbles.

As for compulsory super contributions, raising the effective tax rate they face is equivalent to increasing taxes on lifetime incomes, which undermines the incentives to work and invest. That the proposal involves formidable administrative complexities merely makes its costs greater.

Nor will Bowen's proposal correct any of our superannuation system's myriad weaknesses, which, in addition to high fees and charges, include placing risks on individual savers they are poorly placed to manage.

And the alleged unfairness in the taxation of super would be better addressed by the Henry review's recommendations, which, whatever their problems, were at least more sensibly targeted.

But that doesn't mean the proposal won't strike a chord. There are, after all, fashions in confusion, and Labor's "soak-the-rich" rhetoric admirably suits the Newspeak lexicon that Daniel Hannan, a British Member of the European Parliament, recently diagnosed.

It goes as follows: "Greed: Wanting to keep your own money. Need: Wanting to be given someone else's. Compassion: A politician arranging the transfer."

With more tax grabs looming, expect compassion to get a serious workout in the months ahead.

RBA re-think on low interest rates?

And finally, an interesting observation from the Governor of the Reserve Bank, Glenn Stevens. Maybe the RBA is taking more notice of the impact on retirees of historically low interest rates, including SMSF owners who hold about a third of their assets in cash. We'll see.

Today's retirees 'much worse' off: RBA

- From: *AAP*
- April 28, 2015 8:53AM

PEOPLE leaving the workforce now have got it much tougher than those who left a decade ago and will need to take a lot more risk in order to fund their retirement, the head of the Reserve Bank says.

WITH central banks around the world lowering interest rates to stimulate their economies, yields on low-risk assets such as term deposits have plummeted.

That forces retirees to take more risks than they would have needed to in the past in order to generate an adequate income for the future, RBA governor Glenn Stevens said.
"Just about everywhere in the world, the price of buying a given annual flow of future income has gone up a lot," Mr Stevens told a banking summit in Sydney on Tuesday.
"Those seeking to make that purchase now - that is, those on the brink of leaving the workforce - are in a much worse position than those who made it a decade ago.
"They have to accept a lot more risk to generate the expected flow of future income they want."

The problem would be most severe in Europe but also is potentially "non-trivial" in Australia, he said.