SMSF Owners' Alliance
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SMSFOA Members' Newsletter

 # 4/2016

Dear Members

In this newsletter:

- **The blindside super tax hit in the Budget is wrong on three fundamental counts. It is:**
    - **a broken promise**
    - **a betrayal of trust**
    - **retrospective**

Shock at $1.6 million cap on pension accounts

Members of SMSF Owners have reacted with dismay to the Budget measure that will require anyone with more than $1.6 million in their superannuation accounts to either withdraw the excess or put it in an accumulation account and pay 15% on the earnings.

They are seeing it as a betrayal of trust.

Several times before the Budget, the Treasurer, Scott Morrison told the media that any tax changes to superannuation would be focussed on the accumulation phase and retirees who were already living off their superannuation nest eggs would be protected because any changes would not be retrospective.

So on Budget night it came as a shock that people in the retirement phase now face a new tax that will apply retrospectively to them.

The Treasurer attempted to argue in his National Press Club appearance the day after the Budget that the new limit on tax-free retirement accounts was not retrospective.

He said: *"We are not taxing the earnings out of retirement phase accounts, full stop. What we have done is we have set a limit on what can go into these retirement accounts. That's a different position."*

Sorry Treasurer, but it is, without doubt, retrospective. The $1.6 million cap on tax free superannuation pension accounts from 1 July 2017 will affect savings already made in a tax free environment. That's retrospective in our book.

The Budget Papers are quite clear on this point: *"Members already in the retirement phase with balances above $1.6 million will be required to reduce their retirement balance to $1.6 million by 1 July 2017."* – Budget Paper No2 2016-17 (page 26).

It is also, without doubt, a new tax. There has not previously been a tax on earnings by superannuation funds in the retirement phase.

Now super will again be taxed at three points: on contributions, on earnings in the accumulation phase and on earnings in the retirement phase above the cap.

If people had known the rules would be changed after they had committed their savings to superannuation, they might have made different investment choices.

It is, without doubt, a broken promise and a betrayal of trust. People who have ordered their lives in the context of the current rules – making important decisions like choosing the time to retire, whether to downsize and where to live in retirement – now find themselves faced with a new tax they had not factored into their retirement planning.

It is not just a concern for people already in retirement but also for those in the last decade of their working life who are looking ahead to their retirement.

It is an unexpected change that sets a precedent for future governments to make further changes to the tax parameters of superannuation.

It will shake confidence in superannuation right across the age spectrum.

What the Budget actually says:

"From 1 July 2017, the Government will introduce a $1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the retirement phase. Subsequent earnings on these balances will not be restricted. This will limit the extent to which the tax-free benefits of retirement phase accounts can be used by high wealth individuals.

Introducing a transfer balance cap will improve sustainability and fairness in the superannuation system. Where an individual accumulates amounts in excess of $1.6 million, they will be able to maintain this excess amount in an accumulation phase account (where earnings will be taxed at the concessional rate of 15 per cent). Members already in the retirement phase with balances above $1.6 million will be required to reduce their retirement balance to $1.6 million by 1 July 2017. Excess balances for these members may be converted to superannuation accumulation phase accounts.

A tax on amounts that are transferred in excess of the $1.6 million cap (including earnings on these excess transferred amounts) will be applied, similar to the tax treatment that applies to excess non-concessional contributions." Budget Paper No2 (pages 25-26).

The cap will be indexed in $100,000 increments in line with CPI.

What it means:

A fact sheet distributed with the Budget says:

"Those individuals already in retirement as at 1 July 2017 with balances in excess of $1.6 million will need to either:

- *transfer the excess back in an accumulation superannuation account; or*
- *withdraw the excess amount from their superannuation*

Individuals who breach the cap will be subject to a tax on both the amount in excess of the cap and the earnings on the excess amount." Superannuation Fact Sheet 02

What is not explained:

- Exactly what does "Subsequent earnings on these balances will not be restricted." mean? We understand it means that if the earnings on your capped retirement account exceed the pension you withdraw, then the surplus can remain in your account above the $1.6 million cap. This was confirmed by a Treasury official in the Budget lock-up but we'll need to see the detail on how it will work in practice.
- As you withdraw a pension from your retirement account, will you be able to transfer money from your accumulation account into your retirement account to keep it topped up to $1.6 million? If so, again we would like to see the detail on how this will work.
- What about fluctuations in the value of fund assets which could see account balances moving above and below the $1.6 million cap each year? Will there need to be an annual adjustment between the retirement account and the accumulation account?
- Exactly what is the penalty if you exceed the $1.6 million cap? With money being transferred frequently between accounts, there is a real risk that an inadvertent or mis-timed transfer will take you over the cap.
- Will fund members be able to re-balance their accounts within the fund so they can stay under the $1.6 million cap?
- How will the allocation of assets between retirement accounts and accumulation accounts be managed? For example, what about 'lumpy' assets like real property that may not be able to be neatly assigned to one fund or another? Presumably, this issue can be managed by an actuary but we need to know for sure.
- On the death of a fund member, what are the consequences for the treatment of their account assets, and their exposure to earnings tax, within the fund?

Other practical questions like these are likely to arise – please let us know if you have any. The Government says it will consult on the implementation of the new measures and SMSF Owners' will seek to be involved, even though we are sceptical about whether our views are taken into account – see our comments on consultation below.

How much revenue will it raise?

The Budget papers estimate that the $1.6 million cap will generate $2 billion over the forward estimates - $550 million in 2017-18, $700 million in 2018-19 and $750 million in 2019-20. This and revenue from other superannuation tax measures revenue will offset expenditures of $1.3 billion to reduce tax on super contributions by low income earners, $350 million for 'catch up' concessional contributions for people with interrupted work patterns and $130 million to get rid of the work test for people over 65 making superannuation contributions and other measures. These changes will be largely paid for by the new tax imposed which will fall most heavily on self-managed fund members.

How many is a few?

In selling the new $1.6 million cap, the Government has stressed that *"very few people will be affected by this proposal*" and *"96 per cent of individuals with superannuation will not be adversely affected by these changes."* However, most of the 'few' will be members of self-managed funds because they are the funds that hold high balance accounts. According to ATO data, some 175,000 self-managed fund members have balances of more than $1 million. The ATO data doesn't give a breakdown that would allow us to work out exactly how many have balances of more than $1.6 million but it's probably more than 100,000. Not very few but quite a few.

And that number will grow in time.

In any case, a retrospective tax is not more acceptable if it affects only a relatively small number of people. In principle it is bad no matter how many people are caught.

Why $1.6 million?

It is not clear why the Government chose $1.6 million as the cap. No reason is given in the Budget papers. However, the $1.6 million cap is not far off the $1.5 million mark on which Labor's policy to tax earnings over $75,000 at 15% is based.

It looks like the Coalition has picked up the intent of Labor's policy though it will work differently.

It remains to be seen which approach will be the least worst.

Complexity and cost

Adhering to the new rules will add complexity and cost to the administration of superannuation funds. New accounts may need to be set up and managed. Your accountant and auditor will probably need to do more work on your fund's compliance, at your cost. It will probably also involve more work and more staff for the ATO, which is adept at extracting money from the Government to employ more staff on tax administration.

How might people react?

While some retirees will accept the fact that they will have to pay a new tax on their accumulation fund earnings, others may want to take the option of withdrawing their savings in excess of the cap and investing them elsewhere, e.g. in their residence, which is tax free, or to enable geared investments. From an economist's viewpoint, it is anomalous that super savings will be taxed but savings vested in a home are not.

Retirees may be more inclined to keep their existing houses rather than downsize and put the proceeds into superannuation where it will be taxed. This will tend to reduce supply and prop up property prices. The Reserve Bank may get even more worried about how much of the nation's wealth is devoted to residential property.

Others may work out that it is better to limit their superannuation savings to $1.6 million and simply spend what's left over.

Lower concessional contribution cap

The decision to lower the concessional contribution cap to $25,000 a year for everyone (currently $30,000 for under 50s and $35,000 for over 50s) will make it harder for people to save enough to

be financially independent in retirement and in the longer run increase the cost to the Budget of the Age Pension. It will reduce the flow of savings into superannuation, slow the growth of the national retirement savings pool and reduce superannuation funded investment in the productive economy.

We hope that in time, as the Budget deficit is reduced, the cap can be raised again closer to the high water mark set by Peter Costello as Treasurer when the concessional caps were $50,000 for under 50s and $100,000 for over 50s. Our modelling shows the cap should be restored to at least $80,000 to encourage adequate savings for an independent retirement.

The effect of applying a life-time cap of $500,000 to replace the current $180,000 annual cap on non-concessional (after tax) contributions will also be to reduce inflows into superannuation.

Lest we be accused of being too negative, there were some good superannuation policy changes in the Budget.

- Removal of the work test for people under 75 to be able to make contributions. However, why have an upper limit at all when people are working longer?
- Encouraging partners to contribute to the superannuation savings of their low-income spouses.
- Allowing the roll-over of unused concessional caps to help those with interrupted work patterns and low superannuation balances to make ‘catch up’ contributions.
- Lifting current restrictions on people aged 65-74 from making contributions.
- Providing a tax offset of up to $500 to low income earners so they don’t pay more tax on their super contributions than on their income.

Bear in mind that the new earnings tax on account balances over $1.6 million will pay for much of these improvements.

It was also good to see that the new tax measures will be extended to members of defined benefit funds including politicians, public servants, judges and other public officials. The Government says the Budget measures will be broadly replicated in defined benefit and constitutionally protected funds – these being State based funds. We’ll need to keep an eye on this to ensure the wily public servants don't get a better deal than the rest of us.

The objective of superannuation

In the Budget, the Government adopted the definition of superannuation proposed by David Murray’s Financial System Inquiry: *“The objective of superannuation is to provide income in retirement to substitute or supplement the Age Pension.”* It was an easy decision but a timid one.

In our submission to the Government’s review of the objective of superannuation we pointed out that the FSI wording defines superannuation just in terms of the Age Pension. Instead, superannuation should be recognised as the mainstay of Australia’s retirement incomes system by providing the means for most Australians to save enough to achieve financial independence in retirement. Then the Age Pension should be seen just as a safety net for those who can’t manage to support themselves in retirement.

Another shortcoming is that the objective does not set any benchmark – such as the concept of a reasonable replacement rate – to measure the performance of superannuation.

What's lacking in the objective now adopted by the Government is any sense of aspiration for superannuation to lift the social and economic well-being of Australians.

Indeed, linking the Age Pension implies a levelling of aspirations. Yet in a developed society, everyone should aspire to and be provided with the means and encouragement to save enough to allow them to retire on a pension that bears a fair and reasonable relationship to their income before retirement.

It is regrettable that the thoughtful submissions made to the Government by SMSF Owners and many others on the objective of superannuation have been ignored and not even acknowledged.

It is also regrettable that the Tax White Paper process – to which SMSF Owners made three substantial submissions – was abandoned by the Government without it presenting any assessment of the Australian taxation system or recommendations as to how it can be made more effective and efficient.

If the Government is serious about consultation, it needs to do more to justify the enormous amount of time and effort that advocacy groups like SMSF Owners put into preparing submissions. It has to show that it is listening and properly considering the views put to it which should, at least, be acknowledged if not adopted.

What's next?

With the Budget presented, the Prime Minister is now expected to call a double dissolution election for 3 July.

The clear difference between the major parties when the Coalition previously ruled out any adverse changes to superannuation has gone.

Both the Coalition and Labor will be imposing a new tax of 15% on superannuation earnings in retirement, the Coalition via its $1.6 million cap on retirement account balances and Labor via its tax on earnings over $75,000.

Both proposals are retrospective in changing the rules under which people have saved for their retirement.

Both proposals will pose practical implementation issues.

Both proposals are an attack on people who have taken responsibility for their own retirement.

Hobson's choice.

Not happy? Let your pollie know

If you are not happy with the Budget changes, let your Government Member/Senator know.

In the run-up to the budget, we continued to project our views to Liberal and National Members and Senators and we'll continue this series of briefing notes through to the election. Here's one we sent to Coalition members in April in the lead-up to the Budget.

SMSF Owners' Alliance

Superannuation tax briefing note for Coalition Senators and Members

#3 - April 2016

This briefing note for Coalition Senators and Members comes from the SMSF Owners' Alliance, an independent, not-for-profit advocate for the one million Australians who are trustees and members of self-managed superannuation funds…the people who have grasped the opportunity to secure their financial independence in retirement and not have to rely on a publicly funded pension. It's the first of a series of briefing notes we'll be sending you between now and the election.

Taxing super more is short-sighted

If, as media reports suggest, the Turnbull Government is going to more heavily tax super in the 3 May budget simply to raise revenue, it will miss an opportunity to bring in real reform of superannuation taxation.

Reports suggest that in the Budget the Government will lower the salary point at which contributions are taxed at 30% (twice the normal rate) from $300,000 to $180,000. This will raise revenue but it will do nothing to make superannuation work better.

There have also been reports the Government will lower the cap for concessional contributions from $30,000 (for those under 50) to $20,000. (Note: in the Budget the threshold for the 30% tax rate on contributions was lowered from $300,000 to $250,000 and the cap on concessional contributions was set at $25,000).

If the Government is serious about reforming super tax, it should look at the proposal first made in Ken Henry's review of the Australian taxation system and supported since by SMSF Owners and others in submissions to the Tax White Paper process.

This is to replace the present equal (for those earning under $300,000) tax concession on super contributions with an equal tax rebate. A rebate would be worth comparatively more to people on lower tax scales. This can be done with a neutral or slightly positive impact on government revenue.

Lowering the cap on contributions to $20,000 – five times less than the Howard/Costello Government allowed – would simply reduce the flow of savings into superannuation and mean more people will call on the Age Pension in the future.

The aim of the superannuation system should be to get **more** money flowing into superannuation, not less, so that over time most people can be financially independent in retirement and the Age Pension becomes what it should be – a safety net for those who can't save enough for good reason.

The last Intergenerational Report noted that 70% of people are reliant on either a full or part Age Pension and this won't change much by 2050. Superannuation should have a much more ambitious goal.

SMSF Owners recognises that the Government is facing a challenge in getting the Budget back under control after Labor's mismanagement, but it would be short-sighted to curtail the opportunity for people to save for their retirement and stay off the taxpayer-funded Age Pension. The only real and lasting solution to over-spending is to spend less.

Why SMSFs are successful

Over one million Australians have made the choice to manage their own retirement savings via an SMSF. We contend that SMSFs are the major competitive force in the superannuation sector, offering an alternative superannuation savings vehicle outside the mainstream industry, retail, corporate and public sector funds.

Indeed, without SMSFs competing with the APRA funds, the inherent conflicts within these funds would be even more pronounced because there would be no viable alternative. So it might be said that SMSFs help to keep the major funds honest.

SMSF owners have a relevant interest in the performance and efficiency of the APRA regulated funds as many of them are members of these public offer funds as well as their own funds. ATO statistics show that in 2014, SMSFs held $26.2 billion in "other managed funds". About one in ten SMSF members also has an account with a mainstream fund with an average balance of $174,000.

SMSFs are the most successful type of superannuation fund in terms of enabling their members to achieve the goal of financial independence in retirement. SMSF account balances are large enough to generate an adequate income in retirement. The ATO's statistics show that at age 65 and continuing into retirement, SMSF members have an average of $1 million in their accounts.

Across the age spectrum, SMSF members have an average of $502,000 in their accounts compared with $146,000 for corporate funds, $97,000 for public sector funds, $39,000 for retail funds and $36,000 for industry funds. Source: APRA Annual Superannuation Bulletin – 2015 (Note: Members may have more than one account)

Self-managed superannuation funds have grown strongly because they answer the desires and concerns of their owners:

- The desire to take control of their own retirement savings strategy and not leave this responsibility to others.
- The desire to maximise the income they can generate from their own assets, rather than to accept an averaged return from pooled funds.
- The desire to ensure they have an income in retirement that supports the standard of living they have earned through their working lives.
- The desire to remain financially independent and not have to rely on the Age Pension and their families.
- The concern to ensure that their retirement savings do not run out before they pass on.
- The concern to keep management and administrative costs as low as possible.

The one defining characteristic of SMSF owners is that they are actively engaged with their retirement savings strategy and management of their assets either directly themselves or with the help of advisers and administrators. They are in the driver's seat.
(Extract from SMSF Owners' submission to the Productivity Commission review of competition and efficiency in superannuation.)

Why we are writing to Coalition Senators and Members?

The one million Australians in self-managed funds are relying on you to safeguard their retirement savings.

They believe the money they have saved to ensure their financial independence in retirement – meeting the fundamental objective of the superannuation system – should not be taken from them to pay for Labor's irresponsible spending in government.

The one million owners of self-managed funds are not the 'fabulously wealthy' portrayed by Labor, left-wing think tanks and others who see superannuation savings as a treasure trove to be envied and emptied.

They are hard-working Australians – farmers, small business people, tradesmen, professionals – in cities and regional areas throughout Australia. They have accepted responsibility to take care of the funding of their own retirement and old age, avoiding dependency on the public pension.

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- **No increase in superannuation taxes**
- **No adverse retrospective tax changes**
- **No limit on super fund balances**
- **No raiding of super savings to plug Labor's Budget black hole**

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Shareholders' Association Conference

A reminder for members that the Australian Shareholders' Association is holding its **2016 Grow Your Portfolio Conference** on **16-17 May at Sheraton on the Park, Sydney**.

The ASA have built an impressive program with high calibre, thought-provoking speakers ensuring you receive the maximum return on your registration investment. The comprehensive program includes the following streams:

1. Buying and selling shares
2. Investor's toolkit

3. Investor's opportunities
4. Investor's alternatives

Registrations are now open for the two day conference with an optional third day on which a number of site visits will be conducted.

Full details and more information about the conference are available on the ASA website: https://www.australianshareholders.com.au/conference-2016

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