1 September 2016

Noel Whittaker

If we can believe the rumours, Federal Cabinet is busy working on ways to make its proposed superannuation policies more palatable. It may be a challenging task: at first glance, the Budget 2016 policies seem inconsistent and lacking in logic.

On 16 February 2016, Treasurer Scott Morrison told the SMSF Association National Conference:

"I have great sympathy with the view put forward by the Murray Review that the main purpose of superannuation is to ensure that people are not reliant on a welfare payment in retirement in part or in whole." He added: "*One of our key drivers when contemplating superannuation reforms is stability and certainty, especially in retirement. That is why I fear taxing superannuation in the retirement phase penalises Australians who have put money into superannuation under the current rules … it may not be technical retrospectivity but it certainly feels that way."*
It would be reasonable to read those words as meaning the Government saw the primary purpose of superannuation as getting people off the age pension, while at the same time avoiding retrospective legislation.

Just 10 weeks later in the 2016 Budget, he announced a cap of $1.6 million per member for tax-free money to be held in pension phase, as well as a $500,000 lifetime cap for non-concessional contributions, with the calculation backdated to 2007. The Treasurer claims he has not gone back on his word, as money in pension phase will remain untaxed, just limited.

The Government's justification of the amounts chosen
The conundrum has been to figure out where these figures came from, so recently I bit the bullet and went direct to the Government for some insight. The rationale for the changes, it was explained, was to produce a fair system, while not advantaging older generations over younger generations.

The thinking in Canberra is that superannuation should be set at an amount that is considerably above the age pension cut-off point but not excessively so. You may have noticed that $1.6 million is slightly less than double the proposed asset test cut-off point of $823,000 which will come into force in January 2017. As the pension asset test will be indexed to CPI, the Government believes that the $1.6 million tax free limit should also be CPI indexed. It will rise in $100,000 increments. Current modelling indicates that the $1.6 million limit may rise to $1.7 million in the financial year ending June 2021.

Note that $1.6 million if invested at retirement, at a rate of earning inflation plus 3%, would pay an income equivalent to four times the single age pension for 25 years. The numbers are realistic, and in line with the Government's stated purpose to stop superannuation being used as a tool for squirrelling away large sums of money in a zero tax area for the benefit of one's beneficiaries. For a couple aged 65, this represents an indexed income of $176,000 a year until age 90 if the fund earns 5% and inflation is 2% (Editor note: based on $3.2 million or $1.6 million for each person in the couple).

Backdating of non-concessional most controversial
The backdating of the $500,000 non-concessional lifetime cap, which is the most controversial of the proposed measures, also makes some sense once the logic behind it is explained. The Government has taken the view that wealthier superannuation contributors have already made after-tax contributions averaging $700,000 per person, which should be adequate to get them to the notional target of $1.6 million. They believe that allowing a lifetime cap of $500,000 for everybody from 1 July 2016 would give an unfair advantage to older wealthy people over the young accumulators.

The super changes may not be welcome to many, but at least now you understand the logic behind them.

More belt-tightening to come
The big difficulty for this Government, and future ones, is that Australia, like most developed nations, has serious ongoing budget problems. The Social Services budget, which has ballooned to $159 billion a year, now represents more than a third of the Commonwealth's total annual budget of $451 billion. The terrifying news is that the Social Services budget is growing at 8% a year while total Commonwealth revenue is growing at less than 3% per annum. Given we still borrow $1 billion every month to pay our way, more cuts to welfare are inevitable.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. *noel@noelwhittaker.com.au*