SMSF Owners' Alliance
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17 November 2016

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600
Dear Mr Fitt

Senate Economics Legislation Committee Inquiry into Superannuation Bills:

- **Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016**
- **Superannuation (Excess transfer Balance Tax) Imposition Bill 2016**

The SMSF Owners' Alliance appreciates the opportunity to make a submission to the Committee on the Bills dealing with the imposition of an excess transfer balance tax and other measures.

We understand that the very tight deadline set for submissions is the result of the Government rushing its changes to superannuation through Parliament.

Such haste is not conducive to careful consideration of a package of very complex legislation which the Explanatory Memorandum (EM) takes 364 pages to explain. There will most likely be significant implementation issues and unforeseen consequences.

Forcing the pace on consultation has characterised the Government's approach to the superannuation changes from its abrupt abandonment of the Taxation White Paper process, to its expedient review of the objective of superannuation and its allowance of only a few working days for submissions on each of the three tranches of draft legislation.

In its role as the house of review, the Senate is to ensure Bills that do not meet legitimate objectives and, in particular, are retroactive or retrospective in their action, do not pass into law.

Our superannuation system has been recognised as an important part of the 3-pillar retirement system. However, improvements could be made to increase its effectiveness, fairness and the number of Australians who would be able to retire independent of the government pension.

The proposed legislation does not meet these objectives. In particular, it increases the complexity of the system, contrary to one of the subsidiary objectives the government is proposing to legislate, and the uncertainty regarding the possibility that future governments will continue "fiddling" with the superannuation rules and "raiding" super funds for tax revenue.

The architect of this legislation does not appear to recognise that increased complexity and uncertainty **reduces** returns from super and therefore the effectiveness of the system. To the extent that tax concessions are intended to encourage Australians to forego consumption and save for retirement, increased complexity and uncertainty means that more tax concessions would be necessary to provide the same level of encouragement.

The Government has attempted to justify the superannuation changes by saying they will adversely affect only a small proportion of account holders. The number affected is no justification for retrospective and discriminatory law.

These changes are aimed squarely at self-managed superannuation funds which are the most successful type of fund. Contrary to some commentary, SMSFs have been subject to exactly the same tax rules as other superannuation funds. However, for the first time this legislation contains elements that are exclusively targeting self-managed superannuation funds.

The evolution of superannuation should be reviewed from time to time and adjustments made in the context of building a national retirement savings strategy that increases the number of people who are enabled to make sufficient savings through their working lives to be financially independent in retirement without the need to rely on taxpayer-funded pensions. This is a responsibility we owe to future generations so they are not saddled with the cost of supporting earlier generations.

Changes to such an economically and socially important system should only be made after careful consideration and extensive consultation. The last such review was the conducted in 2010 (Cooper Super System Review) when the superannuation asset pool was $1 trillion – half of what it is today.

Changes should not be driven by short-term budgetary problems or unproven perceptions of unfairness.

Unfortunately these factors are just what is driving the legislation presented to the Senate.

Recommendation:

The legislation should not be supported by the Senate. Instead, the Senate should send the Government back to the drawing board and insist that a proper, independent review of the superannuation system be carried out with the objective of increasing its effectiveness and fairness and the number of Australians who are able to retire independent of the age pension. Renewal of the truncated Tax White Paper process would be a good start.

Alternatively, if the committee does not wish to reject the legislation outright, we propose below some amendments to the legislation which go some way to reducing its negative impact on Australians' savings.

1. Retrospectivity

It is a general principle of tax law that changes to taxation should not have retrospective effect. The Senate is the guardian of this principle.

The Government backed away from its initial proposal to restrict non-concessional contributions to $500,000 because it was widely regarded, including by Coalition MPs/Senators and the Labor Opposition, as retrospective.

The legislation presented to the Senate is still retrospective in important respects by:

- applying a transfer balance cap retrospectively, requiring people to reverse transfers already made into their superannuation retirement accounts in the past under the rules that applied at the time;
- applying an earnings tax to such retirement savings that were not to be taxed at the time the savings were made and the pensioner's decision to retire was made; and
- requiring some assets in a CGT free pension account to be transferred to an accumulation account where they will again become subject to CGT.

With respect to the proposed transfer balance cap, it was incorrect and misleading for the Treasurer to state in his Second Reading Speech that "the cap only limits the amount that can be transferred into the tax-free environment". A large part of the Bill is devoted to requiring those pensioners who have **already** made such a transfer to unwind it and shift funds that have legitimately been transferred into an untaxed pension account **back** into a taxed accumulation account.

Another deleterious aspect, which has not received much attention, is that the legislation is unfair and discriminatory in that it applies differently to people depending on when they reach the balance cap.

Those who are yet to retire will be allowed to transfer capital up to the then transfer balance cap ($1.6m indexed) into their retirement account, and for this amount plus all future earnings on that money to remain tax-free in that account.

However, some people who have already retired will be forced to transfer back into a taxable account some of the earnings and capital gains that they have made since retirement. For these retirees, the Bill applies the $1.6m cap to **both** the capital they transferred into their retirement account **plus** all the accumulated earnings thereon.

This blatant unfairness and discrimination is sufficient reason for the Senate to exercise its responsibility to uphold equal rights for all Australians and reject the legislation outright.

Alternatively (and a very poor second best), we propose the following amendments which would ameliorate some of the negative impacts of the proposed bills.

Recommendation:

1) The retrospective unwinding of transfers into a retirement account does not apply to such accounts established prior to the Budget of 3 May 2016; and
2) Accumulated earnings and capital gains in a retiree's retirement account are not included in the balance for the purposes of calculating any excess over $1.6m on 1 July 2017.

2. Rationale

In his second reading speech, the Treasurer says the reasons for the superannuation changes are sustainability of the system and to prevent tax minimisation and estate planning. The Treasurer has also stated that they are to help repair the budget.

Sustainability

This is a reference to the often-stated, but wrong, claim that superannuation tax concessions cost the budget over $30 billion each year. This claim is usually based on the Tax Expenditures Statement produced annually by Treasury. This claim lacks credibility. First the figure is mathematically wrong because it adds two components – tax concessions on contributions and concessions on earnings – that can't be added, as Treasury has pointed out. Treasury has also said the TES carries no policy message (and therefore cannot be used to justify policy changes) and acknowledges the TES number would be much lower – around $10 billion – if a different calculation method is used.

Furthermore, the TES number takes no account of the savings in age pension payments in the future as the result of increased self-reliance aided by superannuation tax incentives.

The other often stated claim, repeated in the Explanatory Memorandum, is that higher income earners get an unfair share of the value of superannuation tax concessions. This is not so. At the 15% concessional rate, everybody gets a share of the tax concessions in proportion to the income they receive and the income tax they pay. Above an income of $300,000 (reduced to $250,000 in this legislation) the rate of tax applied to superannuation contributions is doubled to 30%.

The claimed justification for this Bill on the grounds of sustainability is flawed.

Tax minimisation

The Government sets the rules on how much can be contributed to superannuation. If people are able to contribute to the limit set by the Government, which has been substantially lowered in recent years, they should not be regarded as tax dodgers, which is the connotation of the term "tax minimisation." In fact, they are doing what the Government has expressly allowed and encouraged them to do.

The phrase 'tax minimisation' should not be included in the Explanatory Memorandum, which in itself is a legislative instrument, unless it is clearly defined.

Estate planning

At what point does prudent saving for a long retirement become estate planning? And why is estate planning considered anti-social? It is a legitimate desire of Australians to pass on to their families the benefits of the savings they have made. Inter-generational transfer of assets will assist the next generation to be more self-sufficient and less reliant on the taxpayer.

It is in the Government's interest for people to have unused retirement savings when they pass on. The Government collects a 17% tax on superannuation assets left to non-dependents. This 'death duty' is little known as most people have not confronted it yet. It will become more relevant as the baby boomer generation reach the end of their lives.

There is another benefit for the Government if people have unused retirement savings when they die as the Government will have saved on aged care costs in the latter stages of life when these costs are likely to be significant.

Again, the phrase 'estate planning' should not be included in the Explanatory Memorandum unless it is clearly defined.

Revenue raising

The real purpose of the changes to superannuation was acknowledged by the Treasurer when he said: *"above all else, this contributes to getting the budget back into balance".*

The Leader of the Opposition has also stated the purpose of the legislation is to help budget repair.

We question whether winding back the benefits of superannuation and imposing new taxes on savings is an economically sensible response to excessive spending by governments.

Running down the nation's savings base to pay for recurrent government spending is shifting responsibility and cost to future generations and may lead to irrecoverable economic deterioration.

3. Segregation

Without notice, the Government introduced a further change to the superannuation system that was not part of the original Budget announcement and surfaced only in the draft exposure legislation.

This change is that self-managed fund members will not be able to segregate their assets between accounts.

This change specifically targets SMSFs and will not apply to industry, retail and other managed funds.

Until now, self-managed superannuation funds have been subject to exactly the same tax rules as other types of fund.

As a principle we object to this discrimination which has no justification.

Presently, where an SMSF has a taxed account and an untaxed account, the trustee may either segregate assets between them or allocate income proportionately across the accounts. In the latter case an SMSF must also pay an actuary to perform the allocation calculations. This is an additional expense which many SMSF trustees wish to avoid and so prefer to segregate assets.

However, the Treasurer is proposing to prohibit such segregation of assets **just for SMSFs** where there are taxed and untaxed accounts as a result of the new transfer balance cap. This will force some retirees to pay the additional cost of an actuary and thus reduce net returns.

The Treasurer's only justification for this is that *"it is to avoid recycling of assets between the two accounts for the purposes of tax minimisation"*. We support this policy intent but believe he has used a sledgehammer to address the issue and has not taken into account the additional complexity and expense it will lead to and the unfairness in specifically targeting SMSFs on this issue.

Recommendation:

We propose that this new proposal be rejected. If necessary, the Bill could alternatively prohibit any subsequent transfers between the two accounts.

4. Deemed CGT

We commend the Treasurer for introducing the concept of "deemed cost base" which is intended to ensure that capital gains in the taxable account will only be taxed on gains from 1 July 2017.

However, for no explicable reason, this element of the Bill has a 10 year "sunset" clause. This means that if assets are not realised within 10 years, they will be taxed when sold on gains made before 1 July 2017.

10 years is not a long time in the life of a superannuation account. This proposal would encourage more trading of assets in superannuation accounts than would otherwise be the case. This might be good for brokers and advisers but artificially distorts investment returns.

Note: Since preparing and lodging this submission, we have learned that the Government is not proceeding with the 10 year "sunset" clause.

Recommendation:

We propose that the 10 year limit be dropped completely – or extended to a more realistic life expectancy of, say, 25 years.

5. Indexation

Indexation of the $1.6 million transfer balance cap is to CPI in $100,000 increments.

However, indexation of concessional and non-concessional contributions (contained in the same package of legislation) is to wages growth (AWOTE).

Indexation linked to AWOTE is more appropriate as superannuation is an outcome of paid work.

Generally, AWOTE grows faster than CPI so applying the lower indexation factor will mean that, over time, the cap will impact an ever increasing number of retirees.

Recommendation:

Indexation of the transfer balance cap should be to AWOTE.

6. Complexity, compliance and cost

The legislation is complex – for example there are three different versions of the balance cap – and it will be implemented to a very tight time-frame. The effective start date is not 1 July 2017 but now, as superannuation funds and their members will have to take action over the next few months to ensure their superannuation arrangements are compliant by 1 July next year.

The compliance task for fund trustees, members, advisers, managers, lawyers, accountants, auditors and actuaries is formidable. There are practical issues, for example SMSFs often don't know their 30 June financial position until some months in to the new financial year, especially those with more complex asset allocations than cash and shares.

The Government's decision to increase the period for rectifying excess balances in retirement accounts from 60 days to six months is welcome, but given the size of the compliance task the implementation date should be deferred by a year to 1 July 2018.

We are advised by a leading practitioner that for SMSFs that are affected by the legislation the cost of restructuring funds and ongoing administration will be of the order of an additional $3,000 to $4,000 per year. At the outset and over time, this is a significant extra cost for self-managed funds whose owners are careful to keep their running costs low to maximise their returns and preserve their savings for as long as possible.

The regulatory impact statement in the draft legislation describes the cost to superannuation funds as "medium". The Committee should ask Treasury to define "medium" and produce the figuring on which it is based.

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