SMSF Owners' Alliance
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SMSFOA Members' Newsletter
 # 17/2016 8 December 2016

In this newsletter:

- **Superannuation changes waved through Parliament**
- **Superannuation objective lacks ambition**
- **SMSF Owners' chairman lashes Government over super changes**

This is the last of the 17 newsletters we've sent to members in what has been a very busy year. We wish all of our members and supporters best wishes of the season and hope you have an enjoyable break.

Busy time ahead for SMSF owners

SMSF owners face a busy few months.

The main changes to superannuation have been passed by Parliament and now the challenge for SMSF trustees is to review your superannuation arrangements and make sure you are ready to comply with the new regime.

Advisers, accountants and other service providers to SMSFs are getting their heads around how the new rules will work in practice.

To recap briefly:

- On 1 July 2017, you will only be allowed to have $1.6 million in your tax -free retirement pension account. Any excess must either be transferred to an accumulation fund or withdrawn from superannuation. Amounts moved back into the accumulation account will be subject to tax on earnings, with income taxed at 15% and capital gains taxed at 10% (where the asset is held for 12 months or more). This tax rate is applied using a proportionate method which means the earnings from the assets in both your pension and accumulation accounts will be pooled together into a total SMSF earnings figure and then taxed in accordance to the proportion of the SMSF that is in accumulation mode. For example, if you have $1.6 million in your retirement pension account and another $1.6 million in your accumulation account, 50% of the SMSF earnings will be exempt from tax and 50% of the SMSF earnings will be taxed at 15% (or 10% if due to a capital gain on an asset held for more than 12 months).

- If, on 1 July 2017, you have no more than $100,000 above the allowable $1.6 million in your pension account, you will have 6 months to reduce the balance, during that time no penalty interest rate will apply.
    - If you are more than $100,000 over the allowable limit, you'll incur a penalty interest rate that will need to be removed from the pension account along with the excess amount and you will also incur an "excess transfer balance tax" penalty. This will be based on a deemed earnings rate.
    - For breaches in subsequent years, the penalties increase.
- If your $1.6 million balance grows through capital growth and good returns on your investments that value can be retained in your pension account without being taxed.
- You won't be able to segregate (separate) your assets to put high-yielding assets in your untaxed pension account and lower yielding assets in your taxed accumulation account within the same SMSF. This 'no segregation' rule applies specifically to SMSFs.
- The assets you transfer to your accumulation account will again become subject to capital gains tax when they are sold. You will be able to reset the value of your assets to their market value as of 1 July 2017, so prior gains on these assets will not be subject to CGT. Eligibility criteria applies and this will create a locked in tax liability based on the tax rate of the SMSF in 2016-17.
- You don't have to actually sell or buy bulky assets like real property to transfer from your pension account to your accumulation account as this will be a paper exercise by your accountant.
- As of 1 July 2017, you will need to value real property and other assets that don't have a daily market value (e.g. cash/shares).
- There are estate planning implications because surviving spouses must keep within their own $1.6m pension limit. That may require some rethinking of how death benefits are set up, particularly if your SMSF does have to hold 'excess' amounts back in the accumulation account.
- Transition to Retirement Pensions (TRIS) are not capped by the $1.6 million limit but they will lose their tax exempt status, meaning earnings inside a TRIS will be taxed as per an accumulation style account.
- The annual non-concessional contribution limit will be reduced from 1 July 2017 from $180,000 to $100,000. Before 1 July, you can still make a $180,000 contribution for the 2016-17 year.
- The ability to make non-concessional contributions after 1 July 2017 is only available to super fund members with less than $1.6m in total superannuation.

Note: This is a brief summary of the main changes. SMSF Owners' does not give financial advice and we recommend that you should check with your adviser/accountant on how you will need to manage your SMSF to comply with the new rules.

Looking on the bright side, the changes may present an opportunity for you to re-assess your whole superannuation strategy.

SISFA Invitation to SMSF Owners – learn more about the super changes

SMSF Alliance members are invited to attend the December meeting of the Sydney chapter of the Self-managed Independent Superannuation Funds Association. SISFA largely represents SMSF practitioners and also welcomes trustee members.

Date: Wednesday 14 December 2016

Time: 6:00 pm to 7:30 pm

Venue: Level 34, 200 George Street Sydney (the new Ernst & Young building)

The agenda includes a discussion on the operation and effect of the new superannuation laws. Other items covered will be the rules related to non-arm's length borrowing and the payment of life insurance in cases of bankruptcy.

The discussion will be fairly technical but any SMSF Owners member who would like to come along will be welcome and there will be no cost.

Annual General Meeting

At the annual general meeting of the SMSF Owners' Alliance on 16 November, Bruce Foy and David Rohr were re-elected as directors for two year terms.

Super Bills waved through Parliament

The first two Bills in the Government's superannuation package, dealing with the $1.6 million account caps and the penalties for excess balances, passed both Houses of Parliament on 23 November.

There was minimal debate in either House and the legislation was 'waved through' quickly. The only Parliamentarian who stood up for what we believe in was Senator David Leyonhjelm (Liberal Democrats) who said:

"We need more people saving for their retirement so that they do not need the pension. We need to send clear signals that there is nothing wrong with saving and aiming for a prosperous retirement."

His speech was so sensible that we've reproduced it in full at the end of this newsletter.

Well, he would say that, wouldn't he?*

"At the next election there is only one party that is going to be seeking to tax superannuation more and that's the Labor Party." - Scott Morrison, media conference 23 November 2016.

On the day the Government's superannuation changes were passed by the Parliament, the Treasurer was ruling out any further changes by the Government to the taxation of superannuation at the next election…much as he ruled out changes to superannuation before the last election, come to think of it.

The reality is that politicians from both sides can't be trusted to keep their hands off our superannuation. Labor has already committed to further wind back contributions and increase tax should it win government.

*With due credit to Mandy Rice-Davies

Objective of superannuation too timid

The third Bill in the package deals with the purpose of super. The Superannuation (Objective) Bill 2016 states that the purpose of superannuation is to "substitute and supplement" the age pension. It will be debated early next year.

It may seem odd that the legislation defining the purpose of superannuation will be considered by Parliament sometime after the legislation to reduce contributions and increase taxes was passed. However, it reveals the Government's priority on raising revenue, as the Treasurer said: *"Above all this contributes to getting the budget back into balance."* Well, at least he was honest about it.

SMSF Owners has made a submission to the Senate Economics Committee arguing that proposed objective is inadequate and lacks ambition to create an efficient and effective retirement incomes policy. Instead of being regarded as just supporting the age pension, superannuation should be the central pillar of a retirement system that encourages and enables more Australians to be financially self-sufficient in retirement.

Our submission is here:
https://www.smsfoa.org.au/images/Advocacy/161206_SMSF_Owners_submission_to_Senate_Economics_Committee_on_Superannuation_Objective.pdf

SMSF Owners' Chairman lashes Government over super changes

At the recent AGM, Bruce Foy opened up with both barrels on the Government's handling of the superannuation changes in his report to members:

CHAIRMAN'S REVIEW - 2016

We formed the SMSF Owners' Alliance four years ago because we knew that sooner or later governments unable to properly manage their budgets would make a grab for our retirement savings and they would zero in on self-managed funds because we have been so successful. This year, it came to pass.

When we started SMSF Owners' we expected the threat to come from the then Labor Government. We did not expect to be blind-sided by a Coalition Government. We were initially reassured by the election of the Coalition in 2013 on the promise that there would be no unexpected, adverse changes to superannuation. That promise lasted only until the change in Coalition leadership last year. Then Malcolm Turnbull and Scott Morrison made a U-turn. They ditched Tony Abbott's promise not to adversely change superannuation, abandoned Joe Hockey's review of the tax system and introduced new constraints on superannuation that will hit self-managed funds.

In the 2016 Budget and the election that followed it, they made the cynical political judgement that Coalition voters with self-managed funds would have nowhere else to go and would roll over. They were wrong. Their attack on self-managed funds caused deep dismay and anger that has not subsided. We felt betrayed by a party that we thought believed in initiative, hard work and self-reliance. This sense of betrayal was conveyed to Coalition Members and Senators by SMSF Owners and by our members directly.

We don't know to what extent consternation about the superannuation changes affected voting but we all know the Coalition's emphatic win in 2013 was slashed in 2016 to the most slender one vote majority in the House of Representatives. And the minor parties, who were supposed to be wiped out by Turnbull's double dissolution tactic, grew even stronger in the Senate. The Coalition back-benchers who managed to hold on to their seats certainly felt the heat and it wasn't long before the superannuation policy that we were told by the Government was set in stone was substantially altered.

One of the key elements - a life-time cap on non-concessional contributions - was withdrawn. That back-flip did not alleviate our concerns.

Five things are particularly disturbing about the Coalition's superannuation changes.
1. They are retrospective.
2. Proper consultation was abandoned.
3. They invite future governments to keep chiselling away at superannuation
4. They make the superannuation system even more complex in breach of the Government's own proposed objective of simplicity.
5. They specifically attack SMSFs, quietly cheered on by the powerful industry fund lobby.

CLEARLY RETROSPECTIVE

We said on the night of the Budget that the superannuation changes were retrospective. The Government tried to argue, in Treasury speak, they were not. However, they had to back down on one measure that was blatantly retrospective - the $500,000 lifetime cap on non-concessional contributions back-dated nine years. This measure would have disrupted the retirement saving plans of people who wanted to boost their super through the sale of a business or downsizing their home. The Government's political fix took some of the heat out of the issue but is still a backward step for self-managed fund members.

The non-concessional limit was lowered from $180,000 to $100,000 and made subject to an overall $1.6 million cap on tax free superannuation savings. People who were planning to make a significant non-concessional contribution to boost their retirement incomes now have a reduced opportunity. The rules have been changed to their detriment with retrospective effect.

The other major plank of the Government's policy - the $1.6 million cap on the amount that anyone can transfer into their tax free retirement pension account - would not in itself be retrospective. However, rather than just implement such a plan for those retiring in future, the Government is proposing to introduce specific legislation that will force those already retired to unwind transfers that they have already made – possibly many years ago. Retroactive or retrospective legislation is legislation that has an effect on events or processes that have occurred previously. A forced unwinding of an action legitimately taken years ago under existing legislation is clearly retroactive and retrospective.

Such retrospective tax legislation is usually avoided by Governments and we understand that the Senate rarely passes such legislation. It would be good to see the Senate stand up on a matter of principle and not be bamboozled by Treasury and the Treasury Ministers. The only reason of introducing retroactive legislation into the transfer cap idea is to raise funds to fix the budget. Otherwise, if the transfer cap was a good idea, it would be much simpler to just introduce it without the retroactive elements.

The new law will require people in retirement to re-structure their superannuation by splitting it into a tax-free retirement account and an accumulation account on which the earnings are taxable.

Earnings on superannuation savings that were previously tax free in retirement are now to be taxed in retirement. This changes the benefits of superannuation for people who made their retirement decision many years ago or even just six months ago.

The second element of the change is that it applies capital gains tax to the sale of superannuation assets previously acquired and that are not subject to capital gains tax in the retirement phase under the current rules. This point has not been picked up by many commentators.

The Government has introduced a “deemed cost base” as at 30 June 2017 for assets that those already retired will be forced to move back into an accumulation (taxed) account. This is an additional complexity only necessary because of the Government’s efforts to make it retroactive and is a sensible and fair idea which removes an unintended consequence. However, what many have missed is that for no explicable reason, the Government has included a ten year “sunset clause”. Any assets sold after 30 June 2027 will be taxed based upon their original cost base – which could have been many years ago. Its effect, intended or not, is to penalise those Australians who are patient investors and do not wish to sell their shares earlier than necessary. *(Note: This report was made before the Government removed the 10 year sunset clause from the legislation).*

This application of capital gains tax to assets not previously caught was not clearly pointed out by the Government in any policy statement until the release of draft legislation recently. Likewise, there's not been much media attention to the capital gains tax consequences of the Government's changes but over time they will be a significant issue for retired people managing their superannuation assets.

The new capital gains tax consequences are, without doubt, retrospective. It is a long established principle of taxation law that changes to taxes do not apply retrospectively, only prospectively. The principle is that people should not be penalised for doing something that was legal and even, in the case of superannuation, encouraged by successive governments. The present Government has trashed this principle.

INADEQUATE CONSULTATION

Superannuation affects the lives of virtually every Australian throughout their working and retirement years - maybe eight decades - and changes should only be made after careful consideration and consultation.

The policy making process under this Government has fallen well short of genuine consultation. First we had the Taxation White Paper process which was supposed to be a comprehensive analysis of Australia's taxation system, including superannuation. Ken Henry produced such a report in 2010 only to have most of it discarded. At least his report was published. This time, there was not so much as an options paper produced.

On the change of Coalition leadership the Tax White Paper process was abruptly abandoned with no regard for the thoughtful submissions made by SMSF Owners and many others. Then, prior to the May budget, the Government embarked on a hasty and expedient process to justify the changes they planned to make in the budget. They invited submissions on the recommendation in David Murray's Financial System Inquiry that superannuation should "substitute and supplement" the age pension. Again, SMSF Owners and many others made substantive submissions. After all, the purpose of superannuation is a serious subject. However there was no feedback from the Government and the submissions made by SMSF Owners and others have not been published on the Treasury website. We can only conclude that it was an expedient consultation, just to show they had gone through the motions.

The section on superannuation was the weakest part of Murray's report and just followed the Treasury line. It seems Treasury doesn't like self-managed superannuation funds because they reckon the people who use them are going to save anyway and it's not necessary to give them tax concessions. Each year in the Tax Expenditures Statement, copied in the budget papers, Treasury perpetuates the myth that superannuation tax concessions cost the budget over $30 billion and most of the concessions go to the higher paid. We have exposed the official dishonesty inherent in the TES. Apart from their flawed methodology, Treasury never concedes that those on higher incomes pay a greater share of income tax than their share of the superannuation concessions.

Finally, we recently had a deluge of draft legislation in three tranches with just a few days to consider and respond to each tranche. The first tranche dealt with the objective of superannuation which picked up Murray's "substitute and supplement" wording. This is a very limited definition of the purpose of superannuation. Instead of superannuation being the central pillar of Australia's retirement incomes policy, it is seen as just having a supporting role to the age pension. No performance benchmark is set for superannuation. It is a great shame the opportunity to define a more ambitious and clearer goal for superannuation has been missed. This sort of thinking will only ensure that the age pension will remain a significant cost to the budget and the latest Intergenerational Report's prediction that in 40 years the majority of Australians will still be on a public pension will come true. Our generation will be passing that burden on to our children and grandchildren.

SUPER NO LONGER SAFE

A disturbing aspect of Morrison's changes is that they directly link superannuation to the state of the budget. At least he made no secret of his intention saying: "above all else, this contributes to getting the budget back into balance." What Morrison has done is to give himself and every following Treasurer a licence to claw back our retirement savings to make up for over-spending by government. We can be sure the current round of changes won't be the last. The temptation for governments that can’t run a surplus budget, or at least a balanced one, will be to dip into the superannuation lolly jar again and again.

It strikes us as very poor economics to use savings to meet recurrent spending on welfare and other government programs rather than invest them to produce reliable income in retirement.

From when he became Treasurer, Morrison has often stated that superannuation is not for tax minimisation or estate planning. He has included this phrase in each tranche of the draft legislation. This is not appropriate in our view. There is nothing wrong in maximising your savings by taking advantage of concessions to the extent allowed by the law. In fact this is precisely the intent of superannuation. It is wrong to imply that people who do so are tax dodgers. Nor is there anything wrong in maximising your savings so you can have confidence that you will have enough to last through a comfortable and hopefully lengthy retirement. Where is the line to be drawn between prudent saving for an independent retirement and estate planning?

It is to the Government's advantage if you still have some retirement savings intact when you die because then you will not be a burden on the taxpayer in the last, likely high cost phase of your life. And if you leave some to your non-dependants, the Government will tax it. Death duties did not die with Jo Bjelke-Petersen - they live on at the Commonwealth level.

Unless this Government and independent Senators quickly realise that this legislation runs contrary to the very principles of self-reliance and small, efficient and fair Government, we can expect this and future governments to keep chiselling away at superannuation. This is not having an adverse impact just on the current cohort of retirees who have found the rules under which they saved for their retirement have been changed, but for all of those who follow who now know that their enforced superannuation savings are not safe. How can any young person starting a working life be confident the one dollar in ten they are obliged to save, instead of spending it on a home and education for their family, will still be there when they retire in four or more decades from now? The Government's changes have shaken confidence in the superannuation system to the core.

MAKING SUPER SIMPLE? WE DON'T THINK SO

In cancelling the White Paper process the Government passed up a great opportunity to simplify and introduce efficiencies and fairness into the system. Instead we end up with hundreds more pages of legislation which make the system more complex, particularly for SMSF's which manage a third of Australia's $2trillion retirement savings pool.

A TARGETED ATTACK ON SMSFs

So much for Prime Minister Turnbull's statement that one of the core principles of the Coalition's philosophy is that individuals should be provided with the opportunity, means and encouragement to act independently within socially acceptable rules, so that the size of Government and the extent it intrudes into every Australian's life is minimised. On the contrary, this Government has been conned by Treasury, the industry funds and their allies - the left wing think tanks - into an attack on the only sector providing individuals the opportunity to take responsibility for and control over their financial independence in retirement…and actually achieving what Governments say they want people to do. SMSFs provide the only cost effective competition to the industry fund sector which is riddled with the self-interest of the union movement, gives no level of democratic involvement of its beneficiaries (members) in the governance of the funds, has all of the structural inefficiencies of oligopolistic businesses and is high cost on an international comparison.

The government's response to the success of SMSFs in reducing their costs and successfully investing after having obeyed the rules, is to say " you have been too successful so let's take money back" which is exactly what setting an arbitrary (and totally insufficient) cap of $1.6 million on the pension account of people already in the pension phase amounts to. The industry fund lobby applauds anything which will increase the complexity (and cost) of running SMSFs and thus reduce the competition for the super fund pool. In their view all superannuation funds should be within their control. They have seen $600 billion of superannuation savings bleed off into self-managed funds because people want control over how their savings are invested and are sick of paying high, percentage based management fees charged by the major funds.

The industry funds continue to criticise the SMSF sector and its asset allocation (too much cash not enough international assets), its legitimate use of gearing, and even recently even blamed the “housing bubble” on SMSFs. Funny how these inexperienced amateurs have proven just as good at managing their retirement savings as the professional fund managers.

WHERE NOW?

As for SMSF Owners, we must now take stock of what we have achieved, what we have failed to achieve and what we can realistically achieve in the future. The Board has begun the process of reviewing our options for the future and we would be pleased to hear from our members. Before closing, I want to thank all of our members for the support you have given to us and to note with appreciation the efforts of our volunteer Board - Malcolm Clyde, Clive Craven, Duncan Fairweather, Barry McWilliams and David Rohr.

Bruce Foy
Chairman

What Senator Leyonhjelm told Parliament:

Senate Hansard extract – 23 November 2016

Senator LEYONHJELM (New South Wales) (10:22): Taxation is a necessary evil rather than some highly principled act. So, if you think you can arrive at a perfectly designed tax system, you will end up disappointed. That said, there are some rules of thumb that should be followed when designing a tax system. One rule of thumb is that it is better to tax consumption rather than income. For those who want the well-off to pay more tax, taxing consumption does the job just as well as taxing income, if not better, and taxing consumption does less damage than taxing income. If there were no tax, we would choose a mix of spending and saving that was in our best interests. Saving is simply deferred spending. If a consumption tax is imposed, we would pay tax on our immediate spending and then we would pay tax on our savings when we eventually used them to boost our consumption. So the imposition of consumption tax would not change our mix of spending and saving by much.

Income tax is different. Apart from taxing wages, it taxes returns to savings, like interest, dividends and capital gains, and because income tax attacks these returns to savings each year it has a compounding effect. Someone who saves for a long time ends up paying far more tax than someone who saves for a short time or not at all. It is natural then for people to react to income tax by saving less and spending more than they would otherwise in their best interests. As a result, people end up worse off under income tax than they would be under a system that raises the same revenue through consumption tax.

Superannuation is a form of saving: it is putting money away for the day when we are retired and no longer working. It is good that people save for their retirement. If nobody did it, the country would be crippled by the cost of supporting millions of retired Australians. In fact, the more people save for their retirement the less a burden there is on those who are still working. The taxes on those still working can be lower, making it easier for them to save for their retirement.

We recognise this in our superannuation system. Taxes on savings in the superannuation system are lower than taxes on wages. But this differentiation is pretty half-hearted, and, with this bill, it will be even more so. Taxes on superannuation contributions and earnings should be zero. If they must be taxed, they should be taxed as lightly as possible. The right time to tax them is when they are used for consumption. But, over the coming three years, we can expect more than $30 billion of taxes to be extracted from superannuation savings. Some of that will be attributable to the bills before us today. They propose to increase superannuation taxes by more than $5 billion over the coming three years. That represents a tax hike of $70 a year, on average, per Australian.

But, obviously, not everyone will pay them. Even if you think these specific tax hikes will not hurt you, what they indicate is that your superannuation savings are not safe. Eventually, your savings will be attacked because we are governed by big-spending parties that think superannuation is a resource to be plundered. These bills impose a $1.6 million cap on the amount that can be transferred to the retirement phase of superannuation, where earnings are tax-free. This means that earnings on amounts over $1.6 million will now be taxed at 15 per cent even after retirement. Getting to $1.6 million will be made a great deal harder. The bills impose marginal tax rates on annual superannuation contributions in excess of $25,000. They also increase the tax rate on a person's annual contributions up to $25,000 if the person's annual income exceeds $250,000. The bills limit annual contributions to superannuation to $100,000 so that earnings on amounts in excess of $100,000 are taxed at marginal tax rates outside of the superannuation system rather than at 15 per cent inside the superannuation system. The bills also remove an income tax deduction that is currently available to superannuation funds when they pay lump sums because of the death of a member. I oppose all these changes because they lift the taxation of superannuation savings towards our excessively high taxation of wages. I also oppose them because they will inevitably lead to more Australians relying on the pension in their retirement.

With the disincentives, building up your superannuation will be harder and saving more than $1.6 million will not be attractive. Instead, there will be increased spending, leaving more people eligible for the pension as they run down their savings. The opposite should occur. We need more people saving for their retirement so that they do not need the pension. We need to send clear signals that there is nothing wrong with saving and aiming for a prosperous retirement. In public policy terms, fewer people on the pension means reduced government expenditure and a greater chance of balancing the budget—and, of course, more funds available for helping the genuinely poor.

But, amidst all this terrible treatment of Australian savers, I will finish my contribution on a high note. Some proposed changes in these bills will slightly offset the tax hikes. One such change is close to my heart because my lobbying made it happen. It is a rule change to allow people to deduct personal contributions to superannuation, even if their wage income exceeds 10 per cent of their income. This change is estimated to save hardworking Australians $850 million over the coming three years. It is the first tax cut the Liberal Democrats can claim some ownership of, and I am proud of it. I applaud this tax cut and the other small tax cuts in these bills, but I condemn the tax hikes. We need any taxes on superannuation to be far less than our excessive taxes on wages so that fewer of us end up dependent on taxpayer funded pensions when we retire. The major parties should keep their grubby paws off our savings.