POSITION PAPER ON SELF FUNDED RETIREES: DR JOHN DOUGLAS MALTAS

INTRODUCTION

1. I wish to submit my paper as a part of the Government's discussion paper *Better Regulation and governance, enhanced transparency and improved competition in superannuation.* I am a self-funded retiree who operates a Self Managed Super Fund (SMSF) which pays my wife and myself a pension. This paper seeks to highlight the difficulties encountered in doing this. Conceding that the technicalities of running an SMSF are beyond my knowledge, I employ the services of an accountant to deal with such matters, for example, preparing an annual tax return. I handle the administration and investment strategies. In this regard I have a story to tell making appropriate comments where necessary. I have also attached a letter (marked Annexure A and attached on pages 6-7 of the Paper) from Senator the Hon. Arthur Sinodinos AO, the Assistant Treasurer, written to Dr Dennis Jensen MP in reply to points raised on the matter of SMSFs. I have also taken the opportunity to respond to certain points raised in Annexure A.

2. I am a retired academic who decided to set up my own SMSF in March 1998. I was determined to provide a pension for my wife and myself without recourse to a Commonwealth Old Age Pension. This Position Paper is written to highlight major inconsistencies in the method of administering SMSFs as I understand them. I do not profess to understand the plethora of regulations that govern SMSFs but I would have thought that the original intention would have been to encourage an ageing workforce to save for their old age. I am told that SMSFs are operated by approximately 100 000 retirees worth some $5billion (assuming there is an average of $500 000 invested per retiree). Many employ specialist bodies to manage their SMSFs for management fees which can be quite exorbitant. Annexure A quotes average audit fees as approximately $546 which is clearly out of date. My experience shows that audit fees are closer to $800 and when added to accountants' fees can top $2000.

3. The concept of SMSFs was first mooted in 1994 with legislation being promulgated in Federal Parliament in 1995. The thrust was to avoid undue pressure being placed on the country in funding old age pensions brought about by a rapidly ageing population. The concept was sensible given that Australia had a deplorable savings record in relation to other countries, particularly those in Asia. Annexure A states that it is an important part of Government's retirement income policy to ensure that all members of the community have an adequate level of income in retirement.

SO WHAT WENT WRONG

4. I believe the initial drafting of the regulations was cumbersome and introduced a number of measures that sought to undermine the original concept. Whilst Annexure A concedes that SMSFs in relation to other superannuation are subject to a reduced level of regulation under the superannuation laws, there is no recognition that SMSFs are by and large small operations providing a pension for a husband and wife. Whilst Annexure A states that Government is committed to reducing "red tape" by cutting excessive regulation, other comments in Annexure A do not address the fundamental

issues involving SMSFs having more freedom to increase the capital base of their funds without age restrictions and the need for a work test.

5. The Superannuation Industry (Supervision) Regulations 1994 – Schedule 7 (Schedule 7 Regulations) deal with the minimum payment amount for a superannuation income stream. There is a series of calculations which determine what an SMSF must pay to its superannuant. In other words the power to determine how much superannuants, as beneficiaries need and how they manage their SMSFs, is not left to their judgment but is governed by the Schedule 7 Regulations. The level of minimum payments is age related and requires a payout at a designated percentage set by the Schedule 7 Regulations. In addition, beneficiaries over the age of 75 years are not allowed to contribute any further funds into their SMSFs unless they meet the requirements of a work test formula. Annexure A mentions that the age limits, together with a work test, prescribing when personal superannuation contributions can be accepted by a superannuation fund are long standing rules of the superannuation arrangements that date back to 1994. These rules are meant to strike a balance between providing an incentive to save for retirement during working life and ensuring that superannuation is actually used to provide retirement income. First of all I believe that there is a need to revisit the age test and work test formula. Secondly, it is my opinion that the age test is taken from socialist dogma that decrees that SMSFs should not be left to the deceased's family by way of an inheritance. Should the superannuant seek to invest the surplus from an enforced pension drawdown he/she will be taxed on the income derived from that investment. With this in mind, the SMSFs rules need to be redrafted to prevent this from occurring and by so doing preventing the very people who need a secure income by way of a pension without being punished with the capital fund being diminished by both the work test formula and age test formula. I think it has to be borne in mind that capital fund of a SMSF also represent funds that might be required to meet certain emergencies associated with old age such as medical expenses, relocation to an aged care facility, etc. It therefore makes no sense to diminish the funds with the aged test formula and to specifically prohibit increases to the SMSF when possible whatever the age of the superannuant. The 1994 rule needs a radical overhaul.

6. To illustrate this more clearly the following table sets out the Age of the Beneficiary and the Percentage factors involved as follows:

Item	Age of Beneficiary	Percentage Factor
(a)	Under 65	4
(b)	65 – 74	5
(c)	75 – 79	6
(d)	80 – 84	7
(e)	85 – 89	9
(f)	90 – 94	11
(g)	95 or more	14

What this table illustrates is that SMSFs must pay to beneficiaries a sum equivalent to the designated percentage of the total SMSF fund dependent upon their age. Another anomaly is the fact that the total fund might include assets that are not revenue

producing. I would like to illustrate how ludicrous the present system is with the following example:

Details of SMSF	$
Cash investment @ 3.7%	1 100 000
Land held as an investment	450 000
Shares	50 000
Total assets in the SMSF	1 500 000

Let us say that the beneficiary is 79 years old. The cash investment is held in a bank term deposit. The land was purchased ten years ago as a hedge against inflation. The shares yield a dividend income of $6 000 pa. As the regulations stand the beneficiary must take a pension of $90 000 ($1 500 000 x 6%). Instead the actual income of the beneficiary would be $43 000 which according to Schedule 7 Regulations would require to be topped up by $47 000 out of capital. The beneficiary is left with three choices. He/she can sell the shares or the land or reduce the amount invested in the term deposit. It would be possible to reinvest the $47 000 but because the beneficiary is over the age of 75 years it cannot be credited back into the SMSF. I believe this is a cynical ploy to force aged pensioners to become taxpayers again after lifetime of paying tax and to prevent the funds being left to the beneficiaries of a Will. Another aspect to be considered is the steadily increasing percentage factor related to age. It is not rocket science to see that as a superannuant ages the capital value of his/her fund will reduce dramatically perhaps to a position where they have to rely on the State for support. This system hardly leaves the aged with any reserves in a time of emergency.

7. There are also complex audit arrangements which require SMSFs to undergo onerous audits to meet the complexities of the Schedule 7 Regulations so that they can be declared complying funds for tax purposes. The costs of such audits are out of all proportion to the size of the funds, especially when added to the costs of accountancy advice in the preparation of a tax return. I know of one SMSF with a capital value of $500 000 being charged audit and accountancy fees of $2000 when the fund was yielding a monthly income of $1600. This reinforces my view that a basically sound scheme to encourage saving for retirement has been totally nullified by regulations that have detracted from the original concept of setting up viable SMSFs.

8 The advent of the GFC which enveloped the World economy in 2008/9 left many SMSFs with depleted revenues because of the collapse of interest rates in term deposits and the fall in the capital value of shares. Many attempted to claim part pensions from Centrelink to relieve their drop in earnings only to find that the capital value of their SMSFs exceeded the designated limits set for part-pensions. A better system would surely be to base a part-pension on the earnings of an SMSF.

WHAT QUESTIONS SHOULD WE BE ASKING OURSELVES

9 I do not believe there is one SMSF that has not been adversely affected by the GFC. Most SMSFs were enjoying returns of between 7 – 8% which gave most a comfortable living. Today I doubt that many would be receiving returns of more than 3.7 – 4% which means that most retirees have taken a drop in income of approximately 100%.

Following the GFC the Rudd government reduced the percentages to accommodate the drop in bank term deposit rates. The Gillard government lifted them again in the 2012/13 financial year once again seriously impacting on large numbers of aged beneficiaries managing their own SMSFs. At the time the then Labor Treasurer, Wayne Swan, referred to SMSFs as the haven of millionaires escaping the tax system. I believe, however, there was a move to destroy SMSFs as those who chose to manage their own superannuation could not be controlled by government. I pondered the question why he would do this given that SMFSs reduce the numbers of retirees claiming old age pensions. If you extend this further it is evident that old age pensioners are more likely to vote for the party that promises to increase their old age pensions. Difficult to prove I grant you, but how can the imposition of so many regulations on what is purported to be SMSFs be explained. On the other hand, Annexure A makes reference to the need for minimum payment rules to prevent SMSFs being used as a tax-free wealth accumulation vehicle, rather than for their intended purpose as a vehicle to provide income in retirement. I am aware that certain unscrupulous persons would seek to circumvent their tax obligation in this manner. I believe that the solution could be solved simply by putting a cap on the capital of SMSFs of say $5 million. It seems wrong to me that the bulk of properly operated SMSFs should be disadvantaged by a few unscrupulous persons seeking to evade their tax obligations.

10 I cannot understand why there is a system in place, SMSFs, specifically created to encourage retiring workers to provide for their retirement, which is burdened with cumbersome regulations, as outlined above, which does the opposite, that is to become dependent on the state pension. Furthermore, I cannot understand why persons rolling over funds from industry funds can elect to be paid in cash. This means such funds can be spent on a variety of items e.g. a boat, caravan, car, etc., defeating the object of providing an income in old age. Surely the Abbott government should be asking itself how it can lessen the effect of an ageing population on the coffers of the State. The current SMSF regulatory regime is in need of urgent overhaul if SMSFs are to achieve their objective which is self-reliance of the aged. The positive effect on the budget bottom line is obvious.

11 Incidentally, I wonder if the Schedule 7 Regulations do not also contravene the *Age Discrimination Act 2004* (Cth) by differentiating between various age groups and disadvantaging older superannuants. The Act specifically provides that the treatment of some persons less favourably than others on the basis of age, constitutes discrimination. I believe that discrimination occurs in two ways. Firstly, the percentage factor increases as superannuants age. Secondly, and possible more damaging, once superannuants reach the age of 75 years they are no longer permitted to invest funds in their SMSFs. This is further reason to completely overhaul the current SMSF regulatory regime.

QUO VADIS SMSFs

12 There is no doubt that the demographic shift in the age of Australia's population will see very many more workers retiring over the next decade. The question that needs to be asked is whether the country can afford to sustain the cost of aged pensions to many more people which will be the inevitable result.

13 In my view the best option would be to encourage people in the workforce to save for their own retirement. In order to facilitate this there will need to be a radical overhaul of the SMSF legislation to make it attractive for potential retirees bearing in mind that it has not changed much since its inception in 1994. I would like to make a few points for consideration when a full review of the current system is undertaken. To begin with I believe paragraphs (a) and (b) below could be implemented immediately and would have the advantage of providing immediate relief to many thousands of superannuants currently governed under the provisions of the Schedule 7 Regulations. The suggested changes are:

(a) The immediate repeal of the table mentioned in paragraph 6 above so that there are no longer any requirements to pay beneficiaries a pension based on the total value of the SMSF;

(b) The immediate repeal of all other regulations seen as a hindrance to the operation of viable SMSFs including the prohibition placed on beneficiaries over the age of 75 years being able to make contributions to their funds;

(c) The development of a simple annual return which can be audited and lodged with the ATO to preserve the fund as a non-taxable entity;

(d) The development of a low-cost fee structure payable to the managers of SMSFs where superannuants choose to, or cannot manage, their own SMSFs;

(e) To cap the total capital contributions to SMSFs at $5 million;

(f) To set audit fees at a realistic level in line with (c) above to keep costs down; and

(g) To set minimum income levels for SMSFs to enable beneficiaries to claim part pensions from Centrelink without the value of fund being the determinant of whether there is a part-pension entitlement.

14 I firmly believe that the concept of SMSFs is right for Australia in that it could encourage all workers to save for their retirement. If managed properly without undue regulation it should help to alleviate the crisis of an ageing population claiming the old age pension. The Abbott government should make this a priority in their review of superannuation funds.

15 Finally, I am prepared to elaborate further on my paper and take part in any discussions should the need arise.

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ARDROSS WA 6153

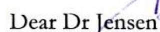
6 February 2014

ANNEXURE “A”

Assistant Treasurer

Dr Dennis Jensen MP
Member for Tangney
PO Box 329
WILLETTON WA 6955

02 DEC 2013



Dear Dr Jensen

Thank you for your personal representations of 17 October 2013 on behalf of Dr John Maltas, 12 Polglass Way, Ardross, WA 6153, concerning self managed superannuation funds (SMSF).

An important part of the Government's retirement income policy is to ensure that all members of the community have an adequate level of income in retirement. Substantial taxation concessions are provided for superannuation savings in order to encourage individuals to save for their retirement and to boost compulsory retirement savings made under the Superannuation Guarantee.

The Government recognises that SMSFs are an integral part of the superannuation system and the Australian economy. The Government is committed to ensuring that SMSFs remain available to people who want to manage their own superannuation and, more generally, it is committed to reducing "red tape" by cutting excessive regulation. Compared to other superannuation funds, SMSFs are subject to a reduced level of regulation under the superannuation laws on the basis that members are in a position to protect their own interests. However, operating an SMSF will necessarily involve some level of administration and compliance costs.

SMSF trustees are required to appoint an approved auditor to audit the operations of the fund for each year or part of the year the fund is in existence. The auditor is required to assess the fund's overall compliance with the law and the accuracy of its financial statements.

The annual audit provides assurance to the Government and the general public that SMSFs are being managed appropriately. Audit fees are subject to a private contractual arrangement between the auditor and the client. The cost of an SMSF audit will depend on many factors such as the size of the fund and the value and type of investments held by the fund. In an Australian Taxation Office publication titled *SMSFs A Statistical Overview 2010-11*, the average audit fee for auditors is $546.

Dr Maltas is also concerned that individuals age over 75 years cannot contribute to a superannuation fund and those below age of 75 years can only contribute up to $25,000 per annum. The age limits, together with a work test, prescribing when personal superannuation contributions can be accepted by a superannuation fund are longstanding rules of the superannuation arrangements that date back to 1994. These rules attempt to strike a balance between providing an incentive to save for retirement during working life and ensuring that superannuation is actually used to provide retirement income.

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As Dr Maltas is aware, the current general concessional contributions cap is $25,000. This cap is expected to increase through indexation to $30,000 on 1 July 2014. A temporary higher concessional contributions cap of $35,000 applies for individuals aged 60 years and over from 1 July 2013, and for individuals aged 50 years and over from 1 July 2014. The Government has committed to revisit the level of the concessional contribution caps once the Budget is back in a strong surplus. I also note that individuals under the age of 75 years can currently make after-tax superannuation contributions of up to $150,000 per year.

Dr Maltas also raises the issue of the minimum payment amounts for account-based pensions. The requirement that an account-based pension pay a minimum amount of income each year is a fundamental feature of the regulatory framework for superannuation pensions. This requirement needs to be seen in the context of the substantial tax concessions which are afforded to pensions, in particular, the fact that income derived from assets supporting pensions is entirely exempt from tax at the fund level.

In return for this concessional tax treatment, the Government believes that superannuation pensions should be used for genuine retirement income purposes. Without minimum payment rules, these products could be used as a tax-free wealth accumulation vehicle, rather than for their intended purpose as a vehicle to provide income in retirement.

The Government will review the minimum payment amounts to assess their adequacy and appropriateness in light of current financial market conditions.

Finally, you may wish to assure Dr Maltas that the Government understands the importance of stability and certainty in superannuation. Superannuation is by its nature a long term investment, and it is important that people have sufficient confidence in the system to trust their savings to it for significant periods of time. Unexpected changes to superannuation can undermine confidence in the system and are particularly unfair on older Australians who have made long-term plans on the basis of existing arrangements. That is why the Government has given a commitment that there will be no more negative, unexpected changes to the superannuation system.

I trust this information will be of assistance to Dr Maltas.

Yours sincerely

Senator the Hon Arthur Sinodinos AO