SMSF Owners' Alliance
Limited ABN 96 161 052 464
Not-for-profit public company

Charter Group
The Treasury
Langton Crescent
PARKES ACT 2600

supercharter@treasury.gov.au

SMSFOA Response to Discussion Paper on the Proposed Charter of Superannuation Adequacy and Council of Superannuation Custodians

The SMSF Owners' Alliance speaks directly for trustees and beneficiaries of self-managed superannuation funds. Members must be trustees or beneficiaries of an SMSF.

SMSFOA welcomes the opportunity to comment on the Government's proposed Charter of Superannuation Adequacy and Council of Superannuation Custodians.

Some of the issues raised in the Discussion Paper have been canvassed by SMSFOA in our Pre-Budget Submission lodged in January 2013 (Attachment A) and in our March 2013 Research Paper "Superannuation in Crisis" (Attachment B).

1. Main Points

SMSFO welcomes recognition in the Discussion Paper that superannuation is a key factor in the economic and social welfare of Australia and makes the following points:

- Changes to superannuation, e.g. contributions and taxation, should be subject to consultation in advance and should not be retrospective in their effect.
- Superannuation should be 'ring fenced' in the Budget and it should not be used by governments as an easy source of revenue when they run up a deficit.
- At current contribution levels, superannuation savings will not be adequate to allow most Australians to be financially independent throughout their retirement – contribution caps need to be doubled.
- The proposed Charter is well intentioned and it should be incorporated in legislation similar to the Reserve Bank Act which sets out the RBA's economic and social function.
- The proposed Council will be ineffective unless it is given real power to shape superannuation policy. Without independence, its cost can not be justified particularly if the cost is recovered from superannuation funds, reducing the value of members' savings.

2. Overview

Superannuation is fundamentally important to the economic and social well-being of the nation, individual Australians and their families. As such, it is appropriate to review periodically whether the superannuation system is meeting its objectives.

Research undertaken for SMSFOA shows that the system is clearly not meeting its objectives in that, under current contribution limits, Australians will not be able to save enough in superannuation to be able to maintain financial independence throughout their retirement. This shortcoming is revealed in our March 2013 Research Paper *"Superannuation in Crisis"* based on the *Pension Sustainability Model** referred to in this submission. The most practical measure the Government can take to improve sustainability is to increase contribution limits.

Our research also demonstrates that an incentive in the form of a lower rate of taxation on income dedicated to superannuation pays dividends to the budget in the long term through lower Age Pension costs.

There is value in developing a Charter of Superannuation Adequacy and Sustainability to set high level objectives for the superannuation system. These objectives should recognise that superannuation is a long-term investment requiring policy stability to engender confidence. To be meaningful, the Charter should have bipartisan support and be embedded in an Act of Parliament. The Reserve Bank Act is a relevant model in terms of setting objectives for the public good.

Peoples' superannuation savings, once made in accordance with the rules, should be untouchable, particularly with regard to tax changes which have retrospective effect. Improvements to the system may need to be made from time to time. Such changes must be considered carefully and introduced without haste and without adverse retrospective effect.

The taxation of superannuation should not be driven by short-term budgetary needs. Ideally, the taxation of superannuation should be ring-fenced in the Budget so it is not caught up in short term fiscal fluctuations. Governments would need to accept that they could not change the taxation arrangements for superannuation to raise revenue whenever there is a shortfall and they would have to exercise more discipline over spending on non-superannuation items in the Budget.

While taxation is, understandably, a key focus of policy discussion on superannuation, there are other important principles that need also to be respected.

One is that the trustees of superannuation funds, both for large pooled funds and for self-managed funds, have a foremost duty to act in the best interests of fund members and make investment decisions accordingly. So they should not be forced into directed investments such as corporate or government debt and infrastructure bonds. If the superannuation pool is to be tapped to help finance public projects, then incentives should be provided to encourage investment.

**Pension Sustainability Model* prepared for SMSFOA by Malcolm Clyde, Harlestone Pty Ltd.

Another important principle is certainty about withdrawal rules. People should be able to make important decisions, such as the age they choose to retire, in the expectation that the withdrawal rules will not be changed to their detriment once in retirement. Where changes in this area are necessary, they should not have retrospective effect, as the proposed 15% tax on some fund earnings does.

This is not to say that there should be no further change in trustee responsibilities or that investment options should be unlimited. Where practices develop that run counter to the objectives of superannuation, they need to be addressed – for example the tightening of rules on collectables. The more recent promotion of geared property investment using an SMSF is an area of mounting concern and should be addressed by restricting the giving of advice on such investments to qualified financial advisers and by warning people of the risk inherent in this type of investment, particularly when a geared property is the fund's only asset.

Superannuation policy settings should be aimed at ensuring that the majority of Australians can save enough through their working lives to retire on a reasonable replacement rate – generally accepted to be 70% of their pre-retirement earnings – that will ensure financial independence throughout retirement. The present arrangements are falling well short of that objective.

Role and cost of proposed Council

We are not convinced that the best oversight of the superannuation system is a standing Council of Superannuation Custodians which has only an advisory role. As the Discussion Paper makes clear, the proposed Council would have no real powers. It would not replace the Treasury as having primary responsibility for advising Government on superannuation taxation, regulation and prudential policy. It would not have power over regulatory or prudential settings, which will remain the responsibility of APRA, ASIC and the ATO. It will not supplant existing sources of advice to the Government via the Superannuation Roundtable, the SuperStream Advisory Council and CAMAC.

If a Council is established, it should have proper powers under legislation and scope to make decisions on the evolution of the superannuation system. Again, the Reserve Bank Act is a relevant model. Governments will need to accept they should limit their own taxing powers given that much of superannuation policy is concerned with taxation.

The Council will require an attendant bureaucracy – probably staffed by Treasury and other public service departments – at a cost to the Budget at a time when the Government should be reducing outlays rather than increasing its spending. If it is intended that the cost of maintaining the Council should be borne by superannuation funds under the Government's cost recovery approach, then SMSFOA would strongly oppose the formation of the Council on the basis that it would not provide value to justify the expense to SMSFs.

Supervisory costs are a significant issue. SMSFs already pay an ATO supervisory levy that is about to be increased by 50% and will cost this sector $513 million in total over five years. In other words, the SMSF savings base will be reduced by half a billion dollars just from this measure. SMSFs with corporate trustees also pay an annual ASIC registration fee amounting to $236 which imposes a significant collective cost.

Policy review

We agree it is desirable from time to time to review the purpose, structure and performance of the superannuation system to assess whether it is meeting its objective of making most people self-sufficient in retirement and reducing demand on publicly funded pensions. In particular, the benefits and practicality of moving over time from the current tax-tax-(partially) exempt (TTE) structure to an exempt-exempt-tax (EET) structure should be considered. A reversal of the current tax structure would remove the cost of up-front and ongoing taxation and allow funds to grow their assets faster while installing an automatic dampener on withdrawals. While this would involve major re-engineering of the superannuation system, it could be achieved over time, respecting the principle that people who have saved under the existing rules should not be disadvantaged by any prospective change to the rules.

Periodic review doesn't require the setting up of a permanent Council. The model of conducting independent reviews or inquiries headed by an eminent authority (e.g. Wallis, Henry, Cooper) has worked well in Australia. It would be useful for the Government to undertake a cost-benefit analysis comparing periodic, independent reviews with creating an on-going bureaucracy.

Having announced the Council in conceptual terms, the Government is now seeking comment on what it should do. This does not suggest there is an obvious and compelling role for it. While we are sceptical of the need for a Council, unless it is given real policy-making powers, we have responded below to the questions in the Discussion Paper about how it might work.

3. Responses to the Discussion Paper

<u>Core Principles Underpinning the Charter</u>

Question 1: What is your view of the core principles outlined above?

We agree with the principles of certainty, adequacy, fairness and sustainability listed in the Discussion Paper, noting that 'fairness' is a subjective term. Fairness in our view means that all superannuation savers are treated equally and some are not singled out for special treatment, e.g. higher taxation, because they are successful. People who are more diligent than others in sacrificing current spending for future saving should not be penalised with higher tax on their superannuation earnings. They have made contributions in accordance with the rules, often including significant non-concessional contributions on which income tax has already been paid at their marginal rate.

It is also fair that superannuation accounts should not be taxed differentially according to the value of the assets held in the fund or the earnings generated by the assets.

In our view, there is no case in logic or equity to argue that someone is getting a higher tax 'subsidy' by way of a deduction (a concessionally taxed contribution) just because they pay a higher marginal tax rate. If this logic was accepted, then the 'subsidy' given to those on lower tax rates should also be regarded as a tax expense.

Question 2: Are they any additional principles that are important in setting retirement income policy?

Yes.

- The outcome of superannuation policy should be for most people to achieve a retirement income at an adequate ‘replacement rate’, generally accepted to be around 70% of their pre-retirement earnings, as acknowledged in the Discussion Paper. The replacement rate objective should be the same for all people, regardless of their level of income. It is not for the Government to determine what income and quality of life people may enjoy in their retirement.
- Consistent with the principle of certainty, and to inspire confidence in the system, changes to the superannuation rules, and particularly taxation, should be measured, fully justified and applied without retrospective effect. When changes are made, existing arrangements, under which people have made important choices and decisions on saving, must be grandfathered. This is particularly important from around the age of 45-50 when people are more seriously considering the adequacy of their retirement savings and stepping up their savings effort.

Certainty

We strongly agree with the points made in the Discussion Paper under this heading. Superannuation is an investment over the term of people’s working lives and retirement – spanning up to 60 years or more. It is necessary, to secure an adequate retirement income, for people to make voluntary contributions above the mandatory SG rate. To encourage people to voluntarily maximise their superannuation savings, they need to have a strong degree of certainty that the rules under which they invest – in particular the taxation of their fund earnings and pensions withdrawn – will not be changed arbitrarily.

The Government’s announcement on 5 April 2013 that earnings from some superannuation accounts will be taxed at 15% breached this principle. It was, in effect, retrospective because it will reduce the value of savings already made and it created uncertainty and undermined confidence. Significant practical issues, such as how the identification and aggregation of earnings from multiple accounts is to be managed efficiently, present an administrative challenge which may be costly to resolve.

Question 3: What safeguards can be placed on changes in the superannuation system to promote certainty?

It is necessary for political parties to recognise and accept that superannuation, as a long-term national savings vehicle, should transcend the budgetary and electoral cycles. Governments must resist the urge to regard the pool of superannuation savings as a reservoir of money that can be tapped to top up revenue when they allow the budget to fall into deficit.

Ideally, superannuation and the taxation of it should be ring-fenced within the budget. Superannuation should be a fiscal ‘no go zone’.

The proposed Charter could be a useful discipline on government, but to be effective it will need clearly expressed bipartisan support and be backed by the authority of Parliament so that governments can only act contrary to the Charter if they have the approval of Parliament.

Incorporating the Charter in the Superannuation Industry (Supervision) Act or in new legislation dedicated to this purpose will provide a measure of Parliamentary authority.

Question 4: How should the Charter reflect procedural fairness, including providing adequate notice of future changes and an open and transparent consultation process?

First, the practice of governments making changes to superannuation and the taxation of it in the budget without prior consultation should cease. Superannuation fund members should not hear on budget night of changes that will affect the value of their lifetime savings.

Second, whenever government changes to superannuation are contemplated, a transparent consultation process should be followed giving ample opportunity and time for everyone with superannuation, that is most Australians, to express their views either individually or through a representative body.

We note that the Government announcement of 5 April 2013 proposing the Charter and Council included the imposition of a new 15% tax on some superannuation fund earnings, and other measures, that were not offered for consultation in advance.

<u>Adequacy</u>

Question 5: What would be appropriate benchmarks for measuring the adequacy of the superannuation system?

The Discussion Paper suggests a 'replacement rate' target of 70% of pre-retirement income and we believe this to be about right. It is broadly consistent with the findings of Henry's *Australia's Future Tax System* and in line with the World Bank's view of an appropriate replacement rate for developed economies. However, a 70% target is simply not achievable by most workers under current superannuation arrangements, as the Henry review recognised.

SMSFOA's Research Paper "Superannuation in Crisis" illustrated that present superannuation policy settings will not deliver the objective of providing a reasonable level of income during their retirement.

The Paper, based on a Pension Sustainability Model developed for SMSFOA, shows that people earning average or even twice average incomes will not save enough at the SG rate to support themselves throughout retirement and remain independent of the Aged Pension. This echoes the observation in Henry's report that even after 35 years of saving at the SG rate, a person will still have to rely on a part Age Pension in retirement.

Our model shows, for example, a 30 year old on average weekly earnings (AWOTE) will need $2.27 million in super savings to retire on a reasonable replacement rate (70% of pre-retirement income), but saving at the SG rate, he or she will have built savings of only $1.3 million.

A 50 year old on average income is in a worse position. Needing $1.04 million at retirement, he or she will have saved only $0.48 million.

These savings will not be enough to allow people to remain self-sufficient throughout a retirement starting at 65. For example, the 30 year old saving at the SG rate will be independent of the Age Pension only for the first 11 years of an estimated 23 year retirement. The 50 year old will be independent for only 8 years.

It is clear that people should be encouraged, by way of higher contribution limits and tax incentives, to save at a much higher rate than the SG levy, especially in the latter stages of their working lives.

The Government recognised this imperative in its 5 April statement and subsequently in the 2012-13 Budget by partially restoring the contribution limit from $25,000 to $35,000 for over 50s. However this measure fell short of the $50,000 voluntary cap promised to over 50s in the 2010 Budget but not delivered. Further, it is not indexed and so will only be an additional benefit to older workers for a limited period.

Our Pension Sustainability Model shows that even if over 50s save at the new voluntary cap of $35,000, they will not have enough saved to sustain themselves throughout their retirement.

Significantly higher contributions caps will be necessary if people are to be able to save enough, with the benefit of a tax incentive, to ensure financial independence in retirement.

In our pre-Budget submission, SMSFOA recommended that the contribution cap for under 50s be restored to $50,000 and for over 50s to $100,000.

We note that Henry suggested that contribution limits be doubled for over 50s and that tax on fund earnings, capital gains and retirement income streams should be set at 7.5%.

A more detailed analysis is contained in our "Superannuation in Crisis" Research Paper at Attachment B.

Fairness

Question 6: What principles would support fairness in the distribution of government assistance in the retirement income system and how should they be incorporated into the Charter?

Fairness is best achieved by treating everyone equally. The same superannuation rules should apply to everyone regardless of whether they are in a pooled fund or manage their own fund; everyone should pay the same rates of taxation on their superannuation contributions and on their fund earnings.

The retirement income system should not be about redistribution of income. That is achieved through Australia's progressive income tax scale.

Fairness means:

- Accepting the replacement rate principle. People, whatever their level of income, should be able to generate an income in retirement equivalent to 70% of their pre-retirement income and maintain their quality of life.
- Encouraging those who have the ability to save to actually do so and not expect access to the publicly funded pension, leaving greater capacity for the government to assist people who genuinely need it.
- Not penalising, through higher tax, people with aspirations to improve their financial circumstances through hard work and diligent saving.

- Not changing the rules with retrospective effect once people have made decisions, such as choosing the time of their retirement, based on the rules on which they contributed to superannuation.

Question 7: What limits could be placed on government assistance and how should this be measured?

Tax incentives for superannuation savings should not be viewed as 'government assistance'. Tax rates on superannuation should be set in the context of an economic and social objective in the national interest. Superannuation tax incentives should be seen as an investment in the future for the nation and for individual Australians. The Government should set tax rates that are necessary to achieve social and economic objectives. A tax rate on superannuation that is lower than the tax rate on ordinary income is appropriate in the context of the desired objective of an effective national retirement savings policy.

Sustainability

The Discussion Paper states that the value of superannuation tax concessions in 2012-13 is nearly $32 billion while the value of direct income support for seniors is $41 billion. We assume these numbers are taken from the 2012 Tax Expenditures Statement. SMSFOA, and others, have challenged the simplistic use of these numbers. They are inter-dependent. If the value of tax concessions is reduced, resulting in people saving less, the cost of pension payments is increased as people will have to rely more on the pension and less on their reduced savings. Treasury has acknowledged in discussion that it is not valid to use the aggregate figure of $32 billion as an estimate of the amount of revenue government would save if there were no tax concession.

We also question the mindset that sees superannuation tax incentives as deadweight cost to the budget rather than an investment by the government in fostering a savings culture in Australia that will reduce future pension costs. This outcome provides a good economic rationale for encouraging savings with a lower tax rate. It requires far-sighted government decisions that transcend the electoral cycle and, ideally, have bipartisan support.

Question 8: How should the costs and benefits of the superannuation system be measured.

First, as we explain in this submission, a narrow focus on the cost to the budget of superannuation tax incentives is, apart from being mathematically incorrect, misleading without acknowledging that a reduction in the value of tax incentives will be offset by higher pension payments. Conversely, an increase in tax incentives will encourage greater superannuation savings and result in greater savings in publicly-funded pensions (as we illustrate in our answer to Q10 below).

Second, a long term view should be taken of retirement income strategy, recognising that a dollar invested by the Government in superannuation tax incentives will be paid off in multiples in the longer run.

Third, by taking into account the value to the Australian economy of an invested savings pool of $1.5 trillion, and growing. It would be useful to undertake an analysis of the ways in which superannuation savings underpin the economy.

Fourth, by acknowledging the inter-generational benefits of not transferring the retirement and old age support costs of one generation to the following generation.

And finally, though this may be difficult to measure, the personal, family and social value in having as many Australians as possible financially secure in their retirement and old age.

It would be useful for a comprehensive cost-benefit analysis to be prepared, taking into account the economic, and as much as possible, the social dimensions of an adequate and sustainable retirement savings system. Such a rigorous and sound analysis should form the basis for superannuation policy decisions. The Pension Sustainability Model prepared for SMSFOA develops scenarios based on age and income to illustrate the adequacy, in fact the inadequacy, of current policy settings for individuals. A broader analysis, calibrating macro economic and social outcomes, would better inform policy making.

Question 9: How should the Charter take into account the goal of administrative simplicity and balance this against other objectives such as fairness and sustainability?

Administrative simplicity, with the aim of reducing costs to the Government and to superannuation savers, is a desirable goal in itself. We do not see that simplicity needs necessarily to be compromised by considerations of fairness and sustainability.

<u>Superannuation and Retirement Incomes</u>

Question 10: What weight should be given in the Charter to the considerations below?

- *Recognising the inherent trade-offs involved in retirement income policy.*

The Discussion Paper does not identify the inherent trade-offs but we assume the key trade off is the provision of tax incentives for superannuation savings at an immediate cost to the budget in return for lower public pension costs in the future. Our Pension Sustainability Model shows that this trade-off is a strong net positive for the budget over time.

For example, for a 30 year old on average earnings saving at the SG rate, each $1 invested by government in superannuation tax incentives will save $$3.94 (in today’s dollars) in future Age Pension costs. For a 50 year old on average earnings, each $1 invested in tax incentives will save $4.26 (in today’s dollars).

These savings are magnified even further if concessional superannuation contributions are made at a higher rate.

If, for example, we returned to the situation where a person under 50 could contribute up to $50,000 and a person over 50 could contribute up to $100,000, the savings multiples would be:

For a 30 year old, a saving in Aged Pension costs of $22.08 (in today’s dollars) for each $1 of tax concession; and for a 50 year old, a saving in pension costs of $14.61 for each $1.

Again, these figures are explained in greater detail in our Research paper “Superannuation in Crisis” at Attachment B.

It follows that the Government should be allowing, and indeed encouraging, taxpayers to maximise their superannuation contribution as every dollar the Government invests in superannuation tax concessions now will pay off in the future in lower publicly funded pension costs.

Of course, it may be difficult for a Government to accept that the rewards of a tax concession given now will be reaped by governments in the future. However, we would encourage policy makers not to think in narrow terms about trading off short-term costs for future gains. What is needed is a better designed system that will deliver sustainable net cost benefits to government – this in turn needs a shared long-term vision with bipartisan support.

- *Considering the interactions between the superannuation system and other elements of Australia's retirement income system, for example, other savings vehicles and government support such as the Age Pension*

Answered in our response to other questions.

- *Recognising the intergenerational costs and benefits of superannuation savings and tax concessions*

Australia's modern superannuation system has been running for two decades and has been relatively successful, though it is still short of guaranteeing most people a secure retirement at a reasonable replacement rate. Higher and more flexible contribution limits at favourable taxation rates will help to lift more Australians into self-sufficiency in retirement and old age.

It is clearly right and fair for each generation to shoulder the responsibility of providing for their own retirement and not leave it to following generations to pay more tax to subsidise the current generation in retirement and particularly in old age when support costs mount. Achieving generational self-sufficiency requires each generation to save enough, encouraged by tax incentives, to support themselves without being a burden on the next generation. We have shown earlier in this submission that current rates of superannuation savings are not sufficient for most people to be financially independent in retirement. To address this shortcoming, we proposed in our pre-Budget submission that the Government should immediately lift contribution limits to $50,000 for those under 50 and to $100,000 for those over 50.

As super fund balances grow over time, it is likely that more people will die with unspent savings in their superannuation accounts. At present, super fund assets passed on to non-dependant family members and other beneficiaries of an estate are subject to a 16.5% tax – in effect, a death duty which does not apply to other assets of the estate. However, this can be avoided if the super fund member withdraws all their savings before death and distributes the savings to their family, then relies on the Age Pension in their latter years.

While we understand this is not a widespread practice, a more rational approach would be to allow unspent super fund assets to be distributed untaxed as part of the settlement of a deceased estate.

We believe the opportunity for people to pass on the benefit of their savings to their families is inherently beneficial. It fosters a savings culture and strengthens families. This is not at the expense of others in the community since we have shown that a dollar invested by government in a savings tax incentive is repaid in multiples in reduced pension costs.

Wealth creation directly stimulates the domestic economy by building financial resources that underpin economic activity, in turn creating and sustaining jobs and maintaining economic growth. Recent global experience is that countries that have a positive savings culture at both government and individual level have stronger economies than those that don't.

Australia's Economy

The Discussion Paper well summarises the significance of superannuation in the context of building a stronger Australian economy.

Question 11: How would the Charter reflect the impact of superannuation changes on the broader economic environment?

The Charter should acknowledge the important role of superannuation in the economy and on the general well-being of Australians by:

- Providing a means for people to maximise their retirement savings through their working lives so they have an adequate income in their increasingly longer retirement and also in the latter stages of their lives, when support costs are likely to be high.
- Reducing demand on publicly funded pensions, leaving more to be spent on those who really need it, and containing higher pension costs for an aging population.
- Fostering a sense of responsibility by individuals in taking control over their well-being in retirement and not expecting to rely on a publicly-funded pension or regarding it as a right.
- Offering an effective method for reducing future pension costs. Our analysis shows that for every dollar in tax incentive, government will save multiple dollars in future pension costs.
- Creating a large pool of investment funds which are productively employed in the Australian economy and also invested offshore. These investment funds support the Australian share market, assist equity and debt capital raising, assist bank liquidity and sustain investment in commercial, industrial and residential property.
- Strengthening the resilience of the Australian economy to cope with negative global economic influences. Improving the capability and scale of Australia's financial sector.

Implementation of the Charter

Question 12: Should the Charter be a policy document, or be enshrined in legislation?

The option of a policy document is vague and unsatisfactory. It is not clear what form a policy document would take and how support for it would be expressed. A policy document would not have binding force and it would be subject to change over time, or simply shelved. While an Act of Parliament does not give total protection, as it too can be changed, it does require a majority of the Parliament to agree to any change and that change would need to be justified in terms of the Charter objectives embedded in the legislation.

So the Charter should be enshrined in legislation. Depending on drafting considerations, it could be embedded either in a new, dedicated piece of legislation or incorporated in the Superannuation Industry (Supervision) Act with cross-reference in the Superannuation (Self Managed Superannuation Funds) Act as appropriate.

Role of the Council

As mentioned earlier, SMSFOA is not convinced of the need for an on-going Council unless it is to have substantive powers to set superannuation policy. The functions outlined in the Discussion Paper can be carried out by Treasury and other government agencies. Consultation on policy issues is a core function of Treasury. The Reserve Bank conducts research. APRA and the ATO publish statistics. Research can also be contracted out to universities and research houses.

If there is concern about the capacity and effectiveness of Treasury and the regulatory agencies to undertake the tasks of policy conception, consultation and advice, this should be addressed at source.

Question 13: Should the Council be able to examine and report on issues on its own initiative?

If a Council is set up it should be able to initiate examination of superannuation issues and make reports. It should not be limited to examining only those matters referred to it by the Government.

Question 14: What powers should the Council be given in order to effectively carry out its role?

The Discussion Paper makes clear that the proposed Council will not have a regulatory role though we argue that it should have a policy setting role. So it would not seem necessary for the Council, as envisaged, to be given any coercive powers.

However, if the Council is to have a more meaningful policy role, then it should be able to require Government departments and agencies to provide it with information, such as research, data and costings, on request.

Question 15: Should the Council have the capacity to recommend policy changes?

Yes, as this is the stated purpose for establishing the Council.

Structure of the Council

Question 16: How should the Council be assembled to adequately reflect the wide range of community views on superannuation?

The Council would need to be as much as possible independent of vested interests, including superannuation sector associations, funds and service providers. To have interest groups directly represented on the Council could prove to be unwieldy and create tensions within the Council given their differing interests.

However, this should not preclude the appointment of individuals engaged directly with the superannuation sector as the Council would need people with a good working knowledge of superannuation as well as an appreciation of its wider economic and social purpose.

The appointment of members of the Council should made by the Treasurer/Minister for Superannuation as the result of an open process with nominations invited from candidates who fit a defined job profile. As well as receiving public nominations, the Treasurer/Minister should also be able to approach suitable candidates.

We would anticipate that suitable nominations would be received from people with experience in finance, small and large business, economics, public administration, the legal and accounting professions and social service.

It will be important to ensure that people with a good understanding and appreciation of the motivation for and operation of self-managed funds are included on the Council, given that SMSFs account for a third of the superannuation asset pool.

Notwithstanding the comments above, made in response to the questions posed, we remain unconvinced that a full-time Council is necessary unless it is to be independent and have a substantial policy setting role.

<u>Relationship with Other Bodies</u>

Question 17: How would the work of the Council relate to the activities of existing bodies?

Sensibly, the Discussion Paper makes it clear that it is not intended that the Council would displace or replace any of the existing regulatory bodies and consultative mechanisms or overlap their work.

This being so, we question whether there is any useful role for the Council, as proposed, if other government agencies are performing their functions effectively.

Question 18: Will the establishment of the Council require changes to the role or structure of existing superannuation oversight bodies?

No, as above.

<u>Establishing the Council of Superannuation Custodians</u>

Question 19: What structure and supporting legislation is necessary to ensure the Council operates at arms length from Government?

If the Council is established on an on-going basis, it should be an instrument of the Parliament established by legislation clearly stating its purpose, objectives, scope and administrative arrangements.

The Council should provide an annual report to Parliament and be subject to examination by Parliamentary committees.

The Treasurer/Minister for Superannuation should be able to refer matters to the Council for its consideration and recommendation, but not to direct or limit the scope of any reference given to it.

Any advice it gives to the Government should be made public at the time it is given.

Prepared and submitted by the SMSF Owners' Alliance Limited – 21 June 2013

SMSFOA would be pleased to discuss this submission with the Charter Group at their convenience.

Contact:
Duncan Fairweather
Executive Director
dfairweather@smsfoa.org.au
0412 256 200

SMSF
Owners'
Alliance
Limited ABN 96 161 052 464
Not-for-profit public company

2013-14
PRE-BUDGET SUBMISSION

January 2013

The SMSF Owners' Alliance Limited (SMSFOA) appreciates the opportunity provided by the Treasurer to make a submission on the forthcoming 2013-14 Federal Budget.

The SMSF Owners' Alliance Limited is a not-for-profit public company recently established to represent the interests of trustees and owners of Self-Managed Superannuation Funds (SMSFs). Whilst there are other organisations with similar interests and objectives, SMSFOA's distinction is that membership is strictly limited to the trustees and owners of SMSFs.

The objectives of SMSFOA are attached.

For information about SMSFOA, visit our website www.smsfoa.org.au or write to us:

Duncan Fairweather, Executive Director

SMSF Owners' Alliance Limited

dfairweather@smsfoa.org.au

0412 256 200

or

PO Box R1490,
Royal Exchange,
NSW 1225

Contents | **Page**

Introduction and background

The purpose of this submission is to outline, on behalf of our members, some important issues regarding the SMSF sector that have received recent media attention and to provide a constructive contribution to any ongoing review and refinement of Australia's retirement system in the context of the 2013-14 Budget.

In essence, our view is that compulsory superannuation, supported by taxation incentives, has proved to be a very successful retirement savings model in Australia, though there remains room for further evolution of the system. Superannuation has grown into a sturdy pillar supporting the Australian economy. Within the broader superannuation spectrum, SMSFs have proved to be a very viable and popular vehicle for building retirement savings, attracting nearly one million Australians and growing by the day[(6)], to take direct responsibility for their welfare in retirement and the later stages of life. Official performance data indicate that the majority of SMSFs are managed in a prudent manner with sound investment strategies that have led them to perform as well or better than professionally managed funds[(7)].

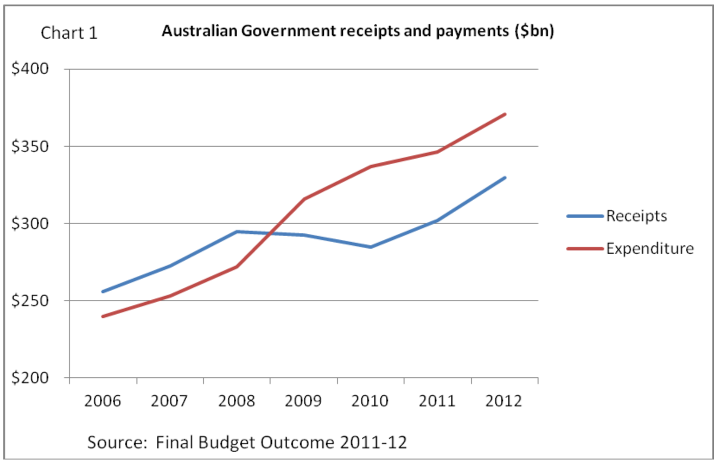
In this submission, the review entitled "Australia's future tax system" headed by Dr Ken Henry[(1)] and submitted to the government in December 2009 is referred to as the "Henry Review" and the work entitled "Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System" headed by Jeremy Cooper and submitted to the government in June 2010 is referred to as the "Cooper Report"[(2)]. We also refer to the recent report published by the Australian Taxation Office ("ATO") entitled "Self-managed superannuation funds. A statistical overview 2010-11"[(3)] and compare this with its similar report in December 2009[(4)]. (ATO Statistical Reviews)

Consistent with the recommendations of the Henry Review[(1)] and the Cooper Report[(2)], government policies should be aimed at facilitating the continuing growth of the superannuation sector in order to minimise the cost of the Age Pension to the Budget[(8)] and to encourage financial independence in retirement. This objective was summarised by the Treasury Secretary, Dr Martin Parkinson in a recent speech as follows: *"At its heart, superannuation is about achieving better retirement outcomes, and therefore improving future well-being, for Australians and Australians should reasonably be able to expect that a system to which they are obliged to contribute, in conjunction with the age pension, will assure them an adequate income in their retirement; that the system is sustainable in the long term; and that the system has integrity."*

Policy should continue to allow all Australians the choice of using an SMSF without discrimination with regard to contributions, allowable investments, withdrawals and taxation and with the minimum necessary government regulatory intervention[(9)] as appropriate for self-managed funds.

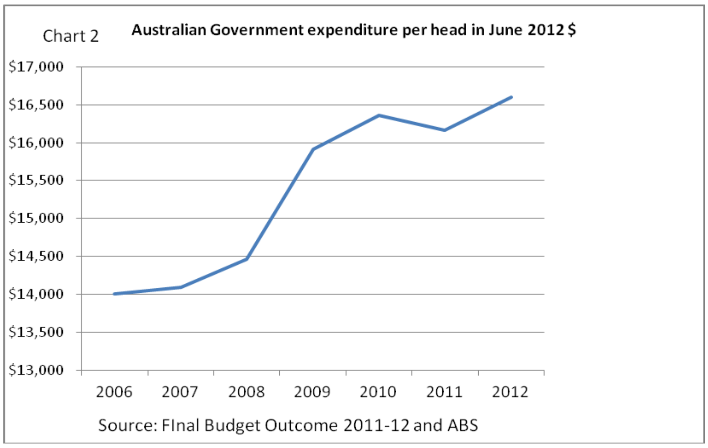
As superannuation is a life-time investment and it is important for Australians to be able to make investment decisions with a high degree of confidence, government policy objectives should be consistent and long-term, with change limited to measures that will enhance the opportunity of all Australians to build a financially secure future. Policy change should not be driven by transitory budgetary needs.

We are concerned at commentary, particularly around the time of the mid-year fiscal and economic review, which appeared to suggest that the government may increase the tax impost on the superannuation sector, and on SMSFs in particular, in order to reduce the current deficit and achieve a balanced Budget outcome. We note the Treasurer's statement that the government would no longer pursue that outcome with regard to the 2013 Budget but would continue to work towards a surplus Budget in the future.



We support the government's long-term objective but note the fact that last year taxes collected were the highest ever with tax receipts 40% higher ($88bn) than they were in 2006-07[(10)], including personal tax receipts equal to an average of about $10,000 per taxpayer. The deficit was because the government's payments last year were also the highest on record at nearly $120 billion (46%) more than in 2006-07[(11)]. Chart 1 shows how rising government expenditures exceeded its taxations receipts in 2009 and has continued rising thereafter.

This illustrates that the amount of money that was spent by the government on stimulus during the early part of the global financial crisis (GFC), justified at the time as necessary one-off measures, has become locked into the budget and is being spent on other programmes.



Even when adjusted for CPI and population growth, government expenditure has risen 18% in the last 5 years. Chart 2 shows expenditure by the Australian government per head in June 2012 dollars has continued to rise over the past six years to over $16,000 per head[(12)].

While it may be argued that government spending should be measured as a percentage of GDP, we do not believe that a growing economy should necessarily give any government a licence to spend more and to tax more, particularly not on a per capita basis.

We are being led to believe that budget pressures will cause continued scrutiny of superannuation incentives (particularly where the government argues that they benefit one group at the expense of the majority). However, SMSFOA contends that there should be no such pressures given the already massive increase in tax revenue received over the last 5 years, an increase of 40%. Rather, the real problem is that expenditure has increased by even more - 46% - and it is this increase that should be scrutinised and savings used to reverse the recent restrictions on superannuation contributions.

Drawing on the nation's superannuation assets and undermining the superannuation system to fix short-term Budget problems risks stifling the development of a sustainable retirement system in Australia to its long-term detriment. The remedy for a deficit is to spend less, not tax more.

In this context, we are concerned that a comment by the Treasury Secretary, Dr Martin Parkinson, [(13)] in the recent speech that *"with the Commonwealth budget coming under increasing pressure…the fiscal sustainability of all policies, including superannuation, will demand greater public scrutiny"* is intended to imply that the government may increase the taxation of, or reduce tax concessions for, contributions to and funding in superannuation funds.

Concessional taxation of contributions is a fundamental element of the superannuation system and applies equally to all super savers. The fact that some savers are more able at some points in their working life to utilise concessional contributions is, perhaps, a function of the stage they have reached in their working lives, their income and the priority they put on saving. While these people may have a greater capacity or willingness at times to make additional concessionally taxed contributions, they may also pay substantially more tax overall as pointed out in this submission. Those who, in good faith, make an effort to maximise their contributions within the rules, making spending and lifestyle choices to do so during their working life, should not be regarded as 'favoured' at the expense of others who cannot do so or who choose to spend their money now rather than save.

Notwithstanding some issues with regard to the current framework within which SMSFs operate, the sector has been the best-performing of the superannuation funds spectrum and was reported in the Cooper Report as being *a "largely successful and well-functioning part of Australia's retirement system*[(14)]*"*. It also recognised that this sector required less regulation than those funds regulated by APRA (referred to herein as "APRA Funds") because *"members" interests in the APRA Funds are not always paramount."*[(15)]

Summary

We list five key issues here and expand on them further in this submission:

1. **SMSFs are successful investment vehicles**

   SMSFs are viewed as successful investment vehicles focussed on the provision of retirement savings and not just as tax-planning structures. SMSFs benefit from the same tax concessions available to the rest of the superannuation sector.

   As well as performing their primary role in building retirement savings, they are a well-performing and efficient funding source for the Australian economy and play an increasingly important role in its development through investment in company shares, capital raising, property investment and bank capital(16). For example, as a sector, SMSFs are directing a substantially higher share of their assets to investments within Australia and a much lower share to overseas investments than the default APRA Funds(17).

   Commentary concerning wealthy SMSF owners being heavily subsidised at the expense of the majority is not supported by the facts and therefore should not influence long term superannuation policy.

2. **SMSFs provide a choice for all Australians**

   Within the overall superannuation system, SMSFs are an effective choice for many Australians who want to build sufficient retirement savings to give them an adequate income through their increasingly longer years in retirement and in the final stages of their life when their support and medical costs are likely to be high.

   A view that an SMSF is only for a wealthy taxpayer and is not justified for a more modest saver is incorrect and may mislead Australians from choosing this efficient, low cost savings option.

   If the government considers that, in a successful retirement system, the Age Pension should just be a 'safety net' then SMSFs are a viable choice for even modestly paid workers who have the desire, capability and commitment to manage their own affairs rather than rely on a third-party manager.

3. **Contribution flexibility**

   The Henry Review referred to the generally accepted proposition that *"an individual's standard of living in retirement should be a reasonable proportion of their standard of living during their working life."*(18) This proportion is generally referred to as the "Replacement Rate".

   The contribution arrangements generally should be designed to recognise reality in the taxpaying workforce rather than basing them on some theoretical person who works continuously for 35 years and receives average weekly earnings in even increments. This is not reality and is leading to unintended policy consequences and dumbing down the effectiveness of the system.

   Whilst we acknowledge that an increased level of mandatory contributions (from the current 9%) appears to be necessary for Australians to save enough for their retirement, we caution against the government forcing too high a level of contribution throughout a taxpayer's working life when some flexibility may provide a fairer system and better result in the long term.

We also agree with the concept of some limits on the tax cost of this system to the government but believe that the current inflexible regime of fixed $ limits on annual concessional contributions disadvantages many savers, in particular women who take time out of the workforce, or work part-time, to nurture a family, carers for family members with disabilities, those with broken or variable employment patterns and those now approaching retirement age.

4. Keeping it simple

Continual regulatory change in the superannuation sector has raised the complexity, regulatory risk, uncertainty and therefore the cost of establishing and operating an SMSF. It can also reduce the efficiency of the whole retirement system by diluting the apparent attractiveness of tax incentives due to fears of subsequent governments “moving the goal posts”.

The Henry Review advised that the complexity of the system is regressive in that it disproportionately disadvantages those with smaller fund balances because of the cost of professional advice on such complexity[(19)].

5. Government should value efficiency

For a multi-pillar retirement system, the more efficient the savings in generating pension income, the lower the cost to the government to produce the same outcomes. SMSFs have proved to be efficient for ALL savers, not just the wealthy, and their growth without unnecessary government regulation and costs should be encouraged.

The more efficient the system, the lower the cost to the government to achieve the same outcome.

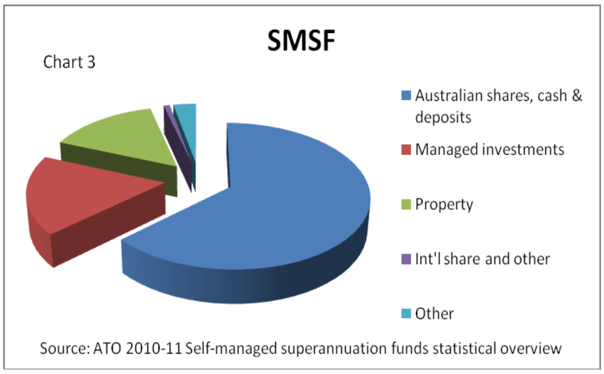
ISSUES

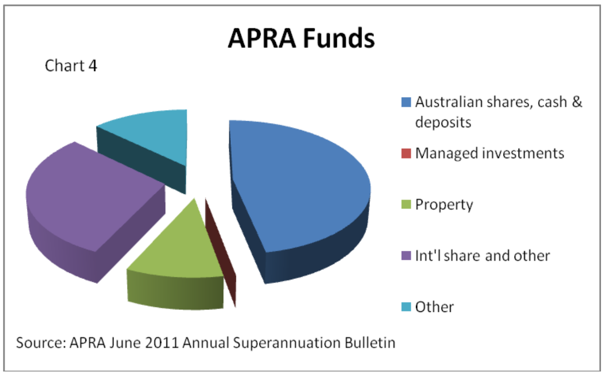
1. SMSFs are successful investment vehicles

We are concerned that recent research, media commentary and even advice from within government describes the SMSF to be primarily a tax-planning instrument(20). SMSFs do not benefit from any additional tax concessions above those available to the rest of the superannuation sector.

The World Bank recommends a multi-pillar retirement income system(21) which has been largely followed by Australia through the use of a government pension, compulsory savings and voluntary savings, encouraged by appropriate tax incentives. The Henry Review endorsed this approach(22) and reported that the relatively successful Australian system has been founded on the concept that the responsibility for providing for retirement is shared between government and individuals, with government's role restricted to providing for minimum and essential needs and facilitating self-provision(23).

Whilst tax concessions for the whole superannuation sector is an important plank in the three-pillar architecture, as endorsed by the Henry Review, the SMSF is an investment vehicle that has proven its worth as a well-performing and efficient funding source for the Australian economy. It is effectively fulfilling its function as an efficient retirement saving mechanism and is playing an increasingly important role in funding Australia's growth(5).



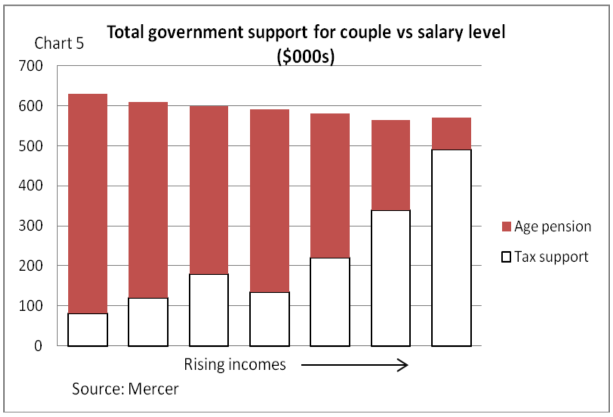


In this context, it should be pointed out that the ATO Statistical Reviews have reported that SMSFs directly invest 78% of their assets with over 60% in Australian shares, cash and term deposits and less than 1% of their savings in overseas investments(16) whereas default APRA Funds held substantially less locally with nearly 30% in overseas investments(17). Refer Charts 3 and 4.

While this may indicate that SMSF investment decisions are conservative and that SMSFs do not have the same capacity to invest offshore as larger funds, nonetheless it remains a fact that SMSFs invest virtually all of their assets in the domestic economy. In June 2012, this amounted to $419.5 billion or 99.13% of total SMSF assets according the ATO(15).

A recent report from The Australia Institute(24) claiming that the superannuation system costs the government more in tax concessions than it would otherwise pay in pensions and that the system is biased in favour of the wealthy, has been widely reported by the media – though not all such reports were complimentary(25)(26). Indeed some serious analysis demonstrates that for Australian couples across seven income levels the total level of support provided by the government actually slightly decreases as income rises or as superannuation contributions increase.

Chart 5 is reproduced from a publication by Mercer illustrates the cost to government for rising couple incomes(26).



The Australia Institute report appears to have been based on the view that all Australians should be on a universal age pension. This approach ignores the reality that Australia has been developing a sophisticated and mature retirement savings system over the past 30 years, fails to acknowledge the aspirations of Australians to have a better standard of living in retirement than a publicly funded pension can provide and doesn't take into account the wider economic benefit of developing a substantial pool of superannuation funds that are productively invested.

Neither the Cooper Report nor the Henry Review found any evidence of the use of SMSFs for widespread tax-avoidance but rather that the system had been very successful in reducing many people's reliance on the government in their retirement(27).

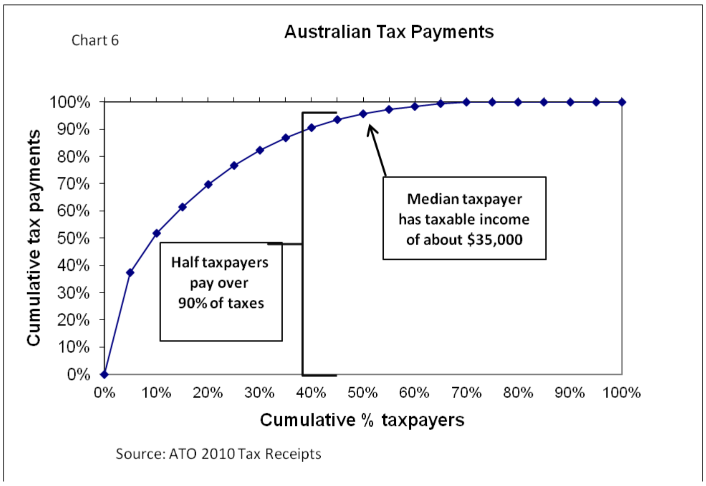


Chart 6 shows the cumulative tax payments (as a percentage of total tax payments to government) made by taxpayers starting with the taxpayer making the largest tax payment. It shows that half of Australian taxpayers have taxable incomes above about $35,000 and that together these taxpayers contribute over 90% of the government's personal tax receipts(28).

Furthermore, the approach taken by The Australia Institute ignores the fact that the extra tax paid by these taxpayers above the average paid by the rest is sufficient to pay the government's Age Pension obligations more than twice over! The tax concessions enjoyed by superannuation savers on higher incomes is far outweighed by the additional income tax, GST and other taxes that they pay.

For example, taxpayers on average weekly earnings, will get an annual "tax saving" of $1,200 on their 9% super contribution, yet will still pay a total of $16,413 in income and contributions tax (and more in GST and other taxes), which is over ten times the average annual tax paid by 50% of Australian taxpayers(28). In addition, The Australia Institute appears to have ignored the future government receipts of tax on superannuation earnings from contributions that accumulate in superannuation funds prior to retirement.

Treasury advised the current government in the 2010 Red Book that *"the superannuation system is increasingly leaking revenue with SMSFs now the tax minimisation vehicle of choice"*(29). We have not seen any evidence to support this claim and neither the Cooper Report nor the Henry Review reached this conclusion. We are somewhat surprised and concerned to read that Treasury's view is that the superannuation system is 'leaking revenue' when tax concessions for superannuation contributions are an essential feature of a retirement savings system long supported by both Labor and Coalition Governments, have been widely embraced by Australian voters and are consistent with international best practice.

We are also concerned that Treasury holds the view that SMSFs are tax minimisation vehicles when they are an integral part of the superannuation system whose members are afforded the same tax concessions on their savings as members of other types of superannuation funds. There is no inherent tax benefit in contributing to an SMSF that could not be achieved by making the same contribution to an APRA Fund. Recent research by RICEwarner[(30)] shows that, while the opportunity for *“better tax management”* is a possible benefit of SMSFs, SMSF owners see other factors as being more important reasons for establishing and operating an SMSF– notably a strong desire for self-control and independence and a justified belief that SMSF owners can do as well or better than letting someone else manage their funds.

We strongly support action to stamp out tax avoidance but equally strongly advise government not to limit the choice for all Australians of superannuation savings vehicle by unreasonably and discriminately clamping down on the sensible and legitimate use of SMSFs for retirement saving purposes.

The real issue is how to ensure the benefits of such a system can be reasonably accessed by all Australians, fairly, without discouraging those taxpayers whose aggregate taxes are more than supporting the other half of Australia’s taxpayers. SMSFs have demonstrated the potential to be an effective vehicle for savings to help reduce the cost burden on the government of the Age Pension.

The Henry Review suggested that *“the government should help make people more aware of the retirement system and therefore better able to manage their superannuation*[(31)]*”.* Government encouragement of the growth of the SMSF sector should further this objective and help develop a more sustainable retirement system in the long term which limits the direct cost of the Age Pension to the government.

2. SMSFs provide a choice for all Australians

Within the overall superannuation system, SMSFs are an effective choice for many Australians who want to build sufficient retirement savings to give them an adequate income through their increasingly longer years in retirement and in the final stages of their life when their support and medical costs are likely to be high.

A view that an SMSF is only for a wealthy taxpayer and is not justified for a more modest saver is incorrect and may mislead many Australians to ignore this choice of an efficient and low cost superannuation fund structure.

If one objective of the government is to minimise the cost to it of Age Pensions and, as per the Henry Review, *"government's role* is *restricted to providing for minimum and essential needs and facilitating self-provision"*[32], then they should be encouraging all Australians to have at least enough funds in their superannuation to provide a private pension at least as great as the Age Pension. Using the assumptions in the Henry Review[33], this level should be at least about $330,000 at retirement at 65 (in today's dollars). Such amount of funds, if invested conservatively, should provide a retiree with an indexed pension approximately equal to the Age Pension[34].

However, given the relatively low cost of running an SMSF, someone with at least $300,000 at retirement could be justified in operating his or her own SMSF, if they so wished.

For example, the ATO has reported that half of SMSFs paid audit fees (for auditors providing other services) under $594 in 2011[35]. This is equal to less than 0.2% of $300,000, which is small in the context of the investment returns that can be achieved through conservative investment policies.

In the year to 30 June 2011, the ATO reported that half of SMSF members had a balance exceeding $300,000[36]. The average operating expense ratio for SMSFs fell over the four years and was 0.54% in the year to 30 June 2011[37]. Operating expense ratio varied substantially with the size of fund and was 1.37% for funds with balances between $200k and $500k[38]. This fund size range also had the largest number of members - about 30.3% of SMSF members[39].

Therefore SMSFs should be a choice available to even a modest saver who would expect to have at least $330,000 in superannuation at retirement. A SMSF may be a viable choice in a well-structured retirement system for such a person with aspirations who wants to, and has the ability to, manage his or her own affairs rather than rely on a third-party manager. It also facilitates provision to be made for spouses/partners who can thereby attain a level of financial independence.

Nearly one million Australians are members of an SMSF and the number is growing strongly[40]. According to the ATO the continued growth in the SMSF sector *"reflects the improvement in community confidence in the economy and the adaptability of the SMSF sector."*[41] It may also be because this sector has outperformed the APRA Funds over the past four years, according to ATO[7].

The test of a superannuation system should be the standard of living that it delivers to people in their retirement and SMSFs are proving as good as or superior to APRA Funds in this regard.

3. Contribution flexibility

a. Compulsion vs incentives

Consistent with World Bank recommendations[21] regarding a long-term sustainable retirement system, Australia's system has three-pillars. A means tested pension which was originally intended as a safety net; a compulsory, wage-related, superannuation component (the Superannuation Guarantee "SG") and, thirdly, voluntary savings above the SG encouraged by tax incentives[8].

All retirement systems around the world need to handle two important trade-offs; state organised vs privately organised systems and individual choice vs mandatory deductions.[42] The trend overseas appears to be towards greater choice with adequate incentives for voluntary contributions rather then increasing mandatory contributions.

Whilst we acknowledge that an increased level of mandatory contributions (from the current 9%) appears to be necessary for Australians to save enough for their retirement, we caution against the government forcing too high a level of contribution throughout a taxpayer's working life when some flexibility may provide a fairer system and better result in the long term.

For low to middle income workers, a higher mandatory contribution rate throughout a working life can cause unnecessary hardship and diversion of funds from education and housing at critical times for young families.

Taxpayers may just consider a higher mandatory contribution as another tax and reduce other savings or reduce repayments on their mortgages to compensate, leading to no increased net savings for the country.

In conjunction with a review of the current inflexible voluntary contribution caps, some improved flexibility at the mandatory contribution level may be justified.

b. Replacement rates

The Henry Review referred to the generally accepted proposition that *"an individual's standard of living in retirement should be a reasonable proportion of their standard of living during their working life".* This "*proportion"* is generally referred to as the "Replacement Rate"[18]. This concept was endorsed by the government for many years through its long-held position of paying government employees a pension equal to a proportion of their salary. Such pensions (up to 75% of salary) are still available to some government employees on defined benefit schemes. The World Bank recommendations regarding retirement systems uses achieved Replacement Rates as a measure of the success of a country's retirement system.

We agree with the concept of some limits on the tax cost of Australia's retirement system to the government but, in principle, any caps or limits on tax-assistance should be more related to incomes such that all individuals can achieve private pensions at reasonable Replacement Rates.

It may be that the modelling upon which the Cooper Report and the Henry Review were based, and on which subsequent government policy relied, assumed a hypothetical individual on a particular salary which grows by the same rate every year until he or she retires.

Reality is different to this. The income patterns for most people do not advance at a steady rate and for various groups can vary dramatically from year to year or at various phases of their working life. This leads to problems and inequalities with the current fixed $ annual cap system.

c. Current disadvantages for women and other Australians

Australians with broken employment patterns, including many women, the self-employed, people unemployed through structural change and those Australians nearing retirement are disadvantaged by a fixed annual cap.

The number of female members of SMSFs is growing substantially faster than male members[(43)] and, in the 34 to 64 age range, there are now more female SMSF members than male members[(44)].

It should also be noted that SMSFs have a large proportion of self-employed members. More that half of SMSF funds also have *"at least one member who is self-employed or derives income from a business or partnership"*[(45)].

For such groups, income can vary dramatically year by year or through their working life and they are thus discriminated against under current contribution "cap" policies.

The Henry Review's view of such groups is that *"support for people who have experienced broken work patterns should be achieved through the Age Pension"*[(46)]. We disagree if there are other ways of providing incentives for, and not restricting, such groups to save for their retirement and thus not become a cost burden on the government.

d. Reality on savings patterns

For a lot of individuals a first priority during their working life would be to save a house deposit, pay off a mortgage, pay off a HECS debt then provide for and educate a growing family before they have any reasonable ability to make voluntary contributions into a superannuation fund above the mandatory contribution rate. Generally it is difficult for most individuals to realistically put enough money aside into a superannuation fund to provide for a private pension until the last decade or two of their working life.

Australians who were in the final phase of their careers when the GFC hit markets and the economy in 2008 have been particularly unfortunate, losing value and returns from their superannuation assets with less hope of being able to recover their losses and make up for the negative performances recorded by superannuation funds over that period.

From the 2007-08 financial year, the government recognised the predicament of Australians who have reached a late stage in their working life (over 50) by allowing them to contribute up to $100,000p.a.. However, this measure was first halved in 2009-10 when caps for other taxpayers was halved to $25,000 and then abandoned from 1 July 2012.

We strongly advocate higher limits for people nearing retirement, especially in the current environment in which the mandatory contribution regime has not been in place for their full working life and continual changes to the superannuation system may have put off many Australians from placing too much reliance of the superannuation system.

e. A fairer way

A fundamentally fairer retirement system should provide pensions at reasonable replacement rates for all Australians.

Flexibility in the contribution regime would provide a better system with lower cost to the government to achieve the same results.

For example, more flexibility in mandatory contributions would remove some current anomalies and distortions in the system. A number of alternatives could be considered. A "soft compulsion" could be an alternative to consider, with "opt-out" provisions that might help protect individuals from under-saving, notwithstanding tax incentives[(47)].

Alternatively, mandatory contribution percentages that step up with age may help families during their early working life.

In relation to voluntary contributions, fixed annual $ caps, as we have now, may not be the fairest and best way to limit the tax cost to the government whilst providing pensions at reasonable replacement rates for all Australians. A “life-time” percentage cap on voluntary contributions (above the mandatory level) could be ideal.

However, in the meantime, the government must recognise that the current concessional contributions cap of $25,000 p.a. may not be sufficient. It does not allow many Australians who are capable of making a greater contribution to do so and be assured self-sufficiency at a reasonable Replacement Rate. In particular, taxpayers nearing the end of their working life, who have not had the benefit of a mandatory contribution system for all their working life are severely disadvantaged.

We therefore strongly urge the government to immediately reinstate the system of caps that was in place in 2007-08. i.e.

- An annual cap of concessional contributions of $50,000 for taxpayers aged under 50; and
- An annual cap of concessional contributions of $100,000 for taxpayers aged 50 and over.

The government should then introduce of a system of 5-year rolling fixed $ caps, similar to the system for non-concessional contributions. This would go some way to providing flexibility in contribution payments from year to year and help to alleviate the disadvantage women, carers, self-employed and mature workers currently face. In order for such a rolling system to be implemented and managed, the cap would have to apply to voluntary contributions above the mandatory level.

Increasing the contribution cap may mean less immediate tax revenue for the government but it is our contention that the long-term objective of Australia’s superannuation system, which draws widespread support from employers, employees, unions and the community in general, should not be compromised by short-term budget needs.

Conceptually, and to the greatest extent fiscally practical, support for superannuation should be regarded differently from the normal expenses of government. It should be viewed as a long term investment in the nation’s economic and social fabric.

4. Keeping it simple

The Cooper Report stated that, in APRA Funds, *"members" interests are not always paramount"* and by contrast, ownership and control of SMSFs are aligned(48). The Cooper Report advised that the SMSF sector therefore required less regulation than APRA Funds and that the trustees of SMSFs should be free, as much as possible, from government intervention(49).

However, it is continual government intervention in the superannuation sector that has raised the complexity and therefore the cost of establishing and operating an SMSF. The uncertainty this causes also reduces the effectiveness and efficiency of the superannuation system. It discourages savers from "locking" away voluntary contributions, notwithstanding the tax concessions, because of fear that a government will move the goal posts and attack their savings, which they made in good faith. Such continual changes thus mean that the tax concessions offered would need to be greater to achieve the same result, reducing the system's overall efficiency.

In particular, the Henry Review advises that the complexity of the system is regressive(19) in that it disproportionately disadvantages those with smaller fund balances because of the cost of professional advice on such complexity.

Under these circumstances and apart from the question of a lack of a demonstrable need, Dr Parkinson's view(13) that SMSF Trustees need to be subject to *"increased accountability requirements"* would not only ensure more complexity and cost but would obviously discourage their use.

For the SMSF sector to be more widely suitable and effective as a retirement savings option, the government should simplify regulation of the sector, restrict its involvement to reasonable, practical and cost-effective compliance and do all it can to facilitate self-provision of retirement funding into this efficient sector. Both the Cooper Report and the Henry Review advised strongly on these points(23) (9).

In particular, restrictions that only apply to SMSFs and not to APRA Funds should be avoided. It is recognised that transfers from associated parties into or out of a superannuation fund should be done at market prices. However, the recent plan that requires such asset transfers with respect to SMSFs to be done through the market, where one exists, imposes an additional cost burden on SMSFs which may be unnecessary(50). This is particularly iniquitous since this requirement does not apply to transfers into and out of APRA Funds.

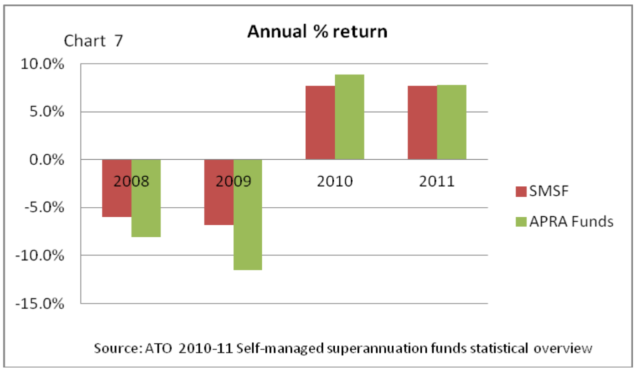
Neither the Cooper Report nor the Henry Review found any evidence that SMSFs have been used for tax-avoidance. The level of audit errors for SMSFs is low and not rising(51). In this environment, care should be taken in introducing tougher rules that discriminate against SMSFs and are regressive.

5. The value of efficiency

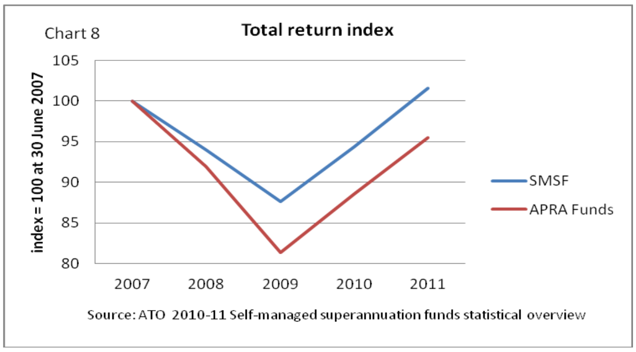
There has been inadequate commentary about the importance of the efficiency of the retirement savings system. The more efficient the investment system, the lower the cost to government and society over the long run to provide the same retirement pension results.

Although the tax concessions are no different to those available to the whole superannuation sector, the SMSF sector has demonstrated its inherent efficiency. The Cooper Report surmised that this may be due to the fact that costs are lower than for APRA Funds and that trustees have ultimate responsibility for their retirement savings, such responsibility perhaps leading to a higher level of engagement of the SMSF owners with the retirement system and more hands-on management of their investments(52). We note that RICEwarner has reported that SMSF owners practice a *"quite extraordinary level of engagement"* with their savings(30).

The cumulative impact of lower costs and higher returns can be substantial. For example, if an SMSF achieved 1% higher net return per annum, it would require about 10% less funds at retirement to provide the same pension(53). The lower contributions then needed to achieve the same pension would result in a lower cost to the government budget of tax concessions.



According to the ATO Statistical Reviews, APRA Funds had not recovered, by 30 June 2011, the position they were at on 30 June 2007, even taking into account dividend income(7). By comparison, investors in SMSFs were at 30 June 2011 ahead of their position at 30 June 2007. Their respective annual returns are shown in the adjoining Chart 7.



However, these annual figures can be misleading as cumulative figures provide a better picture. The larger falls by APRA Funds early in the GFC mean they require larger percentage rises in more recent years to catch up. As a result, average net compound return from SMSFs over the four years up to 30 June 2011 was over 1.4% higher per annum than APRA Funds.

This may have been due to the fact that SMSF's generally have a substantially lower proportion of funds invested in derivatives and managed funds than APRA Funds, investor/owners directly investing, on average, nearly 80% of their savings, generally in a relatively simple and conservative mix of Australian listed shares, cash and term deposits and some property(16).

We understand that the latest performance figures from APRA have shown that APRA Funds have now recovered and, indeed, may have outperformed SMSFs in the past 12 months due to the latter's generally more conservative portfolio.

The SMSF sector has demonstrated that SMSFs can be an efficient savings vehicle and it is therefore in the best long-term interests of the government to encourage it to grow and develop.

OTHER ISSUES

a. Gearing

Whenever the government makes changes to the superannuation system, there may be some unintended consequence.

By progressively lowering the per annum cap on contributions and, at the same time, relaxing borrowing restrictions for superannuation funds, the government may be encouraging SMSF trustees to take greater financial risk than is prudent for the efficient development of a retirement pension.

The lower contributions cap, especially during an individual's last decade of working life when he or she is realistically most able to make voluntary contributions into superannuation, has meant that many people now have minimal chance of saving enough to provide a private pension at a reasonable Replacement Rate. This is particularly true for those who have not worked for their whole life under a mandatory contribution system. In this position, it is tempting for a trustee to introduce a greater chance that he or she might have enough funds by gearing up their investments. We understand that advisers on geared property investments do not need to be specially qualified.

However, gearing always brings greater financial risk. We tend to agree with some market commentators that this situation is an *"accident waiting to happen"*. We note that, whilst the Cooper Report did suggest some relaxation of borrowing provisions[(54)], it appeared cautious about such recommendation and was keen that leverage should not become a core focus for SMSFs. In this context, Cooper recommended that the government review the borrowing provisions two years after his report i.e. about 30 June 2012[(55)].

Although we understand that the level of gearing in SMSFs at this stage is low, we strongly agree that this review should take place and SMSFOA stands ready to make a constructive contribution to any such process. However, we believe it is only realistic and prudent to re-address the ability of SMSFs to gear investment, if the contribution caps for all superannuation funds, including SMSFs, are concurrently raised and changed, as suggested above. We believe that facilitating the expectation for all Australians to provide for their own pension at reasonable Replacement Rates should be achieved more responsibly through encouraging member contributions rather than borrowing.

Our concern is that the current situation could otherwise lead to a crisis in a small number of ill-advised SMSFs, leading to an even stronger push by some elements in government for greater and unnecessary oversight of all SMSFs.

b. Excess Contributions

The government's decision to permit superannuation investors to report an over-contribution without incurring a penalty is sensible. However it is limited by being a one-off measure, having a low threshold of $10,000 and does not apply for excess non-concessional contributions. We agree that excess contributions need to be reversed but believe over-payment should be able to be rectified without incurring punitive tax penalties. We are not aware of any widespread intention by contributors to deliberately exceed the contributions cap, which would readily come to light when tax returns are prepared anyway. It is most likely that excess contributions are made inadvertently in situations such as:

1. Where employers pay more than the mandatory 9% superannuation guarantee levy. For example, under some awards employers make a 17% superannuation contribution. At this rate, an employee on a salary package of $175,000 including super will exceed the $25,000 cap. A salary of this order is common for industries and institutions that employ professionally qualified people and in high wage industries like mining.
2. Where an employee retires or takes a break from work and salary sacrifices up to $25,000 into his or her superannuation then subsequently accepts another job in the same financial year and the new employer's superannuation guarantee levy payment takes the contribution above the limit.
3. Where an employee works at two or more jobs from which the combined superannuation guarantee levy paid by different employers exceeds $25,000. Among others, directors of more than one company can find themselves in this position.
4. Timing issues and processing delays and errors by employers, payroll service companies and funds.

While employees may have the opportunity to advise their employees to vary the SG payment on their behalf, not all will be aware of their potential breach of the contributions cap as superannuation payments tend not to be a top of mind issue for most people as they focus on their work.

In such circumstances, it is difficult to understand why this problem cannot be rectified simply by the repayment of excess contributions with interest when they become apparent – usually in the preparation of a tax return – and the inclusion of the over-payment in the employee's taxable income. Excess contributions on which tax has been paid could remain in the fund as undeducted contributions, if such payments can be made within the allowable limits.

Loss of revenue to the government should not be an issue. Penalty tax gained from the inadvertent mistakes of taxpayers of from circumstances that are largely out of their control should not be factored into the budget as a reliable source of revenue.

c. Supervision

We support the continuing supervision of SMSFs by the ATO rather than APRA or any new, specialist regulator. APRA plays an important prudential regulatory role where money is entrusted to superannuation funds governed by appointed directors. This is not the case for SMSFs where the trustees are responsible for managing their own assets and the ATO is best placed to efficiently supervise and monitor compliance with taxation rules. We do not see the need for any more specific supervision of SMSFs beyond that currently undertaken by the ATO. We are also supportive of ASIC's role in regulating the providers of financial services and products to SMSFs.

The statistical analyses provided by the ATO are useful and SMSFOA is happy to provide our input into any consultative process on enhancement of this data.

d. Caps on super payouts

We have read reports that the Australian Institute of Superannuation Trustees proposes that the government should limit lump-sum payments to $250,000 because of their concern that people may withdraw and then spend all their superannuation funds and then live off the Age Pension.

This situation is true for the whole superannuation system and not just SMSFs. However, it highlights a more fundamental issue. For Australians who have only about $200,000 to $300,000 in superannuation funds, it would be rational for them to withdraw all their funds, pay off a mortgage and other debts, spend any small balance on discretionary items and to then go on the Age Pension. AIST's "solution" does not fix this. A better solution is to ensure the system encourages sufficient contributions so that most Australians will have enough to support a standard of living sufficiently above the Age Pension that relying on the pension is not an attractive option.

In contrast, it should be noted that there has been no evidence that owners of SMSFs actually behave in the way AIST is suggesting. Indeed, it is unlikely to be the case given the high priority SMSF owners place on independence and self-reliance. If there are to be any controls on maximum withdrawals, they should be such that, after any such lump-sum withdrawal, the fund has sufficient moneys to provide a pension at least as great as the Age Pension. This should in any event be less of a problem in future if, through a combination of higher mandatory contributions and additional voluntary contributions, retiring Australians will have enough in their superannuation to support a lifestyle considerably above that provided by the Age Pension.

References

1) As a part of the “Australia’s future tax system” review headed by Dr. Ken Henry (“Henry Review”) the following documents were published:
   a) 10 December 2008 “Retirement Income Consultative Paper”
   b) 12 May 2009 “The Retirement Income System: Report on strategic issues”
   c) 23 December 2009 “Report to the Treasurer”
2) As part of the “Review into the Governance, Efficiency, Structure and Operations of Australia’s Superannuation System” headed by Jeremy Cooper (“Cooper Report”) the following documents were published:
   a) 10 December 2009 A “Statistical Summary of Self-Managed Superannuation Funds”
   b) 14 December 2009 “Phase Three Issues Paper – Structure (including SMSFs)”
   c) 29 April 2010 “Self-Managed Super Solutions”; and
   d) 30 June 2010 “Final Cooper Report”
3) “Self-Managed superannuation funds. A statistical overview 2010-11” by Australian Taxation Office.
4) A “Statistical Summary of Self-Managed Superannuation Funds” December 2009
5) “Self-Managed superannuation funds. A statistical overview 2010-11” by Australian Taxation Office - 01 Executive Summary.
6) “Self-Managed superannuation funds. A statistical overview 2010-11” by Australian Taxation Office – 02 Growth of SMSF Sector
7) “Self-Managed superannuation funds. A statistical overview 2010-11” by Australian Taxation Office page 16 refers to annual growth rates for years ending 30 June 2008, 2009, 2010 and 2011 being -6.0%, -6.8% +7.7% and +7.7% giving cumulative return since 30 June 2007 of +1.6%. The same report gives corresponding returns by APRA Funds of -8.1%, -11.5%, +8.9% and +7.8% giving cumulative return from APRA Funds since 30 June 2007 of -4.5%.
8) “The Retirement Income System: Report on strategic issues” 12 May 2009 page 1
9) “Final Cooper Report” 30 June 2010 page 16
10) “Australian Government Budget Outcome 2011-12” Table 3 compared with “Australian Government Budget Outcome 2011-12” Table 2.
11) “Australian Government Budget Outcome 2011-12” Table B1
12) See Reference 11 for government payments; CPI for 31 December 2006 and 31 December 2011 and population levels from Australian Bureau of Statistics
13) “Future Challenges: Australia’s Superannuation System” Speech to the ASFA 2012 Conference, Sydney, 28 November 2012 by Dr Martin Parkinson, Secretary to the Treasury
14) “Final Cooper Report” 30 June 2010 page 16
15) “Final Cooper Report” 30 June 2010 page 6
16) “Self-Managed superannuation funds. A statistical overview 2010-11” by Australian Taxation Office, page 3 and Table 15
17) A “Statistical Summary of Self-Managed Superannuation Funds” December 2009, page 13.
18) “Retirement Income Consultative Paper” 10 December 2008 page 46
19) “The Retirement Income System: Report on strategic issues” 12 May 2009 page 32
20) “The World Today” 15 August 2012; CAN’T PUT MY HANDS ON THIS
21) “Retirement Income Consultative Paper” 10 December 2008 Appendix C
22) “The Retirement Income System: Report on strategic issues” 12 May 2009 page 1 and “Report to the Treasurer” 23 December 2009 page 96
23) “The Retirement Income System: Report on strategic issues” 12 May 2009 page 1
24) “Can the taxpayer afford ‘self-funded retirement’?” August 2012 by Dr Richard Denniss and David Richardson of the Australia Institute and also earlier report by David Ingles of The Australia Institute dated February 2009.
25) “Hands off our super” 22 August 2012 by Bruce Brammall of Castellan Financial Consulting
26) “Debunking the myth of superannuation tax concessions: Mercer analysis” 24 February 2010
27) “Final Cooper Report” 30 June 2010
28) ATO “Taxation Statistics 2009-10”
29) Treasury “Red Book” 2010
30) ”Survey of Financial Needs and Concerns of SMSF Members” by RICEwarner, October 2012
31) “Report to the Treasurer” Part 1, Overview 23 December 2009 page 86
32) “The Retirement Income System: Report on strategic issues” 12 May 2009 page 1

33) Wage indexation (4%pa), fund earnings (7%pa), inflation (2.5%) and retirement period (23yrs) as per Appendix E in "Retirement Income Consultative Paper" 10 December 2008. Our model assumes monthly withdrawals escalating at projected increase in average weekly earnings. We note that the Treasury model used for the Henry Review's slightly different assumptions in its "The Retirement Income System: Report on strategic issues" 12 May 2009, Appendix F used slightly different assumptions.

34) Assumptions as per reference #33 and to give an opening pension balance such that the pensioner withdrawing a pension of $712 per fortnight plus $1,686 pension supplement, indexed to assumed average weekly earnings growth would leave a zero balance after the assumed retirement period.

35) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – Table 24

36) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – Table 11

37) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 17

38) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – Table 22

39) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – Table 14

40) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 3

41) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 4

42) "The Future of Multi-Pillar Pensions Systems", September 2011 by Lans Bovenberg and Casper van Ewijk.

43) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 8 gives number of female members as 47.4% of 913,550 (i.e. 434,445) and the balance (479,105) being male as at 30 June 2012. According to the "Statistical Summary of Self-Managed Superannuation Funds" December 2009, page 8, the number of female members as at 30 June 2009 was 46% of 772,000 (355,120) and therefore male members totalled 416,880 at that time. These figures show that the growth in female members has therefore been 22.3% over past 3 years and growth in male members has been 14.9%.

44) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 8

45) A "Statistical Summary of Self-Managed Superannuation Funds" December 2009, page 9

46) "The Retirement Income System: Report on strategic issues" 12 May 2009 page 13

47) "Reforming Retirement-Income Systems: Lessons from the Recent Experiences of OECD Countries" by John Martin and Edward Whitehouse for Institute for the Study of Labour, dated May 2008, pages 10 and 11

48) "Final Cooper Report" 30 June 2010 Part 2, pages 73, 76 and 219.

49) "Final Cooper Report" 30 June 2010 Part 1 page 16

50) Australian Taxation Office "off-market transfers between SMSFs and related parties

51) "Self-Managed superannuation funds. A statistical overview 2010-11" by Australian Taxation Office – page 18

52) "Final Cooper Report" 30 June 2010

53) Someone on current average weekly earnings and about to retire would require about $610,000 in a superannuation fund to provide an indexed pension equal to about 75% of his pre-retirement after-tax earnings based on the assumptions referred to in 33 above. If his savings earned a 1% higher return, the retiree would only need about $550,000.

54) "Final Cooper Report" 30 June 2010 Part 2, page 242

55) "Final Cooper Report" 30 June 2010 Part 1, page 49

APPENDIX

Key objectives of SMSFOA

1. Be the independent voice for Australians who have established SMSFs to build sufficient assets during their working lives to support themselves in their retirement years.

2. Offer all owners of SMSFs the opportunity to become members of an association that exists solely to represent their interests.

3. Engage actively in public policy discussions about the development and regulation of SMSFs as an essential element of Australia's superannuation system, becoming recognised by government and regulators as the representative voice for the owners of SMSFs.

4. Foster a retirement savings culture to encourage more Australians to take responsibility for and make provision for an adequate income in their retirement years, reducing reliance of an ageing population on publicly-funded pensions.

5. Consult with members on regulatory policy issues affecting SMSFs, including governance, investment scope, drawdown arrangements and taxation.

6. Convey the views of members in well-researched and cogent submissions and statements to government, regulators, the media and the general public.

7. Liaise with other like-minded associations in the superannuation sector, while always maintaining an independent stance in the best interests of SMSF owners.

8. Communicate the benefits of SMSFs as a retirement savings option and the important contribution SMSFs make to the economic well-being of Australia.

SMSF
Owners'
Alliance
Limited ABN 96 161 052 464
Not-for-profit public company

RESEARCH PAPER

"SUPERANNUATION IN CRISIS"

March 2013

Contents

The SMSF Owners' Alliance Limited is a not-for-profit public company established to represent the interests of trustees and owners of Self-Managed Superannuation Funds (SMSFs). Whilst there are other organisations with similar interests and objectives, SMSFOA's distinction is that membership is strictly limited to the trustees and owners of SMSFs.

Prepared by:
Malcolm Clyde, Director
SMSF Owner's Alliance Limited
admin@smsfoa.org.au

Fundamental Problems

There are some fundamental short and long-term problems in ensuring the existing superannuation system in Australia is sustainable – but unfortunately these aren't the ones the politicians are talking about!

Whilst the SMSF Owners' Alliance (the "Alliance") has already raised some of these issues, it now has the simulation results from the "Pension Sustainability Model" that has been developed to simulate taxation and superannuation results under a range of scenarios. The Alliance can now use this to provide more detailed analysis and reasoning.

1. **Most workers will not have enough super!**

   PM Hawke introduced the superannuation contribution into industrial awards in 1986 with a vision of ensuring all workers would have a comfortable retirement independent of the government's Age Pension. However a couple of years later, he made it harder to achieve this dream by introducing the 15% up-front taxation of contributions and the 15% on-going taxation of superannuation earnings. Up to that time the system was more clearly a "tax-deferral" mechanism with zero tax on contributions and earnings but taxes on pension distributions. PM Keating then introduced the Superannuation Guarantee for all employees in 1992 but did not reverse the taxation of contributions and super earnings.

   Whilst these Prime Ministers should be credited with the introduction of a compulsory component of superannuation, the introduction of up-front taxation of contributions and on-going taxation of superannuation earnings has arguably killed off the development of a sustainable superannuation system. In the opinion of the Alliance, this has been one of the reasons the system fails to provide adequate superannuation for the majority of Australians with the result that the government will continue to bear substantial Age Pension costs unless some fundamental changes are made to the system.

Table 1
Expected Super Balance at Retirement ($m)

Earnings	30 yr-olds	40 yr-olds	50yr-olds
Average	$ 1.35	$ 0.85	$ 0.48
1.5 x av.	$ 2.03	$ 1.15	$ 0.59
2.0 x av.	$ 2.71	$ 1.45	$ 0.70

   The Alliance used the Pension Sustainability Model to carry out simulations of a range of people from 30yr-old taxpayers just beginning to contribute to super to 50 yr olds who have been contributing at the relevant Superannuation Guarantee levels to date. For each age bracket a range of salary levels were considered from average earnings to twice average earnings for each age ("Sample Group") (about $60,000 to $160,000).

Table 2
Necessary Super to provide Reasonable Pension ($m)

Earnings	30 yr-olds	40 yr-olds	50yr-olds
Average	$ 2.27	$ 1.54	$ 1.04
1.5 x av.	$ 3.07	$ 2.08	$ 1.40
2.0 x av.	$ 3.78	$ 2.56	$ 1.73

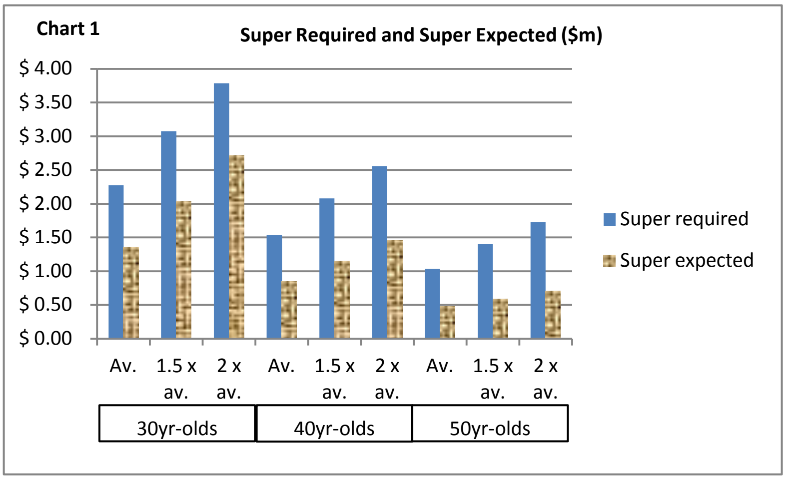
   Table 1 shows the estimated superannuation balance that should be expected by the Sample Group at the time of retirement at 65 if contributing at the currently planned Superannuation Guarantee levels.(i.e. 9% rising to 12%) The balance for 50 yr olds is relatively low because such taxpayers have been saving at the relatively low SG levels compared to the 12% SG at which 30 yr olds will be expected to contribute for most of their working life. The 50 yr old balances are also for their assumed retirement in 2028, whereas the 30 yr old is assumed to retire at 65 in 2048.

The Pension Sustainability Model assumes long-term growth in average earnings of 4% pa and CPI of 2.5%. It assumes a balanced investment portfolio with 25% in cash or term deposits and with a long-term overall gross return, including franking credits, of 7%pa net of fees.

These balances should be compared with those in Table 2 which shows the superannuation balance necessary for each person to provide a reasonable pension.

The simulation assumes a "reasonable pension" for someone on average earnings is equal to 70% of average real after-tax earnings for the last 10 years of their working life; for someone on 1.5 x average earnings this figure is assumed to be 65% and for someone on 2 x average earnings this is assumed to be 60%. These percentages are generally referred to a "Replacement Rates" and are consistent with the Replacement Rates used by Dr Ken Henry in his Review and various World Bank reports on the subject of pension systems for the developed world. It is generally assumed in such work that persons on lower incomes should expect to have a higher pension as a percentage of after-tax earnings. Note that because of our progressive income tax rates, these pensions as a percentage of **pre-tax** earnings are even higher than for those on higher salaries.

It is assumed by the Pension Sustainability Model that a taxpayer draws a pension at aged 65 at the relevant Replacement Rate and that this pension is subsequently indexed by the projected CPI during an assumed 23 year retirement period.



In each of the Sample Group there is a big gap in funding as illustrated in Chart 1. Taxpayers clearly need incentives to save more than the Superannuation Guarantee and/or the contributions they make under the Superannuation Guarantee system need to work more effectively and be taxed less during both the accumulation (working life) and pension (retirement) phases. This should lead to most Australians retiring on a reasonable pension without drawing on the government's Age Pension.

Whilst some aspects of the superannuation system in Australia have been praised, there are other systems that are better. In the opinion of the Alliance, some of the failures of the system in Australia to meet expectations are due to our particular mix of Age Pension levels, low superannuation contribution caps, taxes on contributions and earnings as well as income tax levels in Australia. Our increasing longevity may also require some fundamental changes to our system.

2. The country cannot afford NOT to have a good superannuation system

The Alliance has already issued a statement regarding the Treasury's recent Tax Expenditures Statement (TES) and explained how the quotation of the aggregate, superannuation "tax concession" figures in the TES is misleading. Further analysis has now been undertaken by the Alliance to confirm this and Treasury has agreed that it is not valid to use the aggregate figure of $32bn in tax concessions as an estimate of the amount of tax the government would save if there were no tax concessions.

Furthermore, quoting an estimate of the cost of tax concessions without also referring to the offsetting savings in future Age Pension costs as a result of superannuation is misleading and short-termist. If given any credence by government, this situation could lead to the wrong policy decisions to the long-term detriment of Australian society.

The Alliance used the Pension Sustainability Model to estimate the level of tax concessions for the Sample Group if contributing at the SG level and the expected savings in Age Pension as a result of the current superannuation system.

Table 3

Age Pension savings per $1 of tax concession

Earnings	30 yr-olds	40 yr-olds	50yr-olds
Average	$3.94	$4.23	$4.26
1.5 x av.	$2.66	$2.42	$2.60
2.0 x av.	$1.85	$1.83	$1.78

In all these cases in the Sample Group, the savings in Age Pension for the government are substantially greater than the cost of tax concessions. Even when expressed in today's dollars this remains the case.

Table 3 shows the value of Age Pension savings for each $1 of tax concession for our simulation group.

The cost of additional Age Pensions to the government if it killed off super would have a serious long-term cost to the country.

If there is inadequate incentives, encouragement and certainty to contribute into superannuation, many taxpayers may not contribute above the compulsory SG level. For example, Table 4 shows the number of years such a taxpayer's super would last.

Table 4 **# years before Age Pension**

Earnings	30yr-olds	40yr-olds	50yr-olds
Average	11	10	8
1.5 x av.	13	10	7
2 x av.	14	11	7

This modelling assumes a taxpayers draws on their super balance at their relevant Replacement Rates before reverting to the government's Age Pension In these circumstances the long-term the cost to the government would be unsustainable.

3. The cost of super tax concessions is outweighed by savings in future Age Pension costs

It follows that the government **should** be allowing, and indeed encouraging, taxpayers to maximise their superannuation contributions, as every dollar invested in superannuation savings now by way of a tax concession will pay off in the future in lower pension costs funded by the government.

The Alliance has carried out further simulations to determine the impact on government's net budget of additional, voluntary contributions into super above the projected SG levels. Given that, in the real world, most taxpayers focus first on expenditures such as paying off their mortgage and HECS debt, the Pension Sustainability Model has assumed additional % voluntary contributions are only made in the last 15 years of working life and until any of the aggregate contributions reach the current annual cap.

This analysis shows two particular issues:

a) for additional voluntary contributions by taxpayers, the additional savings to the government from reduced Age Pension costs exceed the cost of additional tax concessions; but that;
b) in all cases in the Sample Group, the current caps on contributions prevent taxpayers from saving enough in super to retire on a reasonable pension.

Table 5 Additional Age Pension savings for each additional $1 of tax concession

Earnings	30 yr-olds	40 yr-olds	50yr-olds
Average	$15.42	$15.42	$16.02
1.5 x av.	$8.21	$8.18	$6.25
2.0 x av.	$6.60	$3.07	$3.56

For the Sample Group, Table 5 shows the additional savings in Age Pension costs for the government for each $1 of additional tax concession.

These figures are greater than those in Table 3, showing that the tax concession on additional contributions later in working life are even more effective in reducing the cost to the government of the Age Pension than contributions at just the SG level.

However, as a consequence, most people will be forced to rely on the Age Pension at some time during their retirement, if they draw on their super savings at their reasonable pension rate and then, when it runs out, draw on the government's Age Pension.

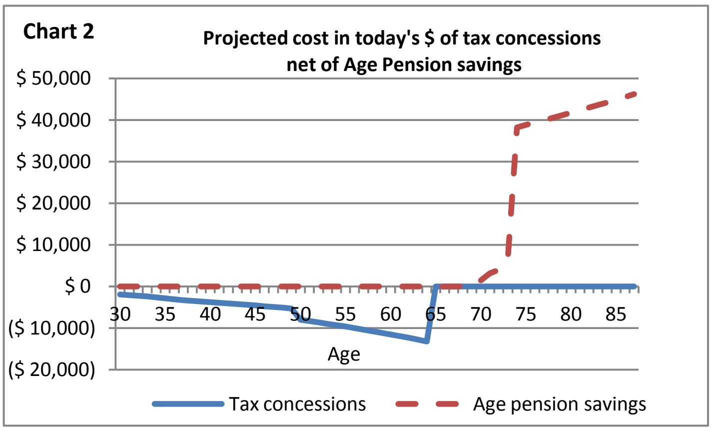
Table 6 # years before Age Pension

Earnings	30yr-old	40yr-olds	50yr-olds
Average	21	19	21
1.5 x av.	17	16	14
2 x av.	16	13	11

Table 6 shows the number of years a taxpayer can last on his super with these extra contributions. Each member of the Sample Group is less reliant on the Age Pension than shown in Table 4 but will still run out of funds (assuming average 23-year retirement period) due to the cap constraints.

Chart 1 is a further illustration of the benefit of extra contributions by showing the projected annual cost of tax concessions followed by the projected age pension savings **in today's dollars** for a 30 yr old on 1.5 x average earnings.

It would therefore appear sensible, as well as socially responsible, for a government to provide adequate incentives, encouragement and certainty for taxpayers to provide more into super than the compulsory SG level.



4. Contribution caps limit the potential for long-term savings in Age Pension costs

All the cases in the Sample Group were constrained by the current system of contribution caps from providing enough into super to avoid the Age Pension. For the simulation in section 3 above it is assumed that the current $25,000 per annum cap is increased by 4% per annum from 2014. If this does not occur, the situation would be worse.

However, in each of the Sample Group the additional savings in Age Pension costs would outweigh the cost of tax concessions if the government lifted the caps and provided adequate incentives to encourage additional contributions. The Alliance therefore carried out further simulations to illustrate this point.

Table 7 illustrates the long-term savings to the government of restoring the contributions cap to its earlier level of $50,000 per annum for taxpayers under 50 to $100,000 for taxpayers aged 50 and over (again all indexed to assumed average earnings growth rate of 4% pa). For each of the taxpayers in the Sample Group, the table shows the **additional** savings in Age Pension for each $1 of **additional** tax concession.

Table 7 Further Age Pension savings per $1 tax concession if Caps raised

Earnings	30 yr-olds	40 yr-olds	50yr-olds
Average	$22.08	$25.96	$14.61
1.5 x av.	$13.38	$12.31	$11.10
2.0 x av.	$8.78	$9.23	$7.98

It should also be noted that none of the Sample Group are constrained by the higher caps and **none** would draw on the Age Pension. It should also be noted that the savings in Age Pension costs are a substantial multiple of the cost of tax concessions.

Apart from being too low, the current system of caps also discriminates against several groups of tax payers and cap flexibility should also be introduced. In particular, taxpayers with broken work patterns and those who have worked for a substantial part of their life under a lower (or no) mandatory contribution regime are particularly disadvantaged by the current limit of $25,000 per annum.

The number of female members of SMSFs is growing substantially faster than male members and, in the 34 to 64 age range, there are now more female SMSF members than male members.

It should also be noted that SMSFs have a large proportion of self-employed members. More that half of SMSF funds also have at least one member who is self-employed or derives income from a business or partnership.

For such groups, income can vary dramatically year by year or through their working life and they are thus discriminated against under current contribution "cap" policies.

The Henry Review's view of such groups is that *"support for people who have experienced broken work patterns should be achieved through the Age Pension"*. We disagree if there are other ways of providing incentives for, and not restricting, such groups to save for their retirement and thus not become a cost burden on the government.

At a minimum the government should introduce rolling caps on voluntary contributions similar to the non-concessional caps as suggested by the Alliance in its Pre-Budget Submission. Such flexibility in the contribution regime would provide a better system with lower cost to the government to achieve the same results.

5. Government threatening extra tax on super is retrograde step.

There are persistent rumours that the government will try to increase the tax on superannuation fund earnings during the accumulation phase and may also tax fund earnings in the pension phase. For many of those in the pension phase (in particular those on lower incomes/pensions), this could be worse than the withdrawals tax recently floated by the government and then ruled out by the Prime Minister!

Many older Australians who have invested in superannuation within the rules now face the prospect of a new tax diminishing the value of their savings and hastening the day when they won't be able to support themselves financially and will have to fall back on the Age Pension.

Many younger taxpayers may think that this will not affect them. However, if the government takes away in tax what appears to be a relatively small amount now and in each future year as a young taxpayer's super balance grows, the **cumulative** impact on his/her ability to have enough to retire on a reasonable pension could be seriously compromised. The lower incentive to make additional contributions into super will also lead to a greater reliance on the government's Age Pension in retirement and higher long-term costs to government.

From the government's budget point of view any additional tax on super does not make sense. To illustrate this the Alliance used the Pension Sustainability Model to compare the savings that would accrue to the government as a result of two changes to the current system:

a) Higher contribution limits (as referred to in 4 above), resulting in lower Age Pension costs; and
b) A 5% higher tax rate on superannuation earnings before and during the pension phase.

The model assumes that, with a higher tax rate on super, taxpayers would not make additional contributions into super above the compulsory level.

The first case (a) [Higher contribution CAPS] results in substantially higher net revenue to the government than case (b) [Higher taxes].

Table 8 shows the estimated impact of these two cases (vs just contributing as the SG level) for 30 yr-olds on average earnings, 1.5 x average earnings and 2 x average earnings for this age.

Table 8 Projected savings vs tax concession costs for the Sample Group ($000s)

	Extra contributions allowed by higher cap			5% higher tax rate on earnings		
Earnings	Age pension savings	Tax concessions	**Net benefit to government**	Age pension savings (costs)	Tax concessions (receipts)	**Net benefit to government**
Average	$ 1,843,698	$ 97,738	**$ 1,745,959**	($ 87,750)	($ 56,143)	**($ 31,607)**
1.5 x average	$ 1,593,385	$ 145,576	**$ 1,447,809**	($ 127,610)	($ 89,543)	**($ 38,067)**
2.0 x average	$ 1,460,671	$ 176,927	**$ 1,283,744**	($ 132,715)	($ 125,972)	**($ 6,743)**

The impact of Age Pension costs on the long-term analysis of super is dramatic. In case (a), you will note that the savings to the government of Age Pension costs, by allowing taxpayers to contribute enough to provide a reasonable pension without resorting to the government funded Age Pension are large and vastly outweigh the cost of tax concessions associated with the extra contributions.

Similarly dramatic is that the extra tax revenue from a higher earnings tax rate is more than offset by the extra cost of Age Pensions due to the lower tax incentives to contribute to super. Not only is the "higher tax" case worse for government net revenue than the "higher cap" case, in the Sample Group, it is predicted to result in **lower** net revenue to government than the current situation.

A classic illustration of how raising taxes can lead down a slippery slope into a "lose-lose" situation for everyone.

6. Government "fiddling" is one of biggest risks to super

It appears to those outside Canberra that politicians and bureaucrats don't properly take into account the direct and indirect costs of changes in legislation or unnecessary regulations with respect to SMSFs.

There has also been some scare-mongering about the risk of your investments in super going bad or another GFC and the dangers of people's exposure to equities.

However, the Alliance has used its Pension Sustainability Model to simulate the impact of another GFC on a small SMSF with a balanced and diversified mix of shares, cash and term deposits and compared the long-term impact of this with the long-term impact of extra costs on an SMSF caused directly or indirectly by the government.

It may be a surprise to note that the risk and cost to SMSFs of government action can be greater than the impact of another GFC! The results of this analysis will be the subject of a further research paper by the Alliance to be published in due course.

7. Government must stop considering your super savings as a source of tax revenue to fix its problems.

It is widely accepted that, for a superannuation system to work effectively, the regulatory environment in which it operates should be stable.

- Changes to the superannuation rules leads to administrative costs which have a long-term impact on the nation's superannuation savings; and
- The uncertainty regarding future changes is detrimental to both the saver and government. To the extent that taxpayers are put off investing in super because of continual changes, tax incentives are less effective than they otherwise could have been (i.e. have to be greater to achieve the same result). This results in additional cost to the government.

Changes to the superannuation system should not be made on the whim of the Treasurer and Prime Minister on budget night. If this government is continuing to spend more and feels it has a mandate to do so, then it needs to find the revenue to pay for such spending using transparent increases in other taxes – or else not spend more and live within the government's (non-super) means.

THE WAY FORWARD

At a minimum, therefore, it is imperative that the government:

a. Raises the Cap levels;
b. Introduces some Cap flexibility;
c. Does not introduce more tax; and
d. Does not increase complexity, regulation and cost burden for SMSFs

The Alliance does not claim to have all the answers. Cooper and Henry both undertook comprehensive reviews of the superannuation systems and the results of these should be more thoroughly and widely debated before the government attempts any further moves on your super.

However, the Alliance is currently in the process of preparing a clear vision of a sustainable superannuation system for Australia that takes the log-term view, is fair to taxpayers and affordable to government.