9 June 2015

Hon Malcolm Turnbull MP
Prime Minister

Hon Scott Morrison MP
Treasurer

Hon Kelly O'Dwyer MP
Assistant Treasurer

Dear Prime Minister, Treasurer & Assistant Treasurer

<u>Intended Consequences?</u>

We believe that much of the backlash against the policy changes announced in the budget is due to lack of clarity and understanding as to the long-term consequences of the policy. Unfortunately a recent meeting with representatives of the Treasurer's office did little to assist this. We are therefore writing directly to you to highlight the issues that could be addressed when legislation of the policy is being drafted that would alleviate many concerns.

The following summarises our view of the intent of the budget measures regarding the new caps from a reading of the budget and its supporting papers.

<u>Re: Transfer Balance Cap</u>

It appears that the announced policy is intended to limit the amount that can be transferred into a tax-free pension account to a sum that can fund a pension equivalent to four times the Age Pension. Any sum above that (Excess) must either be withdrawn from super or kept in a taxable accumulation account.

The papers state that it is intended that this measure will improve sustainability and fairness in the system and minimise the use of such tax-free fund for tax minimisation or estate planning purposes.

<u>Re: Non-concessional Contributions Cap</u>

It appears that the Government acknowledges that some people may not be able to save adequately through concessional contributions and so allow non-concessional contributions to be made to boost their savings in super. The Transfer Balance Cap then limits each individual's pension account, though sums above this cap (Excess) can still be held in an accumulation fund which may, in some but not all cases, be taxed at lower rates than taxation at income tax rates.

It therefore appears that the announced Non-concessional Contributions Cap is intended to limit the size of the Excess.

Again it is stated in the budget papers that the overriding purpose is to improve the sustainability of the superannuation system and ensure the system is not used for tax minimisation or estate planning purposes.

Main issues with budget announcement

Whilst there may be some disagreement with the policy as enunciated above, most of the backlash has been on the retrospective implications of the detail. The problem with this is not just the relatively small number of people that would appear to be directly affected (although it is substantially larger than the number you have been quoting), but the uncertainty it causes regarding the inclination of both major political parties to dramatically change the super rules in this way. This increased uncertainty and 'sovereign' risk then means that government incentives to save in super need to be higher to have the same impact.

We submitted to the Treasurer's office a list of 22 consequences we identified with regard to the announced policy, many of which in good faith, we believed to be unintended. However, the following are the main issues causing concern amongst the members of our organisation and our associate organisations.

1. **Retrospective transfer cap**

   If the Transfer Balance Cap were to only apply to transfers for future retirees and from a future date, workers can either decide to increase their consumption or to change their savings strategy during their working life, working longer as necessary to ensure they have a retirement lifestyle they have anticipated.

   However, extending the policy to apply not only to new retirees but also to those who have already transferred all their funds into a pension account is retrospective in its impact (notwithstanding any 'technical' arguments to the contrary). It is applying a transfer balance cap retrospectively to transfers that have already been made.

   Such retirees have already made decisions regarding consumption and savings methods based upon the encouragement from Government to increase their self-sufficiency in retirement.

   Such decisions cannot be reversed and in almost all cases such retirees cannot move back into the work force, so the policy would appear to be ***unfair*** to those who have already retired vs those yet to retire who can make alternative decisions. This policy will impact those who have genuinely saved in super for retirement purposes and not for estate planning purposes. There are other fairer ways to reduce the possibility of existing retirees using the superannuation system for estate planning purposes which we are happy to discuss with you.

2. **Retrospective application of Non-concessional Contributions Cap**

   The new cap on on–concessional contributions should apply prospectively and not retrospectively back to 2007.

   In comments to a superannuation conference in Adelaide in February this year, the Treasurer seemed to agree that retrospective changes to superannuation are unsettling and unfair.

   "One of our key drivers when contemplating potential superannuation reforms is stability and certainty, especially in the retirement phase. That is good for people who are looking 30 years down the track and saying is superannuation a good idea for me? If they are going to change the rules at the other end when you are going to be living off it then it is understandable that they might get spooked out of that as an appropriate channel for their investment. That is why I fear that the approach of taxing in that retirement phase penalises Australians who have put money into superannuation under the current rules – under the deal that they thought was there. It may

not be technical retrospectivity but it certainly feels that way. It is effective retrospectivity, the tax technicians and superannuation tax technicians may say differently." Treasurer Scott Morrison, 18 February 2016

Three other big issues with the detail of the announcement which, if resolved, would, we believe, dramatically reduce criticism of the budget policy are as follows.

3. Incorrect valuation of Transfer Balance Cap

We take issue with the statement the Treasurer made in his Budget speech that:

"*A balance of $1.6m can support an income stream in retirement of around four times the level of the single age pension." a*nd the indication in Budget Paper No 2 that this order of retirement income stream is commensurate with a defined benefit pension of $100,000.

These comparisons do not account for the risks faced by members of APRA-regulated and self-managed funds:

- Economic risk, including very low interest rates
- Market risk affecting investment returns and possible loss of capital
- Inflation risk eroding the value of savings
- Credit risk, on corporate bonds for example
- Longevity risk that superannuation savings may not last long enough

Members of defined benefit schemes, and age pensioners, do not take any of these risks. Instead the risks are borne by the taxpayer.

Work undertaken for SMSF Owners' by Dr Ron Bewley, former Head of the School of Economics at the University of NSW shows that in order to deliver an income equivalent to four times the Age Pension, the Transfer Balance Cap should be $3.2 million. Or, alternatively, it should be admitted that a $1.6 million cap will only deliver twice the Age Pension.

The equivalent defined benefit pension that can be funded from $1.6m would therefore be close to $50,000 p.a. rather than $100,000.

We further take issue with the limited escalation of the Transfer Balance Cap which, by our calculation, means that someone starting work now will be unable to save in super an amount adequate to fund a pension better than the Age Pension.

We therefore suggest that it would be a more sustainable solution to specify the Transfer Balance Cap as a multiple of the Age Pension. (By our calculation it should be about 130 times the Age Pension).

4. Ability to top up

It appears that the purpose of a Non-Concessional Contributions Cap in addition to an overall Transfer Balance Cap is to limit the funds left in an accumulation account if the tax-free pension account is up to the limit.

However, there may be individuals who for whatever reason have been unable to make adequate concessional contributions but are prepared to top up their super using after tax funds (e.g. from sale of their house). However, the new lifetime Non-concessional Contributions Cap may restrict them from making their desired contribution even though this would not breach the overall Balance Transfer Cap. This appears to be an unintended consequence and unfair on those who have been unable to make adequate concessional contributions.

We suggest that upon retirement individuals may make an additional Non-Concessional Contribution above the $500,000 Cap provided their balance does not then exceed the Transfer Balance Cap.

5. Concessional contributions cap

Finally, but by no means least important is the impact of the lower concessional contributions cap. We applaud the Government for introducing flexibility in contributions but our analysis still shows that the lower cap will in too many cases result in people saving inadequate amounts to fund a pension equivalent to more than the age pension.

In particular, it should be recognised that in the real world most people cannot make contributions up to the $25,000 cap in their early working years but that this cap is inadequate later in their career when they are more able to make substantial contributions.

We strongly recommend the Government reinstate the existing practice that the concessional contributions cap for those over 50 is double the standard cap – that is, $50,000p.a.

We believe the Government should address the issues that we have raised and which are weighing on the minds of many people - many more than 4% of superannuation fund members - who are concerned that the Government's retrospective policy changes will have an adverse impact on their retirement plans and the standard of living in retirement they had planned on the basis of existing policy.

This concern is not held just by the 4% who may be affected adversely by the Budget measures as of now, but many more who are aspiring to have save and be independent of the Government when they retire. We are also concerned that continual changes to superannuation by governments is undermining confidence in superannuation as a reliable savings mechanism, particularly among young people who cannot be sure that the savings they make today will still be there when they retire decades from now.

We would welcome a commitment from the Government that after the election it will submit it's figuring to independent public review. We suggest a panel be appointed, including representatives of Australia's one million self-managed fund members, to check the assumptions and calculations that underpin the Government's policy. If the Government is confident of the policy rationale, and the numbers it has relied on, it should have nothing to fear from such an independent review.

If you addressed the retrospective aspects and concerns about the consequences of the Government's policy, it would clear the way for Labor's retrospective policy to be more strongly criticised.

Yours sincerely,

Bruce Foy
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SMSF Owners' Alliance

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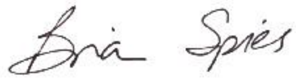
Chair
Australian Shareholders’ Association



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