In Defence of Self-Managed Super Funds

Self managed super funds (SMSF's) have been under fire in recent times with statistics citing a small number of funds with relatively large assets and calls for these funds to be taxed. Whenever these statistics are quoted, there is no mention of how many members are provided for by those funds or for how long those funds need to last those members. The figures are merely sensationalised to portray beneficiaries of self managed super funds as wealthy tax dodgers.

Pauline Vamos and her Association of Super Funds of Australia which claims to be "the voice of super" but which is in fact only a well funded lobby group for corporate super funds, banks, insurance companies and industry professionals seems be targeting self managed super funds in particular. It should be pointed out that ASFA member funds manage billions of dollars worth of super funds whereas a small number of self managed funds have assets of a few million dollars.

According to the ASFA's own research, there are only 475 people in pension mode with account balances of more than $10 million. While this is arguably a large account balance to have, it should be noted that these funds were contributed according to rules applicable at the time and it is probably not a very intelligent idea to formulate future government taxation policies around the good fortune of 475 people.

Is this campaign being waged because the ASFA would like to see self managed super funds eliminated so Pauline's members could have even more funds under management and earn even more fees?

During the leadership of John Howard and Peter Costello, the Australian people were told that there would be increasing numbers of baby boomers retiring in years to come and that the Government would not have enough money to fund the pensions of so many retirees. As a result, the Howard government encouraged people to accept responsibility for funding their lifestyle between when they retired and when they die and they provided incentives for people to set up and fund self-managed super funds. These incentives were open to ALL Australians, not just a select few.

At the time, Peter Costello told the Australian people that if they put the money aside into self managed super funds as per the guidelines the government set out at the time, they would not be taxed. In good faith many people did so, thinking that they could retire in the knowledge that they could adequately provide for their future needs.

Sensible and responsible retirement planning takes into consideration a person's expected lifespan, their lifestyle choices, their future medical needs, spending patterns and their available asset base.

As such, a retirement planning horizon needs to span between 30 and 40 years.

Typically self managed super funds are set up by people who are confident in managing their own financial affairs; who are willing to accept responsibility for their retirement lifestyle and who do not want to become a drain on the public purse.

Typically such self funded retirees do not draw a pension or part pension and do not have a pharmaceutical benefits card. They do not ask for or receive any government support to fund their retirement, nor do they expect to receive a pension before they die. In other words, they accept total responsibility for funding their lifestyle between now and when they die.

In order to create confusion and animosity towards self managed super funds in the minds of taxpayers, figures are quoted of people who live in multi-million dollar homes who draw aged pensions. Many of these people have few assets besides their valuable home and are considered asset rich and cash poor. Many of these people bought their houses long ago in well to do suburbs of cities such as Sydney and Melbourne and did not downsize to adjust for a more modest lifestyle in retirement. These people do not have self managed super funds with large account balances, otherwise they would not qualify for a pension or part pension.

The issues surrounding self managed super funds and asset rich and cash poor retirees in receipt of pensions are <u>two separate and unrelated issues</u> which need to be addressed differently.

If some of the critics of self managed super funds bothered to research the process of setting up the more substantial self managed super funds more thoroughly, they would find that in many cases a lengthy process of restructuring and selling assets/businesses was involved in establishing these super funds. Some of the larger balances in these self managed super funds arose out of the sale of businesses and other income producing operations to fund a long term retirement plan. It was not just a simple matter of moving assets around in order to save tax as some people would have you believe.

The most recent (Sept 2014) national figures released for the ASFA Retirement Standard show that, in general, a couple who own their own home, looking to achieve a comfortable retirement needs to spend at least $58,364 a year.

Even though my experience is that this is a considerable underestimation, if we take this figure and multiply it by an expected lifespan of 30 to 40 years, we find that a super fund balance of between $1,750,920 and $2,334,560 is required! These figures do not allow for changes in spending patterns, the effects of inflation, fund earnings, economic downturns or the possible effects of taxation. Nevertheless, this simple calculation shows that these so called wealthy funds are not so wealthy after all!

We should also remember that when a self managed super fund is in pension mode, a Government prescribed percentage of the fund’s balance must be paid out as a pension every year and therefore the balances in these self managed funds will decline over time as the beneficiaries become older.

I accept that many people would argue that a super fund balance of $2.5m is a lot of money, however, the statistics indicate that it is only a relatively small number of people who have this amount of money set aside in their super fund.

In fact, only 10% of SMSFs (around 54,000 SMSFs) have assets between $2 million and $5 million, although most are closer to the $2 million mark rather than the $5 million mark. Furthermore, because a SMSF balance generally represents at least two members, this balance needs to be halved to provide a more realistic picture of individual member balances.

Nearly three-quarters (70.4%) of SMSFs have fund balances of less than $1 million, and assuming most SMSFs represent two people, the statistics then suggest that nearly three-quarters of SMSF members have less than $500,000 each in super savings. As at December 2014, the average assets per fund member were $549,314. This would hardly qualify these people as being wealthy!

Before labelling self managed super fund beneficiaries as wealthy, we should consider what size account balance is required to finance a life in retirement. For example, if that super balance is invested in term deposits rather than the share market, the income derived from a $1 million account balance is just $33,000 per year, based on the current 3.3% term deposit rate. By comparison, the combined Age Pension for a couple is just under $34,000.

Given that the ASFA says that an annual income $58,364 is required for a comfortable retirement, it is clear that a fund balance of several million dollars is not unreasonable and does not provide for a millionaire lifestyle as we are led to believe.

Before concluding that people with such super fund balances are wealthy tax dodgers however, we should remember that these people do not avail themselves of public funds and their super nest egg needs to last them for the rest of their lives. In other words, they do not see super as a means of paying off their debts, paying for a few overseas trips and a new car, and then when the money has been reduced or used up, applying for the pension. These people are planning to be self-reliant for the rest of their lives!

In many cases, these people have made significant sacrifices during their working lives to fund their future retirement and have probably been astute money managers to provide for their future.

These people also need to spend a considerable amount of their retired life reading and researching financial information, educating themselves and managing their affairs, whereas a pension recipient has extra leisure time available to them because they don't have the burden of financial management.

I agree that people with a substantial asset base should be precluded from receiving the aged pension, particularly if they have the means to look after themselves in retirement. Those people who have chosen not to restructure their assets in preparation for retirement, should not be entitled to receive a government pension in my opinion.

On the other hand, I do not agree that people who have followed the Government's rules in setting up their own self managed super funds in good faith, should now be taxed on those funds, particularly when those super funds are already in pension mode.

If the Government wants to change the rules surrounding self managed super funds for the future to achieve different budget outcomes, then I have no problem with that because everyone can make decisions based on those new rules provided the changes don't take effect immediately. However, those people who are already in pension mode, have made plans for the next 30 to 40 years based on the rules at the time and cannot earn extra money to cover taxation costs which were not part of the original picture.

If the Government erodes the life savings of these self funded retirees, they will eventually end up on the pension and become a drain on the public purse or move overseas where the drawdown of their savings no longer contributes to the Australian economy and this will not help to balance the budget either.

Retired people have more time available than those working. Unless they choose to spend all day in front of a television set, retirees are busily exercising or engaging in sports, volunteering, learning, visiting or minding grandchildren, helping in the community, caring for sick or elderly relatives, travelling, socialising or pursuing hobbies. In other words, they still lead productive lives and contribute to our society and economy.

While some people may think that they can enjoy an active, comfortable retirement on a very low income, the reality is quite different.

Many people put off maintenance jobs on their home until they have more time in retirement and then they find that the repairs and renovations make significant inroads into their savings. Replacing the family car is often deferred to retirement, when the replacement cost becomes a significant depletion of savings.

Many a retiree wants to buy a caravan and head off around Australia only to discover that they are spending a lot more on fuel, maintenance and repairs than they ever did travelling to and from work. While these people are spending their savings in retirement, they are also helping to support many outback towns financially and others help our farmers through causes such as BlazeAid.

As they become older, retirees usually find themselves spending more on healthcare, mobility aids and support services.

While self managed super funds are not taxable in the pension mode, we should also remember that they are also not eligible for tax deductions either. All of the arguments put forward in favour of taxing self managed super funds do not acknowledge that such expenditure would become tax deductible as well, thereby reducing the actual tax collected.

In general, it seems that the proponents of taxing self managed super funds focus on sensationalising the small number of large account balances and ignoring the time frame over which these retirement nest eggs will be drawn down and the fact that these retirees do not qualify for pensions and the pharmaceutical benefits card.

The whole point of having a superannuation account, and the basis behind Australia's Retirement Income Policy (compulsory super, voluntary super contributions and Age Pension safety net), is to ensure that as many Australians as possible are encouraged to save for their future retirement. It stands to reason therefore that, the older a person is, the longer they will have worked and the more likely it is that they will have a larger super account balance, compared to a younger worker.

We should also remember that it is not so long ago that we had a GFC – Global Financial Crisis. What if the super fund balances of many of these so called rich retirees are eroded overnight and these people are too frail to go back to work?

If changes are to be made, they should apply to new funds and not those already in pension mode.