

Dear Sirs

My wife and I have a small self-administered superannuation fund which was set up following our arrival in Australia ten years ago.

Our sole objective is to put ourselves in a position to fund an independent retirement, and we have worked hard and lived frugally in order to try to achieve this.

We are concerned that certain comments and findings in the FSI Report both betray misunderstandings as to the fundamental importance of superannuation savings to hard-working, independent individuals, and pose a threat to the continuing health of the privately funded superannuation system.

Firstly the impression is conveyed in the report that DIY super funds enjoy particular tax privileges.

SMSFs are subject to the same super and tax rules as large super funds. The tax benefits enjoyed by SMSF members are the same tax benefits that anyone in a large super fund enjoys. Any super expert, or commentator, who fully understands how SMSFs operate, would never suggest otherwise.

The University of New South Wales Australian School of Business has conducted some research to investigate whether SMSFs 'were just tax avoidance vehicles'. Ignoring the unfair assertion that 1 million or so Australians who have had the forethought to substantially save for their retirement are potential tax avoiders, I believe the fact that this research was seen as necessary, indicates how much misinformation about SMSFs is swirling about within the financial community. Even so, the university said the research showed a "surprising result".

The university found that although SMSFs may be organised in a different way to other types of super funds, it has nothing to do with tax avoidance, "it is simply a function of the legal structure of the super fund."

The study also found that SMSF trustees were fairly conservative and wanted to be able to "sleep at night and not worry about a knock on the door from the ATO". Most significantly, the research found that SMSFs have no tax advantage over large super funds, that is, the tax rules for each type of super fund are the same, except for one rule relating to tax avoidance, which favoured the large super funds. The research did note that the tax efficiencies may differ between types of funds, which I assume refers to how SMSFs manage after-tax returns. Large super funds have only recently embraced after-tax investment returns as a measure for fund managers.

Secondly, the existence of franking credits is seen as creating some sort of unfair bias in the tax system.

The purpose and effect of the dividend imputation system is to ensure that Australian shareholders pay tax on their dividends at their marginal rate and no more. It is not a tax concession to shareholders.

Until 2001, imputation credits could be used to offset other tax liabilities only up to the limit of those tax liabilities. Any excess credits were simply lost to the taxpayer. Since 2001 any imputation tax credits in excess of tax liabilities are refunded in cash. Taxpayers whose marginal tax rate is lower than the company tax rate obviously benefit from this tax refund. Taxpayers whose marginal tax rate is higher than the company tax rate clearly need to make up the difference.

The refund of unused imputation credits and the tax-free status of super pension funds together explain the popularity of Australian shares inside SMSFs. Because the marginal tax rate of a super fund paying a pension is zero, the imputation credits are refunded in cash to the fund on completion of the fund's tax return. Using the example above, if the fund receives a \$30 refund in addition to a \$70 paid in dividend, the tax refund is more than 40% greater than the dividend itself. Retail and industry super funds paying pensions also receive a refund for their imputation credits but the lack of transparency around their operations means that most members of these funds are unaware of the benefits that Australian shares bring to their retirement savings. That notwithstanding, fund managers most certainly are aware of, and keen to retain, these tax benefits.

We have placed a considerable portion of our superfund investments in blue chip Australian shares, and the future returns of our fund, and therefore its ability to pay our pensions, would be seriously threatened if the franking credits were removed.

We hope that our views and concerns will be carefully considered during the White Paper process

Yours Faithfully

RB and Mrs MC Timmons