THE AUSTRALIAN BUSINESS REVIEW

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Another botched job on superannuation emerges

The Australian | 7:33AM May 3, 2017

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Let’s hope that Treasurer Scott Morrison stays well away from superannuation changes in next week’s budget. Last year’s changes were a complete botch because the people around him on superannuation matters do not understand the industry.

Now in the weeks leading up to the budget, it is clear that the same people are still steering the government’s superannuation ship because another example of superannuation incompetence has emerged.

Separate from the 2017 Budget, Parliament is set to consider a bill that drastically changes the rules for those who have borrowed in their superannuation fund to buy property.

And, surprise, surprise, once again it looks like a botched job so Scott and his people are trying to sneak it through the parliament with very little debate and examination.

The Canberra public servants are brilliant at looking after their gold-plated lifetime pensions and their associated rorts but have no idea how the rest of the superannuation world works.

When it comes to borrowing in self-managed superannuation to buy property, I have never been a supporter of the practices and thought David Murray’s Financial System Inquiry recommendation that borrowing by SMSFs should be stopped was correct. But the government rejected it and instead asked the Council of Financial Regulators and the Australian Taxation Office to monitor SMSF borrowing and report back in three years.

We have not seen any report to justify action but research by Credit Suisse shows that so called ‘limited recourse borrowing’ by self-managed superannuation funds has increased from approximately $2.5 billion in 2012 to more than $24 billion — almost a 10-fold increase in five years. Almost all of this self-managed superannuation fund borrowing is invested in residential dwellings. What started out as a fairly minor investment category is now becoming significantly larger.

If the government has now changed its mind and no longer likes this practice then the right thing to do is to stop it with proper grandfathering. Instead, they are using back door methods with highly complex legislation to attack those that have entered into these arrangements in line with specific government policy.

Duncan Fairweather, the executive director of the Self Managed Superannuation Fund Owners' Alliance, has dropped me a note to alert me to what the government has done.

The Explanatory Memorandum says the Bill will ensure that where a fund has limited recourse borrowing arrangements in place the total value of its assets is properly accounted for in working out individual members' total superannuation balances. That's a reasonable aim.

But the Bill is highly complex and looks like it is designed to make borrowing so difficult for SMSFs that it will become untenable and effectively achieve a backdoor ban on this method of building fund assets. There is no grandfathering.

Fairweather tells me he has had experts trying to work out what the highly technical legislation means and he has not found anyone who can understand it with certainty.

Superannuation should be very simple but poor public servants often hide behind the complexity they create. As best as Fairweather can understand this is how they will attack those with $24 billion in superannuation fund borrowing.

Let's assume a SMSF member's account has gross assets of $2.5 million, of which $1.2 million is covered by borrowing. So the net value of the member's account is $1.3 million.

At this level, under the existing legislation, an eligible member would be able to make a $300,000 non-concessional contribution from July 1, 2017. The fund might then use the non-concessional contribution amount to repay some of the borrowing.

However, under the proposed legislation it looks like the $1.2 million would be a 'credit' back to the member's account, and therefore they will be deemed to have a total superannuation balance of $2.5 million, which then means they are not eligible to make any non-concessional contributions as they are above the total $1.6 million superannuation balance cap.

Frankly, this is a highly controversial argument and understandably this may then affect the borrower's capacity to repay the loan and render the investment uneconomic. Assets covered by borrowing may need to be sold. (Almost in jest I speculate that this maybe a back door attack in the housing market).

The 2016 budget superannuation changes were retrospective but the government said they were not. They were not telling the truth and the backbenchers worked this out and forced change. Here we go again with what looks very like retrospective legislation wrapped in a very complex bill. Our retirees deserve better.