Better targeted superannuation concessions

Consultation paper

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Manager
Media Unit
The Treasury
Langton Crescent
Parkes ACT 2600
Email: media@treasury.gov.au

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Consultation Process

Request for feedback and comments

Interested stakeholders are invited to comment on the issues raised in this paper by 17 April 2023. Submissions may be lodged electronically or by post; however, electronic lodgement is preferred via email to: superannuation@treasury.gov.au. For accessibility reasons, please submit responses via email in a Word, RTF, or PDF format.

Submissions will be shared with other Commonwealth agencies where necessary for the purposes of this review. All information (including name and address details) contained in submissions may be made publicly available on the Australian Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose.

If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment. Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: 17 April 2023

Email	superannuation@treasury.gov.au
Mail	Director Tax and Transfers Branch Retirement, Advice and Investment Division The Treasury Langton Crescent PARKES ACT 2600
Enquiries	Enquiries can be initially directed to superannuation@treasury.gov.au

The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Better targeted superannuation tax concessions

Introduction

On 28 February 2023, the Government announced it would reduce the superannuation tax concessions available to individuals whose total superannuation balances exceed $3 million. The changes will apply from 1 July 2025.

This reform is intended to bring the headline tax rate to 30 per cent, up from 15 per cent, for earnings corresponding to the proportion of an individual's superannuation balance that is greater than $3 million. Earnings relating to assets below the $3 million threshold will continue to be taxed at 15 per cent or 0 per cent if held in a retirement pension account.

As is the case currently, there will be no limit imposed on the amount of money an individual can hold within superannuation, subject to the existing contribution limits.

By 2025-26, the changes are expected to apply to less than 80,000 people, meaning that more than 99.5 per cent of individuals with a superannuation account will be unaffected.

This consultation paper seeks views from interested parties on the implementation of these changes.

Overview

This paper provides an overview of the proposed model for identifying who will be affected, how the tax will be calculated and what the new rules mean for individuals and trustees of both SMSFs and APRA-regulated funds. Each of these aspects are discussed in more detail throughout the paper.

This policy will apply to individuals with a total superannuation balance (TSB) of more than $3 million. An individual's TSB is the combined value of all their superannuation accounts. Where an individual holds more than one account, for example an account in a SMSF and an account in an APRA-regulated fund, the TSB is the combined value of both accounts.

The policy will commence on 1 July 2025 and apply from the 2025-26 financial year onwards. This means individuals with a TSB more than $3 million on 30 June 2026 will be subject to the new arrangements.

Earnings on the part of an individual's TSB over $3 million will attract an additional 15 per cent tax. Earnings for this purpose will be calculated using a formula. Where an individual has multiple superannuation accounts, a combined earnings amount will be calculated. If an individual has negative earnings, these can be carried forward indefinitely and offset against future earnings. Tax will be applied to part of the calculated earnings on a proportional basis. The proportion will be equal to the proportion of an individual's TSB that is more than $3 million.

The additional tax will be applied directly to the individual. There will be no change to the tax arrangements within superannuation funds. Earnings on superannuation balances less than $3 million will continue to be taxed at the concessional rate of 15 per cent. For example, where an SMSF is shared between four members and only one member has a TSB more than $3 million, this will not impact the other three members of the fund. It also means members of the same fund, or spouses, cannot combine their thresholds.

The Australian Taxation Office (ATO) will collect the relevant information and calculate the tax liability. All superannuation funds currently report a wide range of information to the ATO which will be used to calculate the additional tax. While the proposed model is intended to minimise compliance costs, it

is expected that some amendments to these reporting arrangements will be required to support the new rules. For SMSFs this would likely be reported as part of the end of year tax return process. Existing reporting arrangements may need to expand for APRA-regulated funds.

Once the ATO has calculated the tax liability, a notice of assessment will be sent to the individual. This is separate to the individual's personal income tax. Similar to the payment options for Division 293 tax (which is an additional 15 per cent on contributions tax for high-income earners) the individual can choose to pay the tax directly using personal assets or alternatively, they can choose to release money from their superannuation account. Where an individual has multiple superannuation accounts, they can choose which account (noting defined benefit accounts may have existing limitations).

Information relating to the 2025-26 financial year is likely to be reported in the first half of 2027. Therefore, the first notifications for the new tax liability are expected to be issued in the second half of 2027.

As the majority of superannuation members are unaffected by this measure, the proposed approach seeks to avoid imposing significant and costly systems and reporting changes that would impact other members. Superannuation funds, including many SMSFs, have a pooled investment approach which is shared between members. Many impacted individuals have an interest in an APRA-regulated fund, or both a SMSF and an APRA regulated fund, increasing the importance of a sector-neutral approach to implementation. The systems and reporting changes that would support calculating taxable income for APRA-regulated funds at a member level present significant challenges. Utilising existing fund reporting requirements and applying the reforms at the individual level largely avoids these issues, and is consistent with the approach taken in other measures that require different superannuation accounts to be aggregated, such as the Transfer Balance Cap.

Applying the new arrangements equally to accounts held in SMSFs and APRA-regulated funds ensures that it does not influence the choice of members to invest through an SMSF or APRA-regulated fund. This consultation also seeks views on how a broadly commensurate treatment can be applied to defined benefit superannuation accounts. Individuals have the option to choose a superannuation arrangement that best suits their personal circumstances. This policy is designed to ensure that flexibility and choice is maintained.

Implementation detail

Who is in scope?

The measure commences on 1 July 2025, meaning the first test date will be 30 June 2026. The threshold for determining whether an individual is in scope is $3 million. The threshold applies to individuals of all ages, even if an individual is not eligible to access their superannuation benefits (i.e. under preservation age or under 65 and still working).

In practice this means if on 30 June 2026 an individual's TSB is less than $3 million, they will not be impacted. If on 30 June 2026 an individual's TSB is more than $3 million, they will be subject to additional tax on calculated earnings.

Individuals can identify whether they will be subject to the new tax by reference to their TSB at the end of each financial year. The ATO calculates all individuals' TSBs annually using information provided by superannuation funds. If an individual has more than one superannuation account, their TSB represents the combined value of all accounts as at 30 June each year. Individuals can check their TSB through ATO online services which can be accessed via myGov.

As all superannuation funds, including SMSFs, already report the required information to calculate TSBs, this avoids imposing additional reporting obligations on funds and members. SMSFs with unlisted assets, such as real property, already report market valuations for these assets on an annual basis for the purposes of calculating the TSB. This measure will not require additional valuation reporting by SMSFs.

The $3 million threshold will not be indexed. This is similar to other thresholds in the superannuation law, such as the Division 293 threshold or the low-income superannuation tax offset, and provides certainty to people when arranging their tax and financial affairs.

The threshold applies to individuals. It is not shared between spouses or family members, or between other individuals who have interests in the same fund, such as in a SMSF.

Example – Balance not affected by changes

Debbie has a balance in her superannuation fund of $150,000 at 30 June 2025, which is the average superannuation balance.

Debbie's balance at 30 June 2026 is $165,000.

The proposed changes will not apply to Debbie because her total superannuation balance is less than $3 million.

Example – SMSF balance more than $3 million, shared across two members

Joe and Sally are both members of the same SMSF. They have no other superannuation accounts. The investments in the SMSF are shared between both members.

The total value of their investments in the SMSF at 30 June 2026 is $3.2 million. Of this, $2 million is allocated to Joe's accounts and $1.2 million is allocated to Sally's accounts.

Joe's total superannuation balance is therefore $2 million. Sally's total superannuation balance is $1.2 million.

Neither Joe nor Sally has a total superannuation balance more than $3 million. Neither of them will be impacted by the changes.

Example – Balance across multiple accounts more than $3 million

Melanie is 62 and has three superannuation accounts with the following balances at 30 June 2026:

- A pension account in her SMSF with $1 million
- A second pension account in her SMSF with $700,000
- An accumulation account in an APRA-regulated fund with $2 million

Melanie's total superannuation balance captures all of her superannuation accounts.

Her total superannuation balance on 30 June 2026 is $3.7 million. As this is more than $3 million Melanie will be required to pay additional tax.

The tax will only be applied to the earnings on her superannuation balance over $3 million.

Melanie's superannuation balance over $3 million is $700,000 ($3.7 million - $3 million). The earnings from $700,000 will attract additional tax.

Method for calculating tax liability

Once it has been determined that an individual's TSB exceeds the $3 million threshold for a year, earnings relating to the part of their TSB over $3 million will attract an additional 15 per cent tax.

First, earnings in relation to an individual's total superannuation interests are calculated as the difference between their TSB for the current year (adjusted for withdrawals and contributions) and their TSB from the previous financial year.

$$Earnings = (TSB_{Current\ Financial\ Year} + Withdrawals - Net\ Contributions) - TSB_{Previous\ Financial\ Year}$$

For example, on 30 June 2025, Sarah's TSB is $5.5 million. On 30 June 2026, Sarah's TSB increases to $6 million. Sarah makes a withdrawal of $150,000 during the year. Sarah's calculated earnings are $650,000 ([$6 million + $150,000] - $5.5 million).

If the calculated earnings in the first step are negative, this amount is carried forward and can be used to offset future earnings for this purpose. In this case, no further calculations would be required.

Once earnings are calculated, under the second step, earnings are then attributed to superannuation balances of more than $3 million on a proportional basis. The proportion is equal to the proportion of the TSB over $3 million.

$$Proportion\ of\ Earnings = \frac{TSB_{Current\ Financial\ Year} - \$3\ million}{TSB_{Current\ Financial\ Year}}$$

For example, Sarah's TSB on 30 June 2026 is $6 million. The proportion of her TSB more than $3 million is 50 per cent ([$6 million - $3 million] ÷ $6 million). In this case 50 per cent of the calculated earnings from step 1 will attract the additional tax.

Finally, a flat tax rate of 15 per cent is applied to the proportion of earnings attributable to an individual's balance over $3 million.

$$Tax\ Liability = 15\ per\ cent\ \times Earnings\ \times Proportion\ of\ Earnings$$

For example, Sarah's calculated earnings are $650,000, however only 50 per cent of these earnings are attributed to her TSB more than $3 million and attract the additional 15 per cent tax.

Sarah's tax liability is $48,750 (15 per cent x $650,000 x 50 per cent).

Calculating earnings

The approach to estimate earnings seeks to be simple and minimise unnecessary or additional compliance costs by largely relying on data reported through existing arrangements. As noted above, this recognises impacted individuals hold their superannuation interests in SMSFs, APRA-regulated funds and in many cases both a SMSF and an APRA-regulated fund.

The following sections of the paper look at the components of the earnings calculations. Issues relevant to defined benefit interests are discussed separately.

The proposed earnings calculation involves three key components:

- Total Superannuation Balance (TSB) – An individual's TSB is the total value of accumulation phase and retirement phase interests plus in-transit rollovers and certain outstanding limited recourse borrowing arrangements[1] (LRBA) less structured-settlement contributions[2].
- Withdrawals – This is intended to capture amounts which have been removed from superannuation and are not reflected in the closing TSB.
- Net Contributions – This is intended to capture amounts that were added to superannuation and are reflected in the closing TSB, net of any contributions tax.

Some modifications to these inputs may be required for the purposes of calculating earnings where the reliance on the TSB in specific circumstances generates unintended outcomes.

In some cases, the earnings that are calculated for a year will be negative. Negative earnings will be able to be carried forward and used to offset future earnings. Further details about negative earnings are provided below.

Total superannuation balance

The TSB is an existing calculation that applies in determining eligibility for a range of superannuation measures. These include eligibility to carry-forward concessional contributions and to make non-concessional contributions.

The following section outlines how the TSB is currently calculated. Stakeholder views are being sought to determine whether modifications to the TSB are required for the purposes of calculating the earnings tax liability.

The TSB is calculated by adding the value of accumulation phase interests, retirement phase interests, in-transit rollovers and certain outstanding LRBA's, less any personal injury or structured settlement contributions paid into superannuation. This annual calculation relies on information already held by the ATO and information reported by all superannuation funds on an annual basis.

The accumulation phase value is a withdrawal value, reflecting the amount that would be payable if a member's account was closed. It includes transition-to-retirement income streams that are not in the retirement phase. The accumulation phase value is separate from the retirement phase value.

In the retirement phase, the value of an interest is equal to the individual's transfer balance except for account based pensions that are based on the current value. Debits to the transfer balance account relating to structured settlement contributions are disregarded.

The TSB includes the value of any amounts which are in the process of transferring between superannuation funds (in-transit rollovers) and are therefore not reflected in either of the accumulation or retirement phase values. Certain outstanding LRBA amounts are also added to the TSB calculation.

The starting point for the earnings calculation is the difference between the TSB at the end of the financial year and the TSB from the financial year prior. The change over this period may be either positive or negative depending on the earnings generated by the fund, including all notional gains and losses.

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[1] A limited recourse borrowing arrangement (LRBA) is an arrangement where an SMSF trustee takes out a loan from a third-party lender. These funds are then used to purchase an asset inside superannuation.

[2] A structured settlement contribution is a contribution made to superannuation from a personal injury payment.

Example – Calculating earnings

Esther's TSB at 30 June 2025 is $3.5 million. On 30 June 2026 her TSB has increased to $4 million. She makes no contributions or withdrawals during the 2025-26 financial year.

Esther's earnings are calculated by subtracting her TSB from the previous financial year from her current TSB.

Earnings = $4 million - $3.5 million = $500,000.

Adjusting the current TSB to account for withdrawals and contributions

The proposed method for calculating earnings makes adjustments for inflows and outflows that impact the closing TSB either positively or negatively. This ensures changes in TSB reflect earnings generated inside superannuation.

References to withdrawals and net contributions in the earnings formula are not intended to represent a comprehensive adjustment for all cash flows throughout the year. Instead, they make provision for events which would otherwise skew the estimated earnings calculation due to their direct impact on an individual's TSB at the end of the financial year.

Withdrawals

The withdrawals are added back to the current TSB. This is intended to reflect what the individual's current TSB would have otherwise been had they not made the withdrawals. This adjustment will ensure that a decrease in the TSB as a result of a withdrawal does not represent negative earnings generated inside superannuation.

Example – Calculating earnings with a withdrawal

Carlos is 69 and retired. He has a total superannuation balance of $9 million on 30 June 2025, which grows to $10 million on 30 June 2026. He draws down $150,000 during the year and makes no additional contributions to the fund.

Carlos's earnings are calculated by adding back the value of his withdrawals to his closing TSB and then taking the difference between his opening and closing TSB.

$$\boldsymbol{Earnings} = (\boldsymbol{TSB}_{\boldsymbol{Current\ Financial\ Year}} + \boldsymbol{Withdrawals} - \boldsymbol{Net\ Contributions}) - \boldsymbol{TSB}_{\boldsymbol{Previous\ Financial\ Year}}$$

Earnings = ($10 million + $150,000) - $9 million = $1.15 million

Contributions

The value of after tax (net) contributions are subtracted from the closing TSB. This adjustment is necessary to ensure an increase in the closing TSB reflects positive earnings, not amounts an individual has contributed to their superannuation account during the year.

Net contributions include SG contributions or voluntary contributions, including downsizer contributions, payment of insurance benefits for policies owned inside superannuation and transfers such as family law splits.

Contributions made by individuals impacted by this measure are generally expected to be concessional contributions, noting individuals with a TSB more than $1.7 million are not eligible to make non-concessional contributions. As concessional contributions are subject to contributions tax of

15 per cent (or 30 per cent for high income earners), contributions used in the formula are net of tax, to reflect the net amount included in an individual's TSB. Other voluntary contributions such as downsizer contributions would also be subtracted as a net contribution in the year the contribution is made.

Example – Calculating earnings with a contribution

Amanda is 48 and working full-time on a salary of $150,000. She has no other income. Amanda has a total superannuation balance of $4 million at 30 June 2025, which grows to $4.5 million at 30 June 2026. Amanda makes total concessional contributions to superannuation of $27,500. These contributions are taxed at 15 per cent. Her after-tax (net) contributions are $23,375 (85 per cent x $27,500).

Amanda's earnings are calculated by subtracting the value of her contributions after tax, from her closing TSB, then taking the difference between her opening and closing TSB.

$$\boldsymbol{Earnings} = (\boldsymbol{TSB}_{\boldsymbol{Current\ Financial\ Year}} + \boldsymbol{Withdrawals} - \boldsymbol{Net\ Contributions}) - \boldsymbol{TSB}_{\boldsymbol{Previous\ Financial\ Year}}$$

Earnings = ($4.5 million - $23,375) - $4 million = $476,625

Adjustments where previous TSB is less than $3 million

It is necessary to adjust the calculation where an individual's previous year TSB is less than $3 million. This may occur where an individual becomes liable for the additional tax because their TSB has grown and exceeded the $3 million threshold for the first time. The adjustment is required to ensure that the additional tax is only applied to earnings in superannuation from the part of the TSB more than $3 million.

If an individual's TSB from the previous financial year is less than $3 million and their TSB for the current financial year (after adjusting for withdrawals and contributions) is more than $3 million, the previous financial year's TSB will be adjusted to equal $3 million for the purposes of calculating earnings. This approach ensures that any growth in the fund that occurs below the $3 million threshold is not counted as earnings.

No adjustments are required where both balances are less than $3 million as in such cases individuals will not be within scope of the additional tax.

Example – Calculating earnings where opening balance is below $3 million

Tim has an SMSF with a TSB on 30 June 2025 of $2.8 million. He makes $10,000 of concessional contributions to his superannuation fund over the 2025-26 financial year. After the 15 per cent contributions tax, Tim's net contributions are $8,500. Tim has some strong investments in his SMSF and his TSB increases to $3.2 million by 30 June 2026.

Tim's earnings are calculated by subtracting the value of his contributions after tax, from his closing TSB, then taking the difference between his opening and closing TSB. As Tim's opening TSB is less than $3 million, for the earnings calculation this will be replaced with a $3 million value. This is to ensure that the earnings calculation only captures the earnings for the part of his TSB over $3 million.

$$\boldsymbol{Earnings} = (\boldsymbol{TSB}_{\boldsymbol{Current\ Financial\ Year}} + \boldsymbol{Withdrawals} - \boldsymbol{Net\ Contributions}) - \boldsymbol{TSB}_{\boldsymbol{Previous\ Financial\ Year}}$$

Earnings = ($3.2 million - $8,500) - $3 million = $191,500

Negative earnings

Investment losses or fund expenses could cause an individual's TSB to be less at the end of a financial year than it was at the end of the previous financial year. Reductions of this kind are recognised in the earnings calculation and will mean that individual has negative earnings for the financial year. Where this occurs, the amount of the negative earnings will be able to be used to offset positive earnings in future years. This will be done on a gross basis (that is, before proportioning of earnings occurs).

Negative earnings can be applied against any future positive earning, would not expire and could be applied over multiple years. Capital losses that are reflected in negative earnings can be used to offset any future positive earnings that relate to income, including rent and interest.

Example – Negative earnings

2025-26 Financial Year

Consider the alternative scenario where Carlos's TSB on 30 June 2026 falls from $9 million to $8 million. He still draws down $150,000.

His earnings are calculated as ($8 million + $150,000) - $9 million = -$850,000. Carlos has negative earnings for the year of $850,000 and is not required to pay any additional tax.

2026-27 Financial Year

By 30 June 2027, Carlos' balance has recovered to $8.5 million and he has made a further $150,000 in withdrawals.

His earnings for the second year are calculated as ($8.5 million + $150,000) - $8 million = $650,000.

Carlos carries forward his loss of $850,000 from the previous financial year. He uses this to offset the $650,000 earnings from the 2026-27 financial year. Carlos does not pay any tax in the 2026-27 financial year. His residual loss of $200,000 is carried forward for future years.

Adjustments where current TSB is less than $3 million

Similar to the adjustments where a previous year TSB is less than $3 million, an adjustment would be made where the current TSB (after factoring in withdrawals and net contributions) is less than $3 million. This may occur where investment losses cause an individual's balance to fall below the threshold.

In this case the current financial year's TSB will be adjusted to equal $3 million for the purposes of calculating earnings. Making this adjustment to closing balances ensures that individuals who drop below the threshold are able to have negative earnings recognised for future years (in the event that their balance grows again to exceed the threshold).

Consultation questions

1. Do you consider any further modifications are required to the TSB calculation for the purposes of estimating earnings? If so, what modifications should be applied?
2. What types of outflows (withdrawals) should be adjusted for and how?
3. What types of inflows (net contributions) should be adjusted for and how?

4. Do you have an alternative to the proposed method of calculating earnings on balances above $3 million? What are the benefits and disadvantages of any alternatives proposed including a consideration of compliance costs, complexity and sector neutrality?
5. What changes to reporting requirements by superannuation funds would be required to support the proposed calculation or any alternative calculation methods?

Earnings that are subject to the additional tax rate

The amount of earnings which correspond to an individual's balance that exceeds $3 million will be determined on a proportional basis. The proportion of earnings will be equal to the proportion of the individual's TSB above $3 million.

Example – Earnings that are taxed

Using the example of Carlos above, starting from a TSB of $9 million, which grows to $10 million, together with withdrawals of $150,000, his total calculated earnings are $1.15 million. The proportion of his earnings attributable to excess amounts above $3 million are calculated using the following formula:

$$\boldsymbol{Proportion\ of\ Earnings} = \frac{\boldsymbol{TSB_{Current\ Financial\ Year} - \$3\ million}}{\boldsymbol{TSB_{Current\ Financial\ Year}}}$$

Using this calculation, the proportion of earnings attributed to his balance in excess of $3 million is ($10 million - $3 million) ÷ $10 million = 70 per cent.

Carlos' earnings that are subject to tax at the higher rate are $805,000 (70 per cent x $1.15 million).

Consultation questions

6. Do you consider any modifications are required to the proposed proportioning method? If so, what modifications should be applied?
7. Do you have an alternative to the proposed proportioning method? What are the benefits and disadvantages to any alternatives, including a consideration of compliance costs, complexity and sector neutrality?

Tax liability

A flat rate of 15 per cent tax will be applied to the proportion of earnings corresponding to an individual's TSB more than $3 million. As noted above, the amount of additional tax will be determined by the ATO and levied directly on individuals, given the practical difficulties of applying the additional amount at the fund level. This is similar to the existing method for Division 293 tax.

The 15 per cent tax would be imposed separately to personal income tax, and it is intended that the amount of tax payable would not be able to be reduced by deductions, offsets or losses available under the personal income tax system. However, as noted above, negative earnings in a given financial year will be carried forward and used to reduce earnings in future financial years.

As with other superannuation assessments and determinations, the ATO would calculate liabilities and then notify individuals for a given financial year. As ATO calculations will be based on information reported to them by superannuation funds, assessments for a financial year will only be able to be completed after superannuation funds have reported all required information for that financial year.

This includes responding to information requests issued by the ATO (for example, on withdrawals) in relation to specific impacted members, which is most relevant for APRA-regulated funds.

Paying liabilities

Consistent with the approach taken to taxes for excess contributions and Division 293 tax, individuals would have the option of paying their liability either by releasing amounts from one or more of their superannuation interests or by paying the liability from funds held outside of superannuation.

It is noted that in managing a superannuation fund's liquidity, including for both SMSFs and APRA-regulated funds, trustees must understand and comply with requirements in the superannuation laws. This includes the requirement to formulate, review regularly and give effect to an investment strategy which takes into account diversification of assets in the fund and the liquidity of the fund's investments, having regard to its expected cash flow requirements and the ability of the fund to discharge existing and prospective liabilities.[3]

Example – Paying a tax liability

Continuing with the example of Carlos (positive earnings scenario), the 15 per cent tax is applied to his calculated earnings of $805,000. This results in tax payable of $120,750.

Carlos receives the notice of his tax liability from the ATO. He has the choice to pay this amount using amounts in his personal name or release money from his superannuation account. He elects to pay the amount from his superannuation account by completing the election form. The ATO requests the release of $120,750 from Carlos' superannuation fund.

Example – Paying a tax liability when there are multiple accounts

Recall the example of Melanie who is 62 and has multiple superannuation accounts with the following balances at 30 June 2026:

- A pension account in her SMSF with $1 million
- A second pension account in her SMSF with $700,000
- An accumulation account in an APRA-regulated fund with $2 million.

Melanie receives a notice from the ATO outlining calculated earnings of $370,000 resulting in tax payable of $55,500.

Melanie has the choice to pay the tax using amounts in her personal name or release money from one or more of her superannuation accounts. Melanie elects to pay the amount from her accumulation account by completing the election form. The ATO requests the release of $55,500 from the superannuation fund where Melanie's accumulation account is held.

[3] Sections 52 and 52B respectively of *Superannuation Industry (Supervision) Act* 1993 set out the requirements for APRA regulated and self-managed superannuation funds respectively.

Consultation questions

8. Does the proposed methodology for determining the tax liability create any unintended consequences?
9. Do the proposed options for paying liabilities create any unintended consequences?

Defined benefit interests

Design considerations

The Government intends for broadly commensurate treatment to apply to defined benefit interests relative to non-defined benefit interests. This will require modifications to the general approach outlined above as defined benefit interests have different characteristics to defined contribution schemes.

There are broadly two key areas to resolve. Firstly, how defined benefit interests are valued for the purposes of the $3 million threshold and secondly, an approach to broadly commensurately tax defined benefit interests in line with the additional tax on earnings in accumulation interests.

As a starting point, the value of defined benefit interests should be counted towards an individual's TSB, which is then tested against the $3 million threshold. Even where the value of their defined benefit interests is less than the proposed $3 million threshold, an individual may also hold other superannuation interests (for example in an accumulation account with another superannuation fund).

To ensure commensurate treatment is provided in the most appropriate way, the Government will consult closely with those funds that have defined benefit interests (for example, State public sector schemes and providers of corporate schemes).

Background on defined benefit interests

Defined benefit interests are found in both the public and private sectors, and include a range of fully unfunded, partially funded and fully funded arrangements.

Unfunded arrangements, and unfunded components within schemes, exist in many public sector arrangements and reflect that the eventual benefits payable to interest holders will be at least partly financed directly from a government's consolidated revenue. As such there are no contributions invested that are attributable to these components, no earnings upon which tax concessions are received, and no tax payable until the benefit stage. Instead, pension payments attributable to these components are taxable in an individual's hands at their personal marginal tax rate, with a 10 per cent offset provided for some pensioners aged 60 or over.

For fully funded arrangements, and the funded components within schemes in relation to which actual employer or member contributions are made, the earnings received from investments are taxed like any other accumulation interest at a headline rate of 15 per cent.

The transfer balance cap regime implemented from 1 July 2017 imposed additional taxation on defined benefit pensions as the method to extend commensurate treatment to the limitations placed on pension phase tax exemptions for accumulation interests. This involved removing the 10 per cent tax offset for any unfunded components above an annual payment threshold of $106,250 and including 50 per cent of the funded components in an individual's assessable income.

As the transfer balance cap rules are designed to apply at a point in time, the approach may need to be adapted to ensure that the additional tax payable on accumulation interests under the proposed reforms are applied in a commensurate way to defined benefit interests.

Separate to any changes to how the additional tax rate is applied to defined benefit pension interests, modifications may be required for the valuation methodologies that currently apply in working out the value of a defined benefit interest for the purposes of an individual's TSB.

Valuation considerations

The TSB valuations for defined benefit interests in the pre-pension phase rely primarily on a withdrawal benefit calculation, which is reported under existing arrangements. For defined benefit interests in the pension phase, the TSB currently uses the value that counted towards an individual's transfer balance cap at the time the pension commenced. For lifetime defined benefit pensions, this is 16 times the annual payments available under the pension.

Consultation questions

10. Do the existing valuation methods for defined benefit interests in the pre-pension phase (under the existing TSB definition) work appropriately for the purpose of calculating superannuation balances over $3 million?
11. Do the existing valuation methods for defined benefit interests in the pension phase provide the appropriate value for calculating earnings under the proposed reforms?
12. Are there any alternative valuation methods that should be considered for either pre-pension or pension phase defined benefit interests?

Providing commensurate tax treatment for defined benefit interests

Different mechanisms, or a combination of mechanisms, could be used to provide commensurate treatment for defined benefit interests with a value that exceeds the proposed $3 million threshold. There are a range of possible options, including for example, taxing benefits paid from the interest in pension phase.

Consultation questions

13. Are there any preferred options in providing commensurate treatment for defined benefit interests?
14. What are the benefits and disadvantages to any alternatives?

Constitutionally protected persons

Constitutionally Protected Funds (CPFs) are not able to be subjected to tax directly due to constitutional limitations. This applies whether the CPF is a defined benefit arrangement or a non-defined benefit arrangement. Certain individuals who are members of CPFs may also be subject to further constitutional protections from amounts relating to their CPF interests. As such, modifications to preserve this tax-exempt status may be required. This group is generally referred to as 'constitutionally protected persons'.

Regardless of any modifications in respect of the CPF interests of constitutionally persons, such interests will still need to be counted as part of their TSB. This is necessary to ensure that earnings on any other superannuation interest that such a person holds outside of their CPF are appropriately in scope of proposed tax.

Reporting process for funds

As noted above, the proposed approach is intended to leverage existing reporting requirements to minimise the regulatory impact on superannuation funds and members. It is expected some additional reporting by superannuation funds may be required to support the ATO in calculating the tax liabilities. This would be expected to include reporting on benefit payments by APRA-regulated funds noting SMSFs already report benefit payments at the member level on an annual basis.

Where additional information is required, it is proposed the ATO would receive this information directly from superannuation trustees. This could be done through changes to the general reporting requirements, specific requests for information by the ATO, or a combination of both. Targeted reporting obligations are preferred to ensure that the costs of complying with the new proposal are not borne by all superannuation members. Where a superannuation fund has no members with a TSB greater than $3 million, they will not be impacted by this proposal.

The specific changes to reporting requirements will depend on the methodology for calculating earnings.

Consultation questions

15. What would be the most effective method for collecting the required information? What are the benefits and disadvantages for the method identified, including a consideration of compliance costs, complexity and sector neutrality?