INSTITUTE OF FINANCIAL PROFESSIONALS AUSTRALIA

18 October 2023

Director
Superannuation Tax Unit
Retirement, Advice and Investment Division
Treasury
Langton Crescent
PARKES ACT 2600
superannuation@treasury.gov.au

Dear Sir/Madam,

Submission on better targeted superannuation concessions

The Institute of Financial Professionals Australia welcomes the opportunity to provide this submission on the better targeted superannuation concessions exposure draft legislation.

We have examined the exposure draft materials in detail and remain opposed to the government's proposed Division 293 tax on superannuation balances above $3 million. Our reasons for reaching this conclusion remain the same as our earlier submission made to Treasury on 17 April 2023 (see **Appendix A**) but with additional items for your consideration. These concerns are discussed below.

Key issues remain unresolved

The proposed Division 296 tax is largely unchanged from when it was first announced by the government earlier this year. This means the same key issues remain unresolved, such as:

1. **Unrealised gains will be taxed** – this is due to the fact the calculation of 'earnings' is based on movements in a member's total superannuation balance (**TSB**), rather than actual taxable income generated by a superannuation fund.

> **Recommendation** – removing unrealised capital gains from the calculation of earnings and using actual taxable income/earnings as a measure of earnings is a simpler and far more equitable solution. It will also enable the government to achieve its objective of ensuring a fairer superannuation system for all Australians. This solution will not only avoid taxing unrealised gains, but it also rules out the need to calculate an individual's modified TSB by adding back withdrawals and reducing it by contributions received by the fund and eliminates the need to track carried forward negative earnings.
>
> Alternatively, the government could retain the Division 296 tax measure but make certain changes. Refer to our recommendations in Appendix A on pages 11 – 16 for more information.

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2. **The carry forward measure is complex and unfair** – there is no refund of tax paid in years when earnings are negative and a member's TSB drops below $3 million. The exposure draft legislation and examples provided illustrate that the system of carried forward negative losses is overly complex and can lead to inequitable outcomes.

> **Recommendation** – losses should not be a carried forward measure, rather members should receive a refund of the tax they have already paid to offset any current tax liability. This is preferred rather than carrying forward the loss that may or may not be used at a future date, depending on market volatility which will be common as markets go through different cycles. As such, losses should only be carried forward if there was no tax paid in the past.
>
> In default of having a non-refundable loss regime, losses should be refundable in certain circumstances, such as where a member has been under $3 million for a period of time, or if a member dies. Further information regarding this recommendation can be found in Appendix A on page 13.

3. **The $3 million threshold is not indexed** – an unindexed threshold will capture more people over time through bracket creep and will therefore be worth far less in future dollars.

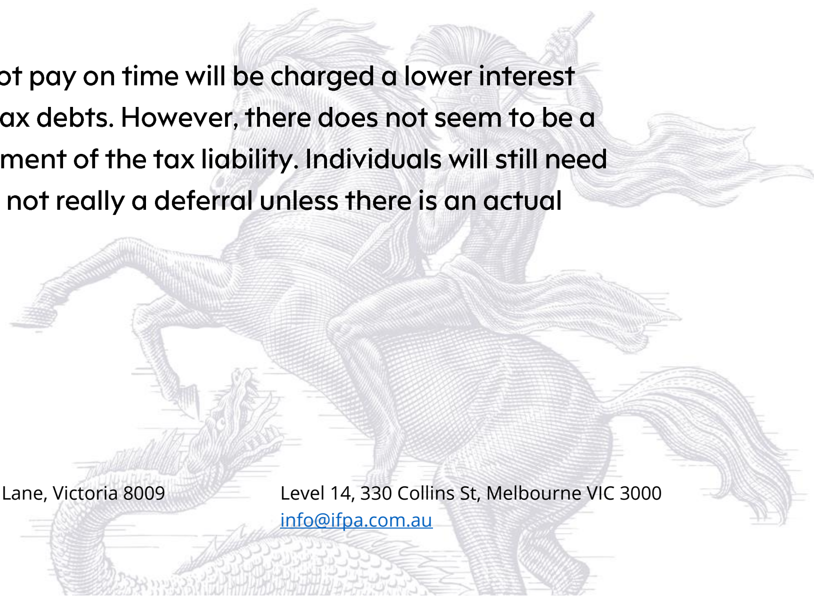
> **Recommendation** – the $3 million threshold must be indexed. In fact, all superannuation caps should be indexed to keep up with inflation and to avoid bracket creep. Refer to our recommendation in Appendix A on page 13 for more information.

Additional matters to address

Although the exposure draft materials provide further clarification on how Division 296 will operate, we propose the following additional changes be made to improve the operation of Division 296 tax should it be legislated.

4. **Introduce a concrete deferral regime** – during the consultation process, it was proposed that where Division 296 tax is assessed on unrealised gains that a deferral regime be put in place. However the proposed legislation does not contain such a regime, other than for defined benefit schemes.

   We acknowledge that members who cannot pay on time will be charged a lower interest rate on Division 296 tax debts than other tax debts. However, there does not seem to be a deferral mechanism to pause ATO enforcement of the tax liability. Individuals will still need to pay their tax liability in any case, so it is not really a deferral unless there is an actual deferral of enforcement.



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Recommendation – rather than relying on the ATO to allow individuals to defer their Division 296 tax liability, we recommend that an actual deferral mechanism or deferral of enforcement apply for the payment of the tax (including interest) to all funds. This way the ATO will be able to administer the measure in this way (ie, not enforce the tax debt and allow interest to accrue). Our preference is that such a deferral scheme allow unlimited deferral. Alternatively, the deferral could be for a maximum period of five years.

5. **Exclude certain amounts from a member's adjusted TSB permanently** – we propose the following modifications be made when calculating a member's adjusted TSB.

Recommendation – to ensure a fairer proportion of earnings is achieved on a member's TSB, certain amounts should be permanently excluded from a member's TSB, such as:

a. Minimum pension payments
b. Amounts withdrawn under a release authority and associated earnings
c. Death benefit pensions
d. Disability benefit pensions
e. Other remediation payments
f. Limited recourse borrowing arrangement (**LRBA**) amounts

These exclusions will be discussed in further detail below.

a. **Minimum pension payments** – as minimum payments are a mandatory requirement to be drawn down, they should not be added back to a member's TSB. Instead, any discretionary or voluntary withdrawals that a member may choose to take in addition to statutory requirements (ie, lump sums or pension payments drawn over and above minimum pension payments) could be added back rather than the mandatory payments that a member must take out.

Recommendation – statutory amounts that must be drawn from superannuation and/or pensions should not be added back to a member's TSB.

b. **Amounts withdrawn under a release authority and associated earnings** – such amounts withdrawn under the law for the payment of superannuation related taxes (such as excess non-concessional contributions) and the associated earnings should not be added back to a member's TSB so there is no double taxation.

As a member's associated earnings attributable to their excess non-concessional contributions are already taxed at the member's marginal tax rate (less a 15% non-refundable tax offset), adding back associated earnings as a withdrawal to a member's

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adjusted TSB is akin to applying a double tax on the same amount if it also is subject to Division 296 tax.

Recommendation – it is unnecessary to include such amounts back in as withdrawals as the excess tax regime already reduces the tax concessions for individuals who exceed the contribution caps.

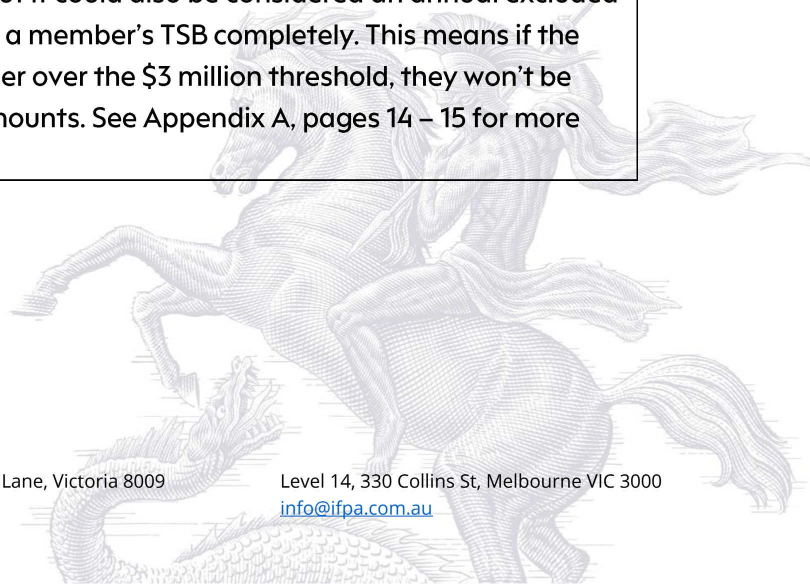
c. **Death benefit pensions** – although any reversionary or death benefit pensions will not count towards the inheriting spouse's TSB in the year of death/receipt, these amounts will increase a member's balance in the next year. This means should these amounts push a member over the $3 million threshold and have earnings in future years, these earnings will also be subject to Division 296 tax.

Recommendation – as death benefits have not been clawed out completely, death benefit pensions should be permanently excluded from the inheriting spouse's TSB as receiving the payment is beyond the beneficiary's control if they are nominated as a beneficiary of the deceased member. See Appendix A, page 14 for more information.

d. **Disability benefit pensions** – these benefits should also be permanently excluded from a member's TSB altogether, like structured settlement amounts. Although any total and permanent disability (**TPD**) payments will be excluded in the first year of receipt from the member's adjusted TSB as a contribution, these amounts will also increase a member's balance in the next year and may therefore mean a member may be taxed in future years on the earnings from the TPD proceeds.

Recommendation – considering structured settlements and TPD benefits are both payments made to individuals who have suffered a serious injury or disability, one-off lump sum payments, such as TPD insurance proceeds and any earnings on such amounts should be excluded from Division 296 tax in the same manner as structured settlement payments.

An alternative solution is that not only could a TPD payment be considered a contribution in the year it is received, but it could also be considered an annual excluded contribution so that it is excluded from a member's TSB completely. This means if the TPD payment amount pushes a member over the $3 million threshold, they won't be subject to Division 296 tax on these amounts. See Appendix A, pages 14 – 15 for more information.



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e. **Other remediation payments to be excluded** – it is pleasing to see that a member's TSB will be reduced by remediation payments or compensation received as a result of fraud or dishonesty. That said, we believe other remediation payments should also be excluded from a member's TSB, particularly where an amount of compensation from a financial service or insurance provider is received by a member's superannuation fund and allocated to their account. This can typically occur where a member received inappropriate financial advice, or if the member paid fees but did not receive advice.

Recommendation – as per the ATO's guidance on compensation arising from financial advice[1] where a member or superannuation fund has engaged a financial service or insurance provider and has a right to compensation, the treatment of compensation in the financial year it is received by the fund should not be considered a contribution and therefore not affect the member's contribution caps. This is because the purpose of a remediation payment is to put a member back into the position they should have been in had the event not happened, but if a member pays tax on this amount, it defeats the objective of a remediation payment.

f. **Exclude LRBA amounts from TSB** – we welcome that LRBA loan amounts that would otherwise be included in a member's TSB will be excluded for Division 296 tax purposes. That said, this rule will remain included for other purposes. It is disappointing this rule wasn't abolished altogether as given the strict rules around LRBAs and the safe harbour terms that apply, this rule is no longer needed.

Recommendation – permanently exclude the add back of LRBA loan amounts from the TSB definition entirely (not just for Division 296 purposes) as the ATO's safe harbour guidelines (PCG 2016/5) operate to ensure LRBAs established by SMSFs are consistent with an arm's length dealing.

[1] ATO Legal Database 'Super contribution caps', 15 September 2021

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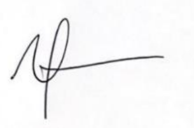
Closing comments

Please find the details of our previous 17 April 2023 better targeted superannuation submission which includes our recommended/suggested legislative changes at Appendix A, pages 11 – 16.

If you have any questions in relation to this submission, please contact Phil Broderick on (03) 9611 0163 or pbroderick@sladen.com.au or Natasha Panagis on (03) 8851 4535 or n.panagis@ifpa.com.au.

Yours faithfully,



Phil Broderick
Institute of Financial Professionals Australia
Board Member
Chair, Superannuation Technical and Policy Committee

Natasha Panagis
Head of Superannuation and Financial Services

About the Institute of Financial Professionals Australia

The Institute of Financial Professionals Australia is a not-for-profit membership association (originally known as Taxpayers Australia, then more recently Tax & Super Australia) and has been serving members for over 100 years. With a membership and subscriber base of over 15,000 practitioners, our association is at the forefront of educating and advocating on behalf of independent tax, superannuation and financial services professionals.

This submission is made by us on behalf of our members' interests.

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Appendix A

17 April 2023

Director
Tax and Transfers Branch
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Dear Sir/Madam,

Submission on better targeted superannuation concessions

The Institute of Financial Professionals Australia is a not-for-profit membership association (originally known as Taxpayers Australia, then more recently Tax & Super Australia) and has been serving members for over 100 years. With a membership and subscriber base of over 15,000 practitioners, our association is at the forefront of educating and advocating on behalf of independent tax, superannuation and financial services professionals. Hence our interest in the consultation paper.

This submission is made by us on behalf of our members' interests.

Superannuation balances should not be capped

While we want the superannuation system to be fair and equitable for all Australians, we remain opposed to limiting the size of account balances in superannuation funds for several reasons, including:

- Larger balances represent a small cohort of individuals (ie, less than 2% of SMSF members). This small cohort of large account balances are the exception rather than the norm. They exist due to the superannuation policies that were around in the past. Changing the law and applying the change on a retrospective basis will penalise individuals who adhered to the rules that existed at the time.
- Changing the rules due to a small cohort of individuals will only create further complexity and uncertainty, causing individuals to second guess whether they should put money into their superannuation.
- The issue of extremely large superannuation balances will not continue into the future as a result of the 1 July 2017 changes which placed further limits on contributions. Further, the limit on amounts that can be held in the tax-free retirement phase has helped reduce the number of large balances that exist.

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- Most individuals with large balances are held by older Australians and considering death benefits must be compulsorily cashed out of the system, it is only a matter of time before large balances will eventually leave the superannuation system.

We believe individuals must be reassured by the stability of the superannuation system from not seeing any further major changes. This will allow individuals to better plan their retirement strategy knowing the rules won't change over the short or long term.

Our association does not support the proposed new tax

More specifically, we do not support the newly proposed tax for the following reasons:

- The proposal does not deliver what the intention of the policy is. According to the consultation paper, this reform is intended to bring the headline tax rate to 30% up from 15% for earnings above $3 million. As conceptually simple as the formula may be, it does not deliver this policy outcome as the definition of 'earnings' is unrelated to the actual taxable income generated by a superannuation fund and does not deliver a headline tax rate of 30% on the proportion of 'earnings' above $3 million.

  Rather, the proposed calculation methodology is essentially a form of double taxation on the same asset. That is, members will pay extra tax every year on the proportion of their balance that exceeds $3 million (assuming their balance continues to grow every year) and then pay tax again when the asset is sold. This means a member will pay extra tax on previously taxed earnings if their balance continues to grow, and then again on any unrealised gains. Even worse, members will not be entitled to a refund for any tax they have already paid. We question why the government has prioritised simplicity of reporting over fairness.

- Taxing unrealised capital gains is a profound change – the unprecedented nature of this new tax heralds a significant change as it is a new type of 'wealth tax'. The current tax regime in Australia only taxes capital gains when they are realised and sold for more than the cost base. However, this new tax captures any growth in balances from the start to the end of each year after adjusting for contributions in and payments out. This will include anything that causes an account balance to go up, such as interest, dividends, rent, and capital gains on assets that have been sold, including any notional or unrealized gains on assets that increase in value, even if the fund hasn't sold them. As such, this new tax is a fundamental shift from the way the existing Australian tax system works as it goes against the general tax principle of paying tax on income that has actually been derived or on actual realized gains.

  Even if taxing unrealised gains is an intentional part of the policy, it creates some (presumably unintended) additional inequity. For example, the rule in section 118-20 of the *Income Tax Assessment Act 1997* (**ITAA 1997**) that excludes capital gains to the extent that they have been otherwise included in an individual's assessable income won't apply when assets are disposed of by the fund as the amounts have been previously included in the

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assessable income of a different entity (ie, the individual member, not the fund). Further, the individual will not receive any benefit from the general capital gains tax (**CGT**) discount. There is no precedent for the interaction between taxing unrealised gains and the CGT discount because the taxation of unrealised gains is unprecedented.

Should this new tax be legislated and therefore become a precedent, we fear the government may apply the same approach to other types of entities, such as individuals, companies, trusts, etc. If we want a fairer and equitable outcome for members, unrealised capital gains should not be subject to this new tax.

- No tax refund if member balance drops to below $3 million – although negative earnings/losses can be carried forward and offset against the new tax in future years' tax liabilities, some members may never use their losses in future years. This may be due to markets falling which causes a member's balance to drop below $3 million and not exceeding the threshold again or could also be due to members drawing down on their fund because they are receiving pension payments. Unfortunately without the loss carry back rules being available, members won't be able to recoup any previously paid tax on unrealised capital gains. Thus, taxing unrealised gains but not providing refunds for unrealised losses is inequitable, that is, in good times cash is paid out but in bad times there is no corresponding relief.
- Cashflow and liquidity issues with volatile and illiquid assets – although trustees have an obligation to properly formulate an investment strategy and consider whether the fund is adequately diversified given the risk profile of members, the fund's investment objective, and the cashflow and liquidity needs of the fund, trustees are still able to hold assets in a single investment.

  While the new tax will apply to both SMSFs and APRA-regulated funds, the inclusion of unrealised capital gains will have a greater impact on SMSFs with exposure to direct property assets. In particular, farmers and small business owners who have legitimately contributed their farms or business properties to their SMSF may struggle to meet this new tax impost where there is no cash available from a sale or if members have little to no wealth outside of superannuation. As lumpy assets generally cannot be partly sold to pay this new tax, restructuring such assets to generate cashflow may require such properties to be sold which may cause business disruption, impact members livelihoods and lead to substantial transaction costs. Further, forced restructures/disposals may occur when the market is in a downturn and therefore the full, real value of the asset may not be realised. As such, members who are asset-rich but cash-poor will be impacted greatly as they will need to find the cashflow to pay the new tax in any given year even though there has been no actual realisation of the asset.

- Basing the new tax on a member's total superannuation balance (**TSB**) will impact more people as a member's TSB includes everything. The extra tax will therefore apply across all funds and accounts a member may have and will also unfairly impact members who may

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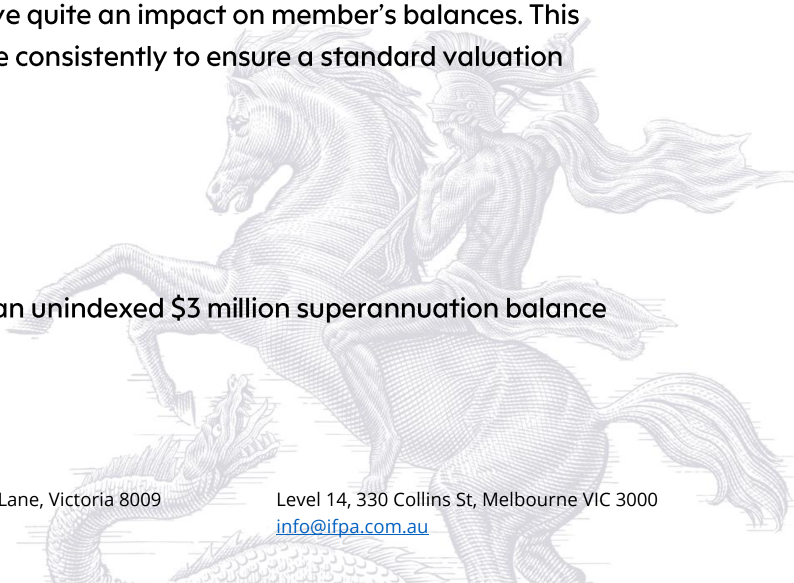
have certain limited recourse borrowing arrangements (**LRBA**) within their fund, or members who receive a disability insurance benefit and draw a disability superannuation income stream, or members who inherit a death benefit pension from their spouse or their parent. In all cases, these amounts will be included in a member's TSB, which can potentially push a member over the $3 million threshold and be liable to pay tax on the earnings.

- The lack of indexation will capture more members overtime – the $3 million threshold will be worth far less in future dollars under various assumptions. Although the measure is expected to impact 80,000 people today, it is estimated that around 500,000[2] Australian taxpayers will breach the cap in their life, where approximately one-third of these superannuation fund members are now under 30. Thus, the long-term impact of the $3 million threshold not being indexed to inflation will lead to intergenerational inequity between the different generations over time.

- Valuations will become critical – the proposal will create more complexity, further administration burden and valuation issues in the superannuation system. From a valuation perspective, not all assets are easy to value at a specific point in time, such as 30 June for the purposes of the TSB. Valuations can be subjective and can vary widely between assets and also between valuation experts, where two very different values can both be technically correct. For many investments, sometimes it's only really possible to know what they're worth when they are actually sold. As valuations will impact the amount of tax paid by members, it is likely that disputes may arise between trustees and valuers due to the taxation of unrealised gains. As a result, it's likely that trustees will shop around for valuers that generate the best outcome.

  This will also put pressure on SMSF auditors as they will be forced to undertake extensive investigations to determine whether trustees are reporting the right values and that amounts are on arm's length because the lower the value, the lower the amount of tax paid. Although the consultation paper states this measure will not require additional valuation reporting, it will put more pressure on auditors when it comes to valuations. The reality is there will be more rigour applied by auditors in practice.

  Further, for members in large APRA-regulated superannuation funds that have pooled investments amongst their members, it will be important to determine how such funds will value their unlisted assets as this could have quite an impact on member's balances. This may force unlisted assets to be priced more consistently to ensure a standard valuation method applies across the board.



[2] FSC media release: Distributional analysis of an unindexed $3 million superannuation balance cap, 3 March 2023

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Proposed options for a fairer superannuation system

Despite our view that superannuation balances should not be capped, if we do need to see the tax settings change for larger balances, we believe there are other ways that are simpler, equitable and fair, which we have outlined in our submission below, including:

1. Tax actual taxable income above $3 million
2. Retain proposed extra tax measure with amended changes

1. Tax actual taxable income above $3 million

If the intention of the policy is to make the headline tax rate on earnings for the proportion that relates to balances above $3 million to 30%, then a solution already exists, particularly for SMSFs.

Existing software programs allow superannuation funds to report and calculate actual taxable income at the fund level and distribute the net amount to each member's account. For instance, as part of the SMSF annual return process, 'Section F: Member information' of the annual return provides a list of all contributions made or received by each member. It also provides information regarding allocated earnings or losses, rollovers and transfers, lump sum and income stream payments and the value of any outstanding LRBAs.

We recommend a slight modification be made to populate a new member label in the annual fund return to break up earnings into two components for each member, that is:

i. Taxable earnings (or losses) – this is actual realised taxable earnings allocated to each member, and
ii. Untaxed earnings (or losses) – this includes any unrealised gains (or losses) allocated to each member.

As this information is readily available in a fund's annual tax return, trustees will be able to use this information and the member's statements to determine actual earnings for each member of the fund. The ATO could then use this information which is reported by all funds that the individual was a member of and calculate the portion of actual taxable income that relates to superannuation capital in excess of the $3 million threshold and apply the extra 15% tax. As suggested in the consultation paper, the member could either pay the tax personally or elect to have it deducted from their fund. This would be the simplest way to tax actual earnings on member balances that are above $3 million as it is based on current tax law principles that apply and will mean members will not be taxed on any unrealised earnings. This option will also mean that funds will not have to undertake tax-effect accounting, which they will be compelled to use under the government's proposal.

If this option of taxing actual taxable income is chosen by the government, there would need to be an adjustment to reflect amounts that were already taxed in the fund above

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15%, such as non-arm's length income (**NALI**). If NALI isn't excluded from taxable income before taxing the individual member, there would be an effective tax rate of 60% on amounts representing some of the individuals share of the income.

That said, this option may be challenging for large APRA-regulated funds to implement but that's only because it has not been done before. There have been many occurrences that both small and large superannuation funds have never had to do, such as transfer balance caps, until the laws changed and superannuation funds have had to get on board and adhere to new rules. As such, large APRA-regulated funds will need to catch up and invest funds in better reporting systems to determine their earnings and correct the tax outcomes for their members. Perhaps an option to allow funds to get ready for such reporting arrangements is to push out the timeframe for implementation. It may also be beneficial for funds to lean on actuarial services to support the calculation for members.

Simplicity of reporting should not come before fairness. This option of taxing actual taxable income of the fund will result in an outcome more in line with the policy intent than movements in a member's TSB would.

2. **Retain proposed extra tax measure with amended changes**

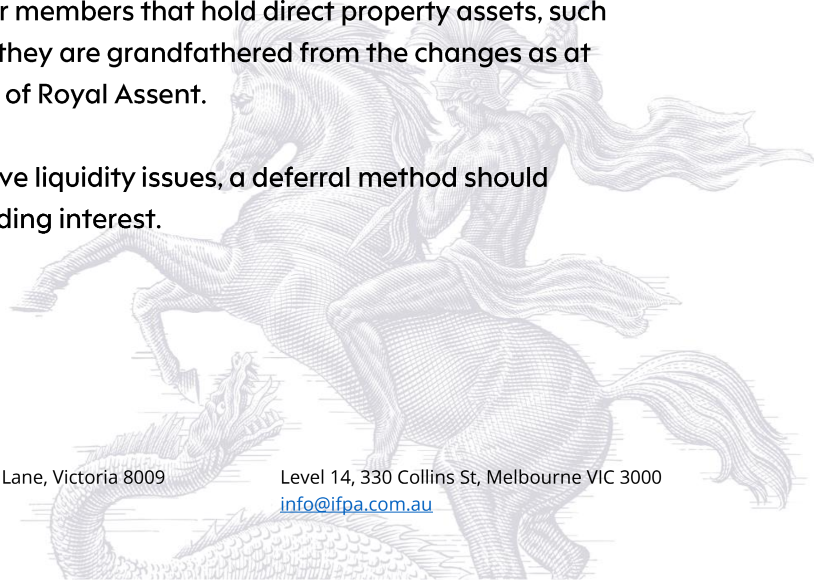
   If we must retain the proposed measure, we recommend the following changes be made to make the proposal equitable and fair:

   a. No taxing of unrealised capital gains.

      For reasons outlined earlier, this change would see an adjustment to be made to exclude unrealised capital gains from the TSB calculation.

      Despite the planned implementation of this measure taking effect from 1 July 2025, the extra tax will still apply to the unrealised earnings of assets already present within a member's superannuation account. As such, it could be perceived as a retrospective tax on existing assets, potentially impacting a member's retirement planning strategy, particularly for those nearing or in retirement. For this reason, we propose the government provides an exemption for members that hold direct property assets, such as farms, commercial property, etc, so they are grandfathered from the changes as at the date of announcement or the date of Royal Assent.

      We also suggest that for funds that have liquidity issues, a deferral method should apply for the payment of the tax, including interest.



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b. Losses should not be a carried forward measure, rather prior year tax that has been paid on unrealised gains should be refunded to the extent of current prior losses. That is, losses would only be carried forward if there was no tax paid in the past.

As noted earlier, some members may never recoup tax previously paid if their account balance does not exceed $3 million again. In practice, if we look at what happened over the past two years, many funds in 2021 experienced large gains followed by a huge year of losses in 2022. Had this proposal been in place for the past two years, there would be many members who would be disadvantaged due to the peak and the fall of the market. For some members, they may never experience the peak again and won't see their balance exceed $3 million either because of the market conditions or because they are in retirement and drawing down their balance to meet their living expenses.

It is only fair that if members are going to pay tax on unrealised gains, they should receive a refund of the tax they have already paid to offset any tax liability. This is preferred rather than carrying forward the loss that may or may not be used at a future date, depending on market volatility which will be common as markets go through different cycles.

c. The $3 million threshold must be indexed.

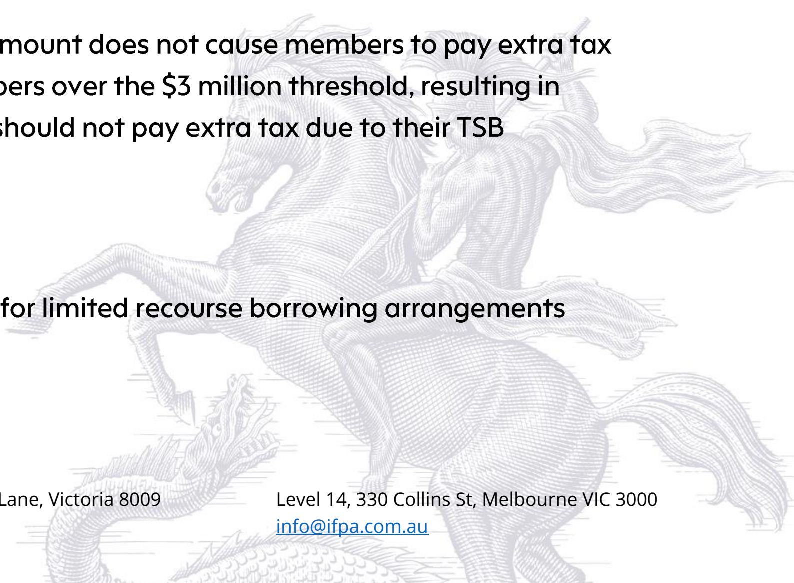
As noted earlier, a lack of indexation will end up capturing a much larger cohort of members over time. It won't be too long before the $3 million threshold may not be considered that significant as a way of being ready for retirement. It is worrying that the consultation paper seeks to justify an unindexed cap on the basis that other superannuation caps are unindexed. All superannuation caps should be indexed to keep up with inflation and to avoid bracket creep.

d. LRBAs should not be included in the TSB calculation.

We believe now is a good time to abolish the measure that LRBA loans are added back to a member's TSB altogether. Given the strict rules around LRBAs and the safe harbour[3] terms that apply, this rule is no longer needed.

Although adding back the LRBA loan amount does not cause members to pay extra tax on the loan amount, it may push members over the $3 million threshold, resulting in extra tax on a loan amount. Members should not pay extra tax due to their TSB increasing because they have a loan.

[3] PCG 2016/5 – Income tax: arm's length terms for limited recourse borrowing arrangements established by SMSFs



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e. Death benefit pensions should not be included in the TSB calculation.

Once a member of a couple has died, their death benefit account should not be subject to the new tax as receiving the payment is beyond the beneficiary's control if they are nominated as a beneficiary of the deceased member.

In practice, there may be couples that have TSBs of less than $3 million each, but the moment they inherit their spouse's superannuation as a pension will mean their TSB will increase. This may cause someone who never expected to be included in this measure to be subject to the new tax.

For this reason, our view is that recipients of death benefit pensions should not have their spouse's death benefit pension included in their TSB. Rather, death benefits and any earnings on these amounts should be treated as an 'excluded contribution'.

f. Other amounts should also be excluded as 'contributions', including:
    - Structured settlements (or personal injury contributions), including earnings
    - Insurance proceeds (for policies owned inside superannuation), including earnings
    - Family law splits
    - Spouse contribution splitting
    - Transfers from reserves
    - Overseas pension fund transfers

It is pleasing to see the consultation paper confirm that amounts such as downsizer contributions, payment of insurance benefits for policies owned inside superannuation and transfers such as family law splits will count as contributions. This adjustment ensures an increase in the closing TSB reflects positive earnings, not amounts a member has contributed to their superannuation account during the year.

While amounts received in the first year will be excluded from a member's TSB, these amounts will increase a member's balance in the next year. This means should these amounts in the future have earnings, these earnings will also be subject to the extra tax.

For instance, although structured settlements are excluded from a member's TSB altogether, any earnings that may accrue on the structured settlement amount will still be subject to extra tax. Most, if not all, of these individuals will have TSBs greater than $3 million, yet having an extra 15% tax payable on earnings will be highly disadvantageous to them as their settlement monies were paid in order to meet projected medical costs for the remainder of their lives. This new tax has the capacity to greatly erode their ability to meet their projected medical costs, and thus impact their ability to live with dignity and comfort.

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For example, assume a member has $2 million in superannuation and then receives a structured settlement of $10 million. The member's TSB will still only be $2 million even though they will have $12 million in superannuation. However, if this benefit earns 10% per annum (ie, 10% on $10 million per year), it will only take the member two years before their TSB reaches $4 million. Despite structured settlements being carved out of a member's TSB, the earnings on the structured settlement amount will still be captured.

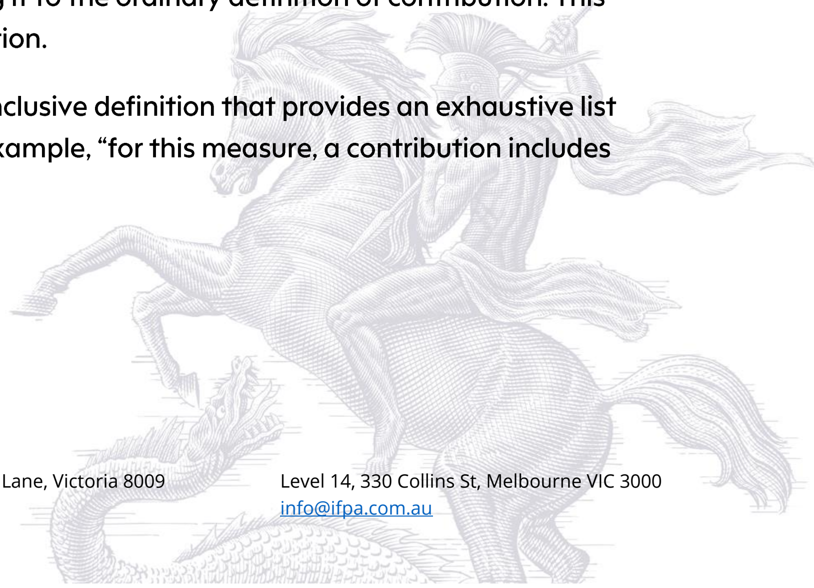
However the same treatment does not apply to a member who receives a total and permanent disability (**TPD**) insurance benefit from a policy held in their superannuation fund. Where a claim is made and the proceeds are paid into the member's account, this will have the effect of increasing a member's TSB in the future and will therefore be included in the earnings calculation. We believe all insurance proceeds should be excluded from a member's TSB, like structured settlements. There are tax concessions on having insurance payments made from superannuation for a reason because they are meant to be used to fund a member's income needs over their lifetime. Consequently, having insurance inside superannuation may end up being worse than perhaps owing it outside superannuation, as TPD and life insurance benefits received directly outside of the superannuation system are not taxable.

To illustrate the impact this new measure may have on certain individuals, assume a member who is in his late 30s becomes TPD. The policy was held in his superannuation fund, which has now received the $5 million TPD payment. This payment must last the member at least 40 years but because it's over the $3 million threshold, the member will be disadvantaged and will pay extra tax on this amount. Members in these situations must not be penalised for receiving a one-off lump sum that must last them and their family's needs during their lifetime.

As such, we propose that one-off lump sum payments, such as structured settlements and insurance proceeds, and any earnings on such amounts are excluded from the extra tax.

g. In drafting the legislation, the abovementioned 'excluded contributions' should be specifically defined rather than leaving it to the ordinary definition of contribution. This will ensure nothing is left to interpretation.

   We suggest the government uses an inclusive definition that provides an exhaustive list of all the items that are included, for example, "for this measure, a contribution includes family law splits, etc".



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h. Allow members to remove the excess if they have not met a condition of release.

Members who meet a condition of release have the option to move money or assets outside of superannuation if they expect to pay a large tax bill every year under this new proposed tax. However this is not possible for members with large balances who have not yet met a condition of release.

The government should consider amending the condition of release rules to give individuals the choice to either keep funds over $3 million in superannuation or to withdraw amounts in excess of $3 million out of the superannuation environment before the measure takes effect and also on an ongoing basis. Individuals should have a choice to move their money, rather than being forced to keep funds/assets in an environment that is taxed differently than at the time the investment choice was made.

If this proposal is adopted, certain rules should be put in place to limit the amount that can be withdrawn from superannuation. For example, it may be sensible to allow members to withdraw amounts in excess of $3 million out, provided the member's balance does not go below $3 million.

Consultation paper questions

We now consider the questions contained in the consultation paper.

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?

As noted, we believe tax should apply to actual taxable income or earnings generated by a superannuation fund. Members should not pay tax on unrealised gains where assets have not been sold.

The extra tax should not be based on a quasi 'earnings' amount where growth in account balances may include anything that causes an account balance to increase over $3 million, including any notional or unrealized gains on assets that increase in value, even if the fund hasn't sold them.

2. What types of outflows (withdrawals) should be adjusted for and how?

If the proposed model is retained, we would like to see nothing left to interpretation. This means we would prefer having an exhaustive list of the items that are included or excluded from the proposed earnings calculation.

We believe withdrawals should also include money that has been paid out under a release authority, such as Div 293 amounts, excess contributions, etc.

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3. What types of inflows (net contributions) should be adjusted for and how?

As stated earlier (see page 8), we believe the following amounts should be excluded contributions from the proposed formula:

- Death benefit pensions, including earnings
- Structured settlements (or personal injury contributions), including earnings
- Insurance proceeds (for policies owned inside superannuation), including earnings
- Family law splits
- Spouse contribution splitting
- Transfers from reserves
- Overseas pension fund transfers

In our view, we also believe the following changes should be made:

- LRBAs should not form part of a member's TSB and should be abolished from being added back to a member's TSB altogether. Given the strict rules around LRBAs and the safe harbour terms that apply, this rule is no longer needed.
- Although structured settlements are excluded from a member's TSB, any earnings that may accrue on the structured settlement amount will still be subject to extra tax. We propose that earnings on structured settlements also be excluded as this new tax has the capacity to greatly erode a member's ability to meet their projected medical costs, and therefore impact their ability to live with dignity and comfort.
- Members who receive insurance proceeds, such as TPD benefits, and any earnings generated on these amounts should also be excluded from a member's TSB, like structured settlements. Members in these situations must not be penalised for receiving a one-off lump sum that must last them and their family's needs during their lifetime.
- When determining a member's earnings and adjusting for contributions made, we question whether the amount being deducted from the calculation is the net contribution (ie, 85% of the concessional contribution) or the gross contribution. In reality, contributions tax does not really exist. It's a misnomer and most funds don't pay anywhere near 15% on their concessional contributions on average. Thus, in terms of the adjustment, we believe the gross contribution should be deducted from the earnings calculation.

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?

Despite our view that superannuation balances should not be capped, if we do need to see the tax settings change for larger balances, we believe there are other ways that are simpler, equitable and fair, which we have addressed in our submission, including:

1. Tax actual taxable income above $3 million
2. Retain proposed extra tax measure with amended changes

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To avoid repetition, please refer to pages 5 – 10 for further information regarding the benefits and disadvantages of the above alternative options. In a nutshell, our proposed options for a fairer superannuation system have low to no costs attached to them.

We also considered suggesting that a deemed rate of return apply to the level of a member's balance in excess of the $3 million threshold. Examples of deeming rates that could be used include:

- The associated earnings rate that is calculated by the ATO to approximate the amount earned while excess non-concessional contributions are held in a superannuation fund, or
- The social security deeming rate that is used to work out income from financial investments. As the deeming rules assume assets earn a set rate of income, no matter what they really earn, these rules could be used for amounts above $3 million.

Although the benefit in using this option is using existing ATO and/or social security systems, which will be simple and would not require funds to do any calculations of actual earnings, this option (just like the one proposed by the government) will not be fair and equitable for all individuals. For example, a deemed rate will still need to apply to an amount (ie, such as a member's TSB at the end of the year) and will produce different outcomes based on what TSB methodology is used. As mentioned above, the only fair and equitable approach is for the extra 15% tax to be applied to taxable income.

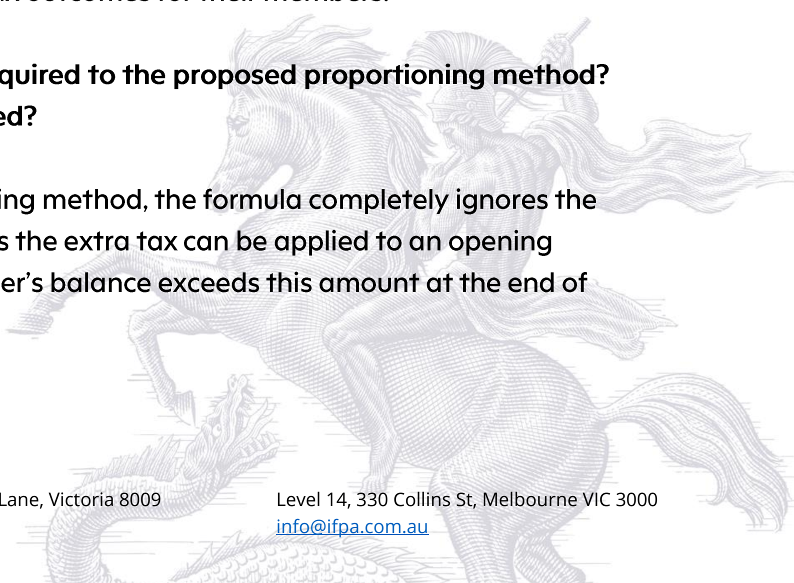
5. **What changes to reporting requirements by superannuation funds would be required to support the proposed calculation or any alternative calculation methods?**

Our proposed options for a fairer superannuation system aim to rely on already established reporting requirements to keep things as administratively simple as possible.

To reiterate, our proposals are about taxing actual taxable income above $3 million. The reporting is already technically available and can be used (if not already) by SMSFs. APRA-regulated funds would need to catch up and invest funds in better reporting systems to determine their earnings and correct the tax outcomes for their members.

6. **Do you consider any modifications are required to the proposed proportioning method? If so, what modifications should be applied?**

When it comes to the proposed proportioning method, the formula completely ignores the balance at the start of the year. This means the extra tax can be applied to an opening balance of less than $3 million if the member's balance exceeds this amount at the end of the year.



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For example, assume a member had a TSB of $2.5 million which then increased to $4 million on 30 June due to a pension reversion. The existing formula would apply the extra tax assuming the member's balance was $4 million throughout the entire year, even though there was only one day in the year where the member's TSB was above $3 million. Consequently, this will cause more members to pay the extra tax.

We offer the following suggestions for members who have starting TSBs under $3 million:

- A pro-rata approach could apply, but this may not be a simple or practical option to implement, or
- Looking at an average balance of an individual's TSB for the year in the 'proportion of earnings' formula to compare to $3 million may be better than just the year end measure.

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?

As mentioned earlier, we believe tax should apply to actual taxable income or earnings generated by a superannuation fund. Members should not pay tax on unrealised gains where assets have not been sold.

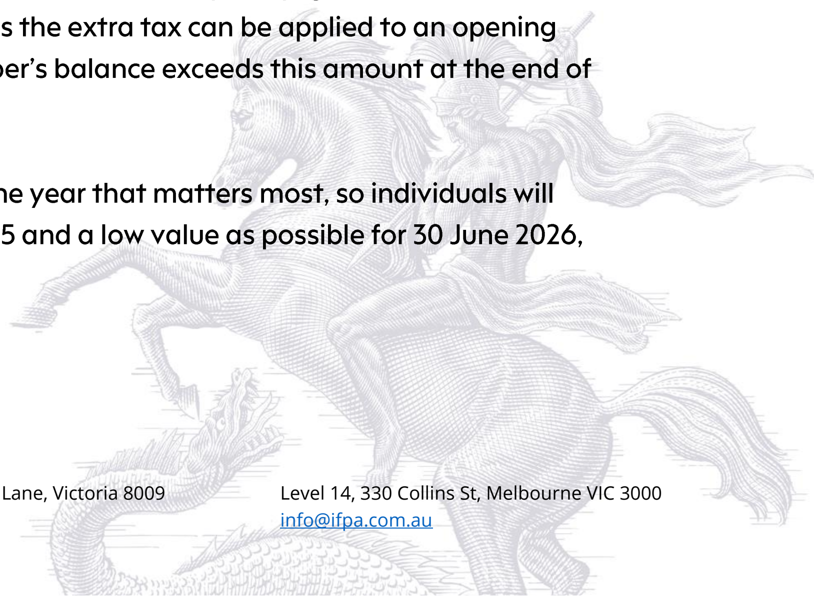
To avoid repetition, please refer to pages 5 – 10 for further information about our proposed options.

8. Does the proposed methodology for determining the tax liability create any unintended consequences?

Yes, the proposed methodology will create unintended consequences. The $3 million threshold is tested only at year end which may be unfair when fund asset values fluctuate throughout the year.

As mentioned in our answer to question 6, the formula completely ignores a member's balance at the start of the year. This means the extra tax can be applied to an opening balance of less than $3 million if the member's balance exceeds this amount at the end of the year.

As a result, it is the balance at the end of the year that matters most, so individuals will want a high value as possible for 1 July 2025 and a low value as possible for 30 June 2026, and so on.



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Further, the timing delay of lodging annual returns also poses a problem. For example, the 2025/26 annual return will report balances at 30 June 2026 but practically will not be reported until May 2027 (assuming a 15 May annual return date). Tax will then be calculated and assessed after that point in time, which may be 11 months down the track, even if the member's balance is now below $3 million. This could see a member potentially drawing money out of superannuation to pay tax from an account that is no longer above the $3 million threshold.

It should also be noted that if a member's TSB is lower at the end of a financial year than at the beginning, and there are no withdrawals or contributions, there will be no refund for tax paid in the prior year.

9. Do the proposed options for paying liabilities create any unintended consequences?

We don't believe so. Providing members with the choice of either paying the tax out-of-pocket or withdrawing some or all the amount from their super fund(s) will provide members with flexibility to pay the tax. This will be particularly useful for funds that have cashflow issues.

10 – 14. We will not be answering questions 10 through to 14.

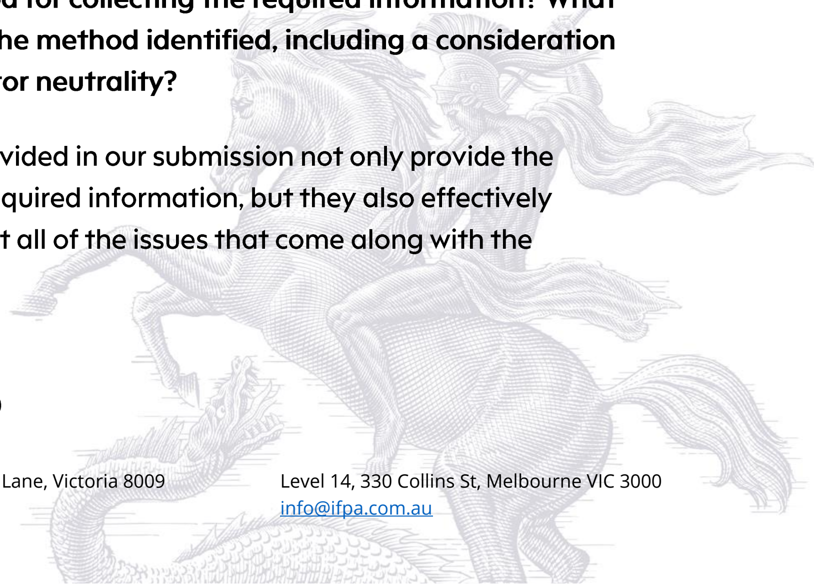
We will leave it to technical experts in the defined benefit interest sector to provide their views on these complex arrangements.

However, we do hope defined benefit funds will also receive commensurate treatment as non-defined benefit funds.

On a similar note, we would also like to see the government legislate the two-year window to allow people to convert their legacy income streams (such as defined benefit pensions) to new style pension products, such as account-based pensions. This proposal was originally announced in the 2021 Federal Budget and if legislated, will help reduce the number of legacy income streams that may be subject to a complex workaround if they are subject to the new tax.

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?

The alternative options which we have provided in our submission not only provide the most effective method for collecting the required information, but they also effectively deliver the policy's stated intention without all of the issues that come along with the proposed model.



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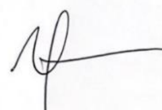
If you have any questions in relation to this submission, please contact Phil Broderick on (03) 9611 0163 or pbroderick@sladen.com.au or Natasha Panagis on (03) 8851 4535 or n.panagis@ifpa.com.au.

Yours faithfully,



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