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Proof Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023

(Public)

THURSDAY, 18 APRIL 2024

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ECONOMICS LEGISLATION COMMITTEE

Thursday, 18 April 2024

Members in attendance: Senators Bragg, McKim, Dean Smith and Walsh

Terms of Reference for the Inquiry:

To inquire and report into:

Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023

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BRIGGS, Mr Blake, Chief Executive Officer, Financial Services Council [by video link]

HAMILTON, Mr Jesse, Chief Financial Officer, Wilson Asset Management

JOHNSON, Mr Aidan, Policy Manager, Superannuation, Financial Services Council [by video link]

Committee met at 10:21

CHAIR (Senator Walsh): I declare open this hearing of the Senate Economics Legislation Committee into the Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 and a related bill. I begin by acknowledging the traditional custodians of the land on which we meet and pay my respects to their elders past and present. I extend that respect to Aboriginal and Torres Strait Islander peoples here today.

The committee will be conducting today's hearing via video conference and in person. These are public proceedings being video streamed live on the parliament's website, and a Hansard transcript is being made. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence.

Witnesses have a right to request to be heard in camera. The Senate has resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. If a witness objects to answering a question, they should state the ground upon which the objection is made, and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Commonwealth officers appearing today are also reminded of the Senate order specifying the process by which a claim of public interest immunity should be raised. A copy of the order is available from the secretariat.

I now welcome representatives from the Financial Services Council and Wilson Asset Management. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. I invite you to make a brief opening statement, if you have one.

Mr Briggs: Thank you to the committee for the opportunity to appear today in relation to the bill. There are a range of provisions in the bill including some the FSC strongly supports, particularly the resolution of the long-term uncertainty of foreign financial services providers, and some we have concerns with, such as the lengthening of review cycles for the Financial Regulator Assessment Authority. For the purpose of the introduction, however, I will focus on the FSC's concerns with the superannuation tax components of the bill, which are well understood and are grounded in our sense of fairness for superannuation consumers.

The FSC supports the bill being amended to index a $3 million threshold, prevent the taxation of unrealised capital gains and address the retrospective nature of the new tax. When the parliament is asking Australians to contribute for upwards of 40 years for their own retirement, it has an obligation not to change the goalposts and certainly not to change them as regularly as has been done over the last decade. Neither political party has clean hands in this regard; however, the industry was of the view that there was a clear commitment to no tax changes to superannuation in the light of this parliament. We're disappointed this has proven not to be the case. The government is separately legislating an objective for the superannuation system but has chosen not to assess this tax change against the objective. We think this is a mistake and, as such, the assessment should be a necessary first step before finalising any changes.

A long-term savings scheme relies on robust humour confidence to maintain public support for the mandatory 12 per cent contribution rates. I would encourage the Senate to consider our proposed amendments to the bill and to reflect on the point at which the litany of tax changes risks excessively undermining consumer confidence in what is otherwise a world-class superannuation system.

CHAIR: Thank you. Mr Hamilton?

Mr Hamilton: Thank you, committee members, for allowing me the opportunity to speak here today. As the Chief Financial Officer of Wilson Asset Management, I represent over 130,000 retail investors, primarily comprising self-managed super funds and retirees. We have a commitment at Wilson Asset Management to advocate for the fair and equitable treatment of these shareholders. Today I am compelled to address two critical issues with the proposed bill: the taxation of unrealised gains and the failure to index the $3 million cap with inflation.

Firstly, taxing unrealised gains would create a dangerous precedent. It introduces a tax on paper profits—that is, earnings that have not been realised through the sale of an asset. The policy could force superannuation members to liquidate investments prematurely to satisfy tax liabilities that should not exist. This is particularly troubling as there are no existing taxation laws targeting unrealised gains in Australia. Such a measure would not only place undue financial pressure on investors but potentially destabilise and break the trust and confidence in the superannuation system.

Secondly, the proposal's oversight in not indexing the $3 million cap with inflation is shortsighted. As the economy grows and with the impact of inflation, the real value of the cap will diminish, disproportionately affecting younger investors and those in the early stages of accumulating their retirement savings. It disheartens me to sit before you today discussing the unintended consequences of these proposed policy changes. Unfortunately, this is not the first time we've encountered such issues. While some might argue the consultation and committee process is designed to surface these concerns for resolution, the recurring nature of these problems highlights a troubling pattern. It suggests a fundamental inadequacy within Treasury and the government to draft logical and fair tax reforms that are sustainable and make sense for the future of Australia.

What has become clear, though, is that, through these discussions, the committee has an essential role in correcting these missteps. The issues at hand are not mere political talking points; they represent real threats to the fairness and equity of the tax system. Neither Labor nor Treasury have presented a compelling justification for maintaining these two problematic components in the legislation. As we consider the path forward, I strongly advocate for amendments that would only tax capital gains upon realisation, and we propose that a $3 million cap on large superannuation balances be indexed to inflation. This adjustment would ensure that the cap reflects real economic conditions over time, safeguarding the intent and integrity of the policy for future beneficiaries. This isn't just about adjusting a flawed policy; it's about upholding the principles of equity and foresight in our legislative process. We owe it to all Australians to ensure that our tax laws are not only fair at their inception but remain fair into the future.

CHAIR: Thank you very much. To the Financial Services Council: I think in your opening statement you said you support measures towards sustainability and equity of the superannuation system. Is that right? You do support sustainability and equity in the super system?

Mr Briggs: The comments I made in my opening section were around the fairness of the legislation towards superannuation consumers. There are things that can be done to make the superannuation system more equitable, and we've argued for things like government policy—like the payment of superannuation contributions on the Paid Parental Leave scheme. However, we don't feel comfortable with the proposition that you need to take measures that are unfair for one cohort in order to make it fairer for other cohorts. I note that the government hasn't sought to tie things like the payment of superannuation on PPL to the passage of this measure—for all the right reasons. Superannuation contributions should be made on paid parental leave schemes because it is the right thing to do and the policy stacks up in its own right, and those measures are what would make the system fairer for those who don't get the same level of benefit from it. But I don't think you can follow that through to this bill, or tax change, being necessary in order to achieve fairness.

CHAIR: Do you have any dispute with some of the central policy propositions of the government here that this is going to affect 0.5 per cent of superannuants, the around 80,000 people who are fortunate enough to have these balances of over $3 million, and the rate to be applied is still a concessional rate, that it only applies to the portion of the balance that is over $3 million and earnings on that? Do you accept the general arguments put forward by the government about who this is affecting and how?

Mr Briggs: My understanding of that estimate is that the 80,000 only applies to the number of people currently in retirement with balances over $3 million, so it's a state-at-time assessment at this point in time. The FSC has done analysis to estimate how many people that are currently in the workplace will be affected, and our estimate—and we think it's quite conservative—is actually about 500,000 people, because, by virtue of the government's decision not to index it, the effective threshold for someone who's currently in their 20s is much closer to a $1 million. So the concept that we're really only targeting the very top end of Australians, I think, is a bit misleading because the reality is, by choosing not to index it, you're actually very much targeting Middle Australia of future generations' retirees, and we don't think that is fair and equitable.

CHAIR: To clarify that: the threshold, as it's set, would capture 80,000 people—0.5 per cent of people who have a superannuation account. You've gone there, just to be clear, to the indexation issue, which you've raised, and that's essentially the way these things work, isn't it? It's up to the parliament and future parliaments to set indexation rates. It's pretty uncommon for tax measures to be automatically indexed from the get-go, isn't it?

Mr Briggs: I think that's a conscious decision of this government—to choose whether or not it should be indexed. It's completely within the government's power to say, 'We think it is fairer for future generations of Australia and more equitable to introduce indexation at this stage to make sure that future generations aren't unfairly paying more than current generations of Australians.' I think it just speaks volumes that there was a conscious decision made not to do that and that, I suppose, the long-term revenue benefits were prioritised over the intergenerational equity element. So that's a concern, and that's why we support indexation now, because it probably shouldn't be left to future generations of Australians to be paying a higher tax burden relative to current retirees.

CHAIR: Just to clarify that—and I accept that's your position—as a regular submitter to committees like this one, on a range of pieces of legislation, would you agree that if this particular measure, the threshold, were to be indexed it would be pretty exceptional, that it would be the exception to the norm?

Mr Briggs: I don't think that's true. I think there are plenty of thresholds in the superannuation system that are indexed. My colleague Aidan, who is the tax expert in the group, could probably point to a couple of the current thresholds in the system that are indexed. I'm not quite sure how that argument can be sustained.

CHAIR: Okay. We'll put some questions to Treasury when they come at the end of the day about the indexation. Just going to the treatment of loss and unrealised assets and the concerns that you have around that, how do you think that the loss carry-forward provisions interact there and on any issues that you have raised?

Mr Briggs: If you don't mind, I might defer to the CFOs and tax experts in the room and then follow up with some principled questions.

CHAIR: Do you mean for witnesses later in the day or do you mean—

Mr Briggs: Sorry to handball this one to you, Jesse, but I think you are probably better qualified as a CFO and a fund manager to speak to these points.

Mr Hamilton: I appreciate the intent of the carry-forward loss provisions, but you could end up in a situation where you never get to utilise that loss. If you are a retiree and you're paying tax on unrealised gains right now and in the future you don't get to utilise that carry-forward loss then you'll have lost a portion of your retirement savings to a tax that should never have been due and payable to begin with. We've spent the last two weeks on the road talking to our shareholders. We're talking about unrealised gains here, but we could be in a real position where there could be people above the $3 million cap that have realised gains and income that can utilise an unrealised loss to lower their tax bill in those years through the way the measure has been designed. I can't imagine that is the intent of Treasury or the Labor Party.

CHAIR: The intention is to deal with uncertainty and provide people with the ability to use a lower valuation of an unlisted asset, for example, in one year and offset that against unrealised gains in future years. But you are suggesting it wouldn't work that way.

Mr Hamilton: You are just forcing people into a position to pay a tax liability when they haven't actually realised the asset. So, for someone who might hold property in their superannuation fund, how do you propose that that might work? Does the participant need to sell the asset to fund the tax liability if it's gone up in value? I can't imagine anyone sitting here today would love it if they had an investment property that went up in value and all of a sudden they had to pay tax today on an unrealised gain. That property valuation can fluctuate year to year.

CHAIR: So you don't see the loss carry-forward provision as being helpful with that?

Mr Hamilton: Unless it were refundable in actual cash back to the participants, no, I do not think it would be effective.

CHAIR: There are liquidity requirements, aren't there? You referred to the argument that somebody might have to sell something. There are liquidity requirements, including for self-managed super funds.

Mr Hamilton: I understand that, but, if we are talking about tax reform, super reform and good tax policy, I can't imagine taxing unrealised gains was the original intent of Treasury. I feel that this is where we ended up with the bill, but I think there is a more effective way to address this. As you mentioned, 0.5 per cent of the population today is impacted. I can't imagine those people have many super funds. I imagine lots of those individuals have just the one superannuation fund versus multiple funds. I imagine those participants would be able to work out their realised gains versus their unrealised gains and would be happy to pay tax on their realised component, but paying tax on unrealised gains is an unprecedented piece of tax policy.

CHAIR: I accept your submission on that. As a related issue, in terms of the administration of self-managed funds, they are already required to know and report to APRA the value of their assets, aren't they? So the administration part of this—if you're going to do something, which I accept you don't wish the government to do,

in your submission—is largely consistent with current practice. People already have to know and report the value in their fund to APRA.

Mr Hamilton: Yes. I agree that people know and report the value, but paying tax on the unrealised component of that value is a separate concept.

CHAIR: Yes. Excellent. I'll go to the deputy chair.

Senator BRAGG: I might just ask you a few questions about these issues. Firstly, in relation to unrealised gains, how will it work? Are you expecting that people will just have to sell assets at a time when it may not be in their best interests? How do you think it will work in practice?

Mr Hamilton: You can take the GFC as an example. In 2007 I think the equity markets were up 30 per cent, and then they fell 50 per cent in the two subsequent years. So, in 2007, people would have been forced to sell assets to pay the tax liability—that they would be addressed—and then, in the subsequent years, suffered significant unrealised and potentially realised losses. So people will be forced sellers of assets today to fund that tax liability if they do not have the available cash sitting there on the sidelines.

Senator BRAGG: This is a stupid idea, and I don't see how it can be done. But let's assume that the government wanted to fix it—or the parliament wanted to fix it perhaps. How can it be fixed? Could you defer the tax to the point of sale?

Mr Hamilton: Potentially, but that's what happens in reality when you sell. You are currently deferring your tax to the point of sale. That's essentially what 'unrealised' is. You defer it until the point in time that you sell, and then you're taxed on that gain amount at that point in time. When you look at the intent and design of the bill—and I can say I truly don't believe that it was the intention to end up here. In terms of the portion of people that we're currently dealing with, I imagine most of them have that money in self-managed superannuation funds, or, if they do have some money within industry super funds, if they were given a period of time to move those assets into one fund, make an election on that fund—that new tax will apply to that superannuation fund—and be able to report their realised gains each year, we could circumvent this and address the issues at their core.

Senator BRAGG: But it's not deferred, is it?

Mr Hamilton: Sorry, what was that?

Senator BRAGG: It's not deferred. They have to pay the tax in the year that it's due.

Mr Hamilton: Yes, with the current proposal, they would have to pay the tax. But what I'm suggesting is that, if there's an administrative burden to working out what the realised component and the unrealised component are, I imagine that every superannuation participant would very happily work out that realised component to pay the appropriate tax on the value that they should, not the unrealised component.

Senator BRAGG: Have you provided that drafting in your submission?

Mr Hamilton: Yes.

Senator BRAGG: That's very helpful. Let's move on to the issue of indexation. These might be questions better asked of the FSC. How many people are hit now—80,000, is it? And you're saying that half a million will be hit by what year?

Mr Briggs: That's right. Our understanding is that the Treasury estimate relates only to people who are currently caught by the tax. What we did is inflate it for CPI, on a fairly conservative estimate, and based on ATO tax statistics our estimate is that 500,000 people who are currently in the workforce would be impacted. I think Treasury came out with a larger estimate based on those who are not yet in the workforce. Those who are will have the full benefit of 12 per cent superannuation over their working life. Even on Treasury's own numbers, the 80,000 is a very small estimate.

Senator BRAGG: On an intergenerational basis, who is this going to hit the hardest? Would it be the millennials, the gen Z or someone else? Who is it going to hit hard?

Mr Briggs: That's right. The way it's designed at the moment is it will have the greatest impact on younger Australians because the effective threshold for those income earners is much closer to around the $1 million mark.

Senator BRAGG: So it's better for the boomers than it is for the millennials?

Mr Briggs: That's right.

Senator BRAGG: That's very helpful. Your modelling was that 500,000 people would be impacted by the new tax. Do you know if the Treasury did their own model?

Mr Briggs: I don't know that, sorry.

Senator BRAGG: Have you given your model or your research to them?

Mr Briggs: When we released our data, which I believe was around March 2023, we released the full table, with all the underlying assumptions, because we knew this would be subject to some scrutiny. We can provide that to the committee, if you like.

Senator BRAGG: I'm asking: did you provide this to the Treasury?

Mr Briggs: We released it publicly, so, yes, they would have received it.

Senator BRAGG: Have they indicated that there is any problem with the modelling?

Mr Briggs: No, they have not.

Senator BRAGG: Has anyone suggested that your modelling is wrong?

Mr Briggs: Not that I'm aware of.

Senator BRAGG: So, as far as you can see, no-one is disputing the fact that—is it in 20 years from now?

Mr Briggs: We modelled back to someone aged 25, which would be 40 years before the preservation age, but we did it with five-year age cohorts. So between retiring in the next five years and retiring in 40 years time—we did everyone within that range.

Senator BRAGG: It certainly has a long-term impact on the idea that superannuation is the savings vehicle of choice.

Mr Briggs: Yes, that's correct.

Senator BRAGG: Is this new tax going to apply to the Prime Minister, Minister Wong and other politicians?

Mr Briggs: I don't know their superannuation circumstances, to be honest. I don't know if they are in the old DB scheme or not, sorry.

Senator BRAGG: Maybe I'll ask you it this way: do you know whether this scheme will apply to defined benefit members?

Mr Briggs: It will, yes.

Senator BRAGG: How does it do that?

Mr Briggs: The methodology for that assessment is extremely complex and is being released, I believe, through regulations. We're currently still working with members through the implications of that. A number of our members do run DB schemes, but at this stage they're still working through the details because they were released more recently than the original bill.

Senator BRAGG: Do you know when were they released?

Mr Briggs: I'd have to check that.

Senator BRAGG: But it's recent?

Mr Briggs: It's more recently. Yes, that's correct.

Senator BRAGG: Do you know whether that is going to be workable from a defined benefit perspective?

Mr Briggs: One of the notorious things about trying to calculate the incidence of tax on defined benefit schemes is that there are many different types of defined benefit schemes—they're not all the same—so trying to design a set of regulations that applies to them equally is extremely difficult. I think what would most likely be evident in the drafting is that there will always be different impacts on different cohorts. We've already seen a lot of subgroups, such as members of the judiciary or former members of the judiciary and public servant, coming out and saying: 'This isn't fair on us. There are problems with how it's designed.' I'll allow them to speak for themselves, but I think without a doubt it will be complex and costly to implement and there will inevitably be issues because it impacts differently designed DB schemes in different ways.

CHAIR: Last question.

Senator BRAGG: Finally, why do you think the government wants to wind back the financial regulator accountability authority reviews?

Mr Briggs: I must admit we didn't expect this policy announcement.

Senator BRAGG: It's not very transparent, is it?

Mr Briggs: The recommendation to have a review process and an agency to do that was a royal commission recommendation. If you think about it—and as it should be—all of the royal commission recommendations are effectively sacrosanct because of the magnitude of the issues that were exposed during that period. If the private sector were to come out and ask to wind back or repeal recent royal commission recommendations that have been

implemented, I think there would quite rightly be a very strong public backlash. The idea that one of the ones that scrutinise government agencies is already being wound back is just a strange choice, to be honest, and I think it will have the effect of lessening the scrutiny of regulators when there are areas that the royal commission exposed that are deserving of a high level of scrutiny. So we don't understand the rationale for this. I think, for the industry, it was quite unexpected, but here we are.

CHAIR: Thank you very much to the witnesses on this panel for appearing today. That concludes the questions we have for you. If you took any questions on notice, answers are due cob Thursday 2 May. Again, you go with our thanks.

BRODERICK, Mr Phil, Director and Chair, Superannuation Policy and Technical Committee, Institute of Financial Professionals Australia [by video link]

GRECO, Mr Tony, General Manager, Technical Policy, Institute of Public Accountants

NEGLINE, Mr Tony, Superannuation and Financial Services Leader, Chartered Accountants Australia and New Zealand

WEBB, Mr Richard, Superannuation Lead, Certified Practising Accountants Australia

[10:51]

CHAIR: I now welcome representatives from Certified Practising Accountants Australia, Chartered Accountants Australia and New Zealand, the Institute of Financial Professionals Australia, and the Institute of Public Accountants. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. I'm probably hoping that not everyone has an opening statement that they wish to give! How many do we have?

Mr Greco: I will provide a joint opening statement, if that is okay with you.

CHAIR: Fantastic. Please proceed.

Mr Greco: Retirement requires long-term planning. Even without this additional tax increase, superannuation is already impacted by its current tax settings because of the impact of the compounding nature of the existing taxes. We have a long list of objections to this so-called better targeted super tax concessions measure. First of all the consultation time frame for this particular policy has been too short and should have been more open to improvements or other alternatives. We consider the policy overall to be retrospective. It treats equally important aspects of retirement differently—for example, homeownership and savings in particular. It penalises taxpayers who are either good investors or who accessed very generous contribution rules before 2007. Most individuals who are impacted by this are older. On death, most of their account balances must be paid out of the superannuation system. In other words, this is a short-run problem that the government is seeking to address.

The proposed policy is incredibly complex and costly to administer for government, superannuation funds and individuals. We consider the cost estimates contained within the bill's explanatory memorandum to be low. All superannuants are impacted by these policies, as all administration systems, disclosure documents, annual statements, call centre scripts et cetera must be adjusted. Everyone is going to pay for this.

This policy taxes unrealised gains. The capital losses under the policy are carried forward and are not refundable. This, importantly, creates a contingent liability for government finances. As has already been discussed, when account balances fall below $3 million and do not go above that value again, tax is being paid but can never be returned to the taxpayer. Our modelling indicates that it is very difficult to predict when the tax will be payable from one year to the next, and cash flow management is often practically impossible. It will force some funds to sell assets because they are unable to defer the payment of the tax.

The application for defined benefit members is particularly complex, just looking at the regulations that have been released as an exposure draft, and those who have already started pensions within DB schemes can't plan around this tax or take any active action. Those without a preservation condition of release are not allowed to take money out of the system. The early-stage investor incentives, which provide incentives from a capital gains tax perspective, are eliminated as a result of this particular measure. It applies tax to those who die on 30 June but not on other days of the financial year. It penalises those who are in receipt of disability or terminal illness benefits.

Our improvements to the policy, at the very least, are as follows: increase the $3 million threshold to a multiple of the general transfer balance cap, index the threshold by movements in average weekly earnings every 1 July, allow refunds to be paid when the total super balance declines from one year to the next, and remove the restrictions on after-tax contributions that can be made to superannuation. In other words: return to the policy that was put in place by the Hawke and Keating government back in the late 1980s.

CHAIR: Thank you very much. Was that all of the opening statements?

Mr Negline: Yes.

CHAIR: Thank you very much. There were a few things in your opening statement and the submission that probably need to be clarified. When you say that this will cost every superannuant, it's probably important to clarify whether or not you agree with Treasury's modelling and the government's assessment that this affects 0.5 per cent of superannuants—80,000 people who are fortunate enough to have these sorts of balances. I understand that you're trying to make an administration point there, but do you agree with the essential proposition that it's 0.5 per cent of people who are covered?

Mr Negline: It might be a small number of taxpayers now, but, as was discussed by the previous organisations providing evidence, the $3 million threshold is not indexed. So the number of people impacted in the future will, by design, increase as balances increase by inflation, capital value increases and so on. That is issue No. 1.

Issue No. 2 is that there are costs that are going to increase in the running of superannuation funds which would be impossible to only target at those high-balance individuals. All admin systems have to change, all disclosure documents have to change, all annual statements have to change—and so on—and those costs are going to be spread throughout the system. Everyone is going to pay higher costs for this. And, because of the way the tax is collected, the ATO is going to incur greater money.

CHAIR: In terms of the indexation argument: again, it's okay for witnesses to put this evidence, but we have to be clear that this is 80,000 people—0.5 per cent of people—today and the modelling that's being referred to, covering a larger number of people, is 40 years away. Indexation is not something that is common to the kinds of arrangements we're talking about, personal taxation arrangements. Do you accept that it would be abnormal to—

Mr Negline: No, we don't accept that. It is very unusual in the superannuation tax settings for values not to be indexed. Off the top of my head—and I'm happy to hear from my colleagues—I can only think of one other item that is not indexed, and that involves small business superannuation contributions. That is the only threshold, off the top of my head, that is not indexed. All other thresholds, contribution amounts, benefits paid out and so on are subject to indexation, and generally by average weekly earnings.

CHAIR: In terms of general, personal, individual taxation arrangements, your submission is that they're generally indexed?

Mr Negline: No, no—in a superannuation context, Senator. In relation to personal tax matters, such as personal income tax rates, they're obviously not indexed. There has been lots of coverage of that over the last little while.

CHAIR: Yes.

Mr Negline: But in the superannuation setting it is very unusual for them not to be subject to indexation automatically.

Mr Broderick: And, Tony, you could add that thresholds like contribution caps, concessional and non-concessional, and the transfer balance cap—these are all similar types of caps that we're talking about with this new measure, and they're all indexed.

Mr Webb: Senator, could I add to that as well that there are caps on benefit payments, such as the untaxed plan cap and the low rate cap, which are all indexed as well. They actually apply to benefits taken and determine the tax that is paid on those benefits as well.

I should add, while we're on the subject of tax and superannuation, that the transfer balance is currently a cap that's basically set on how much can be moved into the pension phase, and it's generally agreed that $1.9 million is enough of an amount for that amount to be tax free. That amount is actually indexed to CPI. You can do some very basic modelling on this using the 2½ per cent default figure that ASIC's Moneysmart website likes to go for and work out that the transfer balance cap, which is currently set at $1.9 million, will overtake the $3 million unindexed division 296 threshold by 2044. That's only 20 years away. Most people are in superannuation for about 40 years of their working lives.

CHAIR: In terms of the unrealised assets issue that you talked about, I think you made the assertion that's been made about people having to sell things. I'll certainly ask Treasury questions about that later in the day. But I put this question to the previous witnesses as well. Funds are required to have diversification and they're required to have liquidity to meet their expected liabilities. Isn't it the case that these 80,000 fortunate people, 0.5 per cent of Australians superannuants, should be able to meet their obligations—they should have diversification and they should have the liquidity in their fund to meet any potential liabilities?

Mr Greco: I might address that particular question: surely, if there is diversity. But you have a situation where small businesses have their real property, which they use in their business, as their principal asset in the super fund, so it's an illiquid asset. They may not have the funds to pay this impost. I know you're referring to a small portion of the population being subject to this new impost, and I think we have to stop and think about what we're actually doing here. What we're doing is imposing an unfair tax on the basis that it impacts only a small number. That illiquid asset is a situation of not necessarily having the cash to pay for that. Not all funds have got that investment diversity of assets in their SMSF or APRA fund. So it may not actually be possible to generate the sort of cash to deal with this.

This goes against established principles. When you realise an asset you have the cash to pay the capital gains. Why are we going against established principles? If we tried to tax unrealised gains outside of a superannuation environment, I think you'd have very little chance of that getting off the ground, but here we have this situation where we are considering going against established principles, and the established principles are there for a good reason—that is, if the asset is realised, you may have the cash to deal with that impost.

To answer your question, not all funds will have the diversity in their asset allocation to meet this impost. The legislation does provide for two options: it can come out of the superannuation environment, or it can come out of personal funds. We do accept that that flexibility is offered in the legislation.

Mr Broderick: May I also add that most of these larger balances are in self-managed funds. There's no strict obligation for them to actually have diversity or liquidity. They are obligated to consider those issues, but they're not obligated by law to have them. There are many funds that have done really well because they have these certain illiquid assets, and that has pushed them over the $3 million. You can imagine that movements in these assets could be very large, with very large increases of unrealised gains and a large tax bill, and, while you have the liquidity for your normal fund activities, you don't necessarily have the additional liquidity to also pay these potentially large div 296 taxes.

Mr Webb: If I could correct something there as well, the requirement for self-managed super funds is essentially that they implement and maintain an investment strategy that's appropriate to them and the members of the fund, and that that includes consideration of the liquidity profile of the fund. For a lot of funds that hold large illiquid assets at the moment, the trustees will probably find that they currently have a compliant investment strategy in place that provides them with all the liquidity they need to actually cover what they need to do in place of current fund taxation arrangements as well as any benefit payments or pension payments or anything else that's going out of the fund at the moment. What this new measure will probably do is require trustees to consider changing their investment strategies and to look at their liquidity profiles more carefully. What that does actually end up doing is impose a little bit more liquidity risk, reinvestment risk and pricing valuation risk on a fund.

I'll just take you through how that could occur. If a fund is up for a big tax bill, and they've got a large, bulky asset that's largely illiquid, it does raise the possibility of a fire sale needed to fund a large tax bill. It could then be the case that the asset is sold for far less than what it's currently valued at, and that would essentially mean that the tax would have been imposed on what has become lost value.

CHAIR: I understand the views that you're putting, but there are liquidity requirements today. People are required to have some room for unexpected eventualities and costs. This is something that will be expected, right? It applies from financial year 2026-27, so there's also time to prepare for this, in terms of the liquidity issues that you're raising.

Mr Broderick: But, as Mr Greco put forward before, the issue is that in your normal, traditional tax system that applies everywhere else you get income and you pay tax on it, but you've got the income to pay the tax. If you make a capital gain then you've got proceeds from your capital gain to pay the tax. If you had a particular parcel of real estate in your fund that was fortuitously rezoned and doubled in value, you'd have a massive unrealised capital gain. You can't plan for the huge tax bill you'd get as a result of that.

CHAIR: It's right that that shouldn't be the only thing in your fund, isn't it?

Mr Broderick: But it might make up a good proportion of it, which gives a disproportionate tax bill because of the disproportionate capital—you just don't have enough liquidity to pay for a huge unrealised gain in the event that I just referred to.

Mr Negline: It's a good problem to have, but it's a very nasty problem.

CHAIR: I note your comment there. There is the loss carried forward provision as well. Those were your words—that it's a good problem to have, if you've got that sort of appreciation of your assets going on in your fund.

Deputy Chair, I think you have questions.

Senator BRAGG: Firstly, in relation to the unrealised gains issue, what is going to happen for people if they are going to meet the tax threshold in the bill and they have a fund full of liquid assets? They may be holding a farm. They could be holding property. They could be holding exposure to private equity, for example, which is subject to a lock-in period. What is actually going to happen here, do you think?

Mr Broderick: A tax bill will be issued to the taxpayer individually, and then they will have a choice of paying that tax bill outside of super and/or by withdrawing an amount outside their super fund. They've got to work out whether they've got enough liquidity inside and/or outside of super. If they don't have sufficient liquidity

inside or outside of super, it's just a normal taxpayer tax assessment. Even though the explanatory memorandum references this point and says that there could be liquidity issues and that there will be a reduced interest rate, it doesn't have a deferral model like the defined benefits system has a deferral model for this system. Your non-DB funds don't have that deferral model, so you really are at the whim of the ATO because you've got an outstanding tax assessment which is accruing this interest, and there's nothing—

Senator BRAGG: Sorry to cut you off. What actually happens in practical terms? Does a person have to sell things at a time that is—

Mr Broderick: That's right. They've got to pay that tax bill somehow. They've got to sell something; if they've got no cash, they've got to sell something in super or—

Senator BRAGG: Let's do an example. I think there are a lot of farmers who have their farms held in self-managed super funds. If they get a tax bill from the ATO, what have they got to do? Have they got to sell part of the farm?

Mr Broderick: Let's just say there is a $100,000 tax bill, just to make up a dollar figure, and they don't have $100,000 outside of super or $100,000 of cash in super. Either they've got to sell that farm in the super fund and then withdraw that amount or, alternatively, they've got to sell something outside of super to pay that amount.

Senator BRAGG: That sounds very unusual.

Mr Broderick: It is. That's why we are really, really passionate against the unrealised gain part of this. That's why most of the criticism around this tax system is around this. It's not a fair system in the sense of that we otherwise pay tax everywhere else on just realised gains.

Senator BRAGG: It seems absolutely wild. Why wouldn't it be operating like this: once I sell an asset or once I complete a transaction then I pay tax on it? Why couldn't they have done it that way?

Mr Broderick: Well, that is certainly an alternative in submissions that have been put by members of this group. There is some feedback that you hear that that gain has to be attributed. If you've got a large membership, how do you attribute that realised gain to the membership? We feel, from a self-managed super fund point of view, that they would be able to attribute that on a realised system. We don't speak for large funds, but you'd imagine it's possible for large funds as well. I don't know if any other members giving evidence would like to comment on that.

Mr Webb: Adding to what Mr Broderick has said, there are some large funds that would be able to do this—for example, platforms and maybe a couple of other types of funds. It might be difficult in certain others, but there are professionals who are able to do this sort of financial mathematics.

Senator BRAGG: In effect, if the government was so hell-bent on having a new tax on super, it could achieve that objective by setting the tax up so that you only pay tax if there is a realised gain. In other words, once there is a completed transaction, tax would be payable. That is achievable, is it not?

Mr Negline: It's technically feasible, but maybe an alternative would be to go back the system which used to exist prior to 2007, and that's to apply tax when you take money out of the system, so it's an additional tax on withdrawals from the system itself. In other words, completely redesign it so that it is easy enough to apply to every type of fund and it's only paid by those with a high balance when they are removing money from the system. Maybe that might be a simpler system, rather than having to worry about distributing capital gains and worrying about capital losses and so on during the year. So if you've taken money out of the system, you potentially pay an additional tax.

Senator BRAGG: That's something I imagine we will look at in the report. That deals with that unrealised gains piece, which is sounding like it's unworkable. What about the defined benefit matter here? Have you had a chance to review the government's proposed regulations?

Mr Negline: We've done our best at the moment. Submissions are due by tomorrow week, so we're in the process of finalising our submission for them. We haven't come to a firm view at this point in time. It would be fair to say, however, that the regulations are very complex. They're being adjusted at the same time. They rely on family law rules, and those family law rules are sunsetting and the Attorney-General's Department is consulting at the same time in relation to a new version of those family law rules. It's very difficult for us to get our head around exactly what is going on. As was provided in evidence about half an hour ago, there are more defined benefit systems and adjustments and so on in defined benefit funds than most of us have had hot dinners.

Senator BRAGG: Is there a way that this can actually work? It sounds horrible.

Mr Negline: Yes, it is horrible. I think Treasury have probably given it a pretty good go, but because of the way the system is designed it's pretty complex. It's going to be incredibly hard for an individual who belongs to

one of these funds to know whether or not their calculations have been done correctly or not. It's going to be incredibly difficult because there are so many twists and turns in these particular rules. You can't actually look at the system and say, 'Yes, they've actually inputted all of the right data into my calculations and got it a hundred per cent correct.'

Mr Broderick: We could also make the point that there is horizontal inequity in all of this in the sense that we are now going to have three regimes. You've got your constitutionally protected funds where members don't pay the tax; you've got your DB funds that pay it under this complex formula, but it's deferred until it's crystallised and payment time; and then you've got everyone else who pay annually on an unrealised gains type model.

Senator BRAGG: Do the regulations apply to the parliamentary schemes?

Mr Negline: As we understand it they do—well, to the old parliamentary scheme. As we understand it, the new parliamentary scheme is an accumulation scheme, based on your account balance and so on, like most of us have. But, yes, it should apply to the old DB parliamentary scheme as we understand it.

Senator BRAGG: What about judicial pensions?

Mr Negline: Yes, it will, but only to those who are new to the scheme, I think. Is that how it's meant to work?

Mr Webb: There are some—

Senator BRAGG: I'm trying to work out if anyone's going to get out of this bad tax, if we're going to have to have it.

Mr Broderick: I believe that the judicial pensions are excluded. If they've got other pensions outside, if they've got other accumulation, it counts, but I understand that their judicial pensions are excluded from the measure.

Senator BRAGG: How much tax, on your reading of these regulations, will the existing members of the parliamentary schemes pay? I might get you to take that on notice.

Mr Negline: I don't think we can actually calculate that. I don't know enough about the rules of that scheme to actually work it out.

Senator BRAGG: You can't take it on notice?

Mr Negline: In the deadline, I'm not entirely sure we could get our heads around the scheme to actually calculate it correctly.

Senator BRAGG: There'll be a large amount of public interest in how this new tax will be applied to politicians; I can assure you of that. This question will be answered by someone. Perhaps I should put these questions to the Treasury. I'm sure Treasury will be getting their calculators out now. We'll leave you off the hook on that one. Just to finish on that, you don't have any way of being able to tell, with all your experience of defined benefit schemes and tax legislation, how much someone like Mr Albanese would be paying in tax?

Mr Negline: It depends on so many different factors, too numerous to mention now, for us to actually say, 'The tax is going to be calculated in this way at this particular time, and therefore we can actually nominate how much tax is actually going to be paid.' We would have to do an enormous amount of research in order to make sure that we understood the fund, understood the factors that are going to be used and understood each member's personal circumstances in relation to that particular fund and whether or not they take a lump sum or a pension or whatever it might be in order for us to actually nail down what the tax liability would be.

Senator BRAGG: Let's just try and play this out. We've got a bill before the parliament. You've come to give evidence at the Senate committee. We're reviewing the legislation on this new tax. Because you know the provisions which would apply to ordinary people, like farmers and the like that have SMSFs, you're able to tell me—are you not?—how much tax a farmer might pay if they have a balance of over $3 million.

Mr Webb: Defined contribution schemes are generally quite a lot easier to do the maths on than the defined benefit funds that you were referring to a moment ago, just based on the factors that my colleague Mr Negline has mentioned.

Senator BRAGG: We know that.

Mr Broderick: Yes. We note there's a formula. You work out the gain from the increase of account balances from the start to the end, you put it in the formula, and out comes the tax.

Senator BRAGG: Let me just try this again. Do we know the likely tax impost on a farmer who is using an SMSF with a balance exceeding the new tax threshold in the bill?

Mr Negline: We do. Our only drama with answering that with any certainty is that we actually don't know the market value of assets at the end of the year until the end of the year.

Senator BRAGG: But you have a formula that you can apply?

Mr Negline: Correct.

Senator BRAGG: We know how much an ordinary person, like a farmer, might have to pay because we have the formula in the bill before the Senate now. The question is: do we know the likely tax burden on the politician who will be subject to this new tax?

Mr Negline: You can work it out, but for people who don't administer that scheme and don't work with that scheme all day every day it's very difficult.

Senator BRAGG: Is there any way that we can work out how much Mr Albanese would be up for paying in the new tax that he is seeking to apply to other people?

Mr Negline: Technically you can do it.

Senator BRAGG: How much would it be?

Mr Negline: The problem is that there are so many different factors that it's a matter of having the time. It's such a complex matter to actually answer when you don't deal with that fund all day every day, and we don't deal with that fund all day every day.

Senator BRAGG: Do you think it's a good idea that the parliament is being asked to vote on a bill which is going to impose a new tax on Australians, but the detail of how this will apply to politicians like Mr Albanese is not known in this process, and we can't even get a sense of how much tax a politician like Mr Albanese would have to pay?

Mr Negline: I think it's probably the case that it's for all defined benefit members, not just for one. I think this problem exists for all of those individuals. Clearly that's a less than ideal situation, isn't it?

Senator BRAGG: So why wouldn't the regulations be part of the main bill? Is there a reason for that?

Mr Broderick: That would be a question for Treasury, but it might have been because it's so difficult.

Senator BRAGG: But would it be possible to have all the information together in this bill? It would have been possible for the regulations here to be in the bill. Isn't that right?

Mr Broderick: Yes.

Mr Negline: Yes, but the rules for DB funds are complex, and it's probably better that they're in regulations.

Senator BRAGG: But my point to you is that, when we look at a bill, we have a Senate process. We have transparency. We can come in and ask you, the longstanding superannuation experts, about how this is going to work, how fair it is and how reasonable it is. There are significant equity issues here about a politician, particularly a prime minister, excising himself from the primary bill and then setting it off to subordinate regulation. There's no scrutiny there, is there?

Mr Negline: Regulations are disallowable, aren't they?

Senator BRAGG: But are we going to have a hearing into these regulations?

Mr Negline: I don't know.

Senator BRAGG: It's very unlikely, as you know. So wouldn't it be better if all these matters were dealt with together?

Mr Broderick: From a legislative point of view and from someone who interprets legislation, yes, it's much better all in one spot. I agree.

Senator BRAGG: I would have thought so. Thank you very much for that. Finally, can I ask you about this issue about the indexation. The decision not to index this scheme, this new tax, is going to hurt who the most?

Mr Webb: Eventually, it will hurt more and more people. The current figure of 0.5 per cent that's put around is a figure that exists currently. Inflation being what it is, of course, we would expect that that figure would increase by 1 June 2026 or when this comes into effect. That, of course, does increase more and more as we go into the future. In our submission to Treasury on the consultation paper, we pointed out that, in 20 years time at 2½ per cent CPI, the transfer balance cap would come up to parity with the division 296 threshold, which creates a policy conundrum of sorts, given that I think it's generally a bipartisan view that the transfer balance cap is doing what it's supposed to be doing, and that's limiting the amount that goes into the tax-exempt pension space.

Senator BRAGG: Thanks very much.

CHAIR: Thank you very much to the witnesses on this panel. That concludes the questions that we have for you. If you've taken any questions on notice, please provide any responses by COB Thursday 2 May. You go with our thanks.

Proceedings suspended from 11:29 to 11:46

BURGESS, Mr Peter, Chief Executive Officer, Self Managed Super Fund Association

CLARE, Mr Ross, Director, Research, Association of Superannuation Funds of Australia

DELAHUNTY, Ms Mary, Chief Executive Officer, Association of Superannuation Funds of Australia

KOVAL, Mr James, Head, Policy and Advocacy, Association of Superannuation Funds of Australia

LINDEN, Mr Matthew, Executive General Manager, Strategy, Super Members Council

SCOTCHBROOK, Mrs Tracey, Head, Policy and Advocacy, Self Managed Super Fund Association [by video link]

CHAIR: Welcome. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. Mr Linden, do you have an opening statement?

Mr Linden: I do, and I'll whip through it as quickly as I can. I want to thank the committee for the opportunity to appear before you today in this important inquiry into this bill. I start by acknowledging the Ngunnawal and Ngambri peoples of the Canberra region.

Super Members Council advocates on behalf of 11 million Australians who entrust over $1.5 trillion in their savings managed by profit-to-member superannuation funds. Our purpose is to advocate, to advance their interests, and to ensure superannuation policy is stable, effective and equitable.

Australia's super system has generous tax concessions built in. It's a bargain between Australians and the government. Savings are preserved until retirement and, in exchange, they are lightly taxed. It is important that these concessions are efficiently targeted to those who need them most. Governments should ensure that concessions are equitable and those on lower incomes, younger Australians, part-time and casual workers and many women are adequately compensated for the foregone consumption on compulsory savings and get their fair share.

Successive governments have sought to better target super tax concessions. Most recently—before this bill—in 2016-17 the former Morrison government made a raft of changes to advance that objective, including lowering the annual non-concessional contributions cap, introducing a cap on tax-free pension savings, the transfer balance cap and lowering the division 293 threshold for contributions by higher income earners. In 2020, the *Retirement income review* pointed to a need for further work to better target super tax concessions. It also said:

Further improvements in targeting … concessions would improve the equity of the retirement income system.

SMC supports the proposed legislation we're dealing with today. In particular, those measures dealing with individuals that have a total super balance that exceeds $3 million are a step in the right direction. SMC supports further measures to improve equity in the super system, especially for low-income earners, who are disproportionately women.

We believe there is a need for governments to continually revisit the equity of these concessions, and to particularly look at the adequacy of tax concessions for lower income earners. We think there has potentially been an opportunity missed to look more holistically at these issues. Currently superannuation tax concessions could be better targeted. The stronger savings incentives apply to those who retire on incomes and savings well above what is necessary to have financial security in retirement and would likely continue to do so even if concessions were less generous.

We know, of course, the committee has dealt with the objective super legislation which should enjoy bipartisan support, and it includes sustainability objectives and ensuring the system is affordable. That includes ensuring that concessions are well targeted. Government should be constantly assessing these settings and ensuring they align with community expectations. I look forward to the committee's questions.

CHAIR: Thank you, Mr Linden. Ms Delahunty, do you have some opening remarks?

Ms Delahunty: Thank you, Chair. ASFA, the voice of super, has been operating since 1962 as the peak policy, research and advocacy body for Australia's APRA related superannuation industry. We speak on behalf of over 100 organisations who are our members, from corporate, industry, retail and public sector funds and the implementing service providers that support those funds.

ASFA supports the intent of the current proposal regarding superannuation balances over $3 million as a measure to improve equity and the long-term sustainability of the superannuation system. Our world-class system with the current settings delivers better retirement outcomes for the majority of Australians; however, ASFA and our members have longstanding views regarding the need to ensure tax concessions underpinning the system are

distributed equitably. We have, for many years, called for reforms limiting the tax concessions that flow to those on high-incomes and/or those with very high superannuation balances.

To assist the committee in your assessment of this legislation, we also provided, in a letter through the chair, a snapshot of data and characteristics of the affected population from our research using the reliable ATO sample data set. We trust this is helpful to understand the impacted cohorts.

Our submission goes to the elements of the proposed measure and subsequently released regulations that are operational in nature. We have suggested areas the committee may wish to consider for changes to ensure the proposed division 296 tax can be administered as efficiently as possible to avoid imposing a cost burden on superannuation funds that would indirectly be borne by fund members whose total superannuation balances are below the threshold at which the tax will apply.

Under the theme of 'lessening the cost burden where possible', we draw the committee's attention to the effect of the proposed process on defined benefit superannuation funds. There are around one million Australians with a defined benefit superannuation account or interest. The draft regulations, which were released on 15 March, propose that the valuation methods used for family law splitting purposes be also used for the purposes of division 296 valuation of defined benefit entitlements. We contended that while the family law valuation methods are appropriate for family law situations, they do need modification to be appropriate in this context. In particular, the family law valuation factors would lead to females being assessed with a higher tax amount given their longer life expectancy. There also is an increase in the valuation of defined benefit interest if a person has a spouse, and funds would need to establish this annually—a costly process and rather intrusive. ASFA considers that females and males at the same age with the same salary or life pension should pay the same amount of tax.

We welcome the opportunity today to expand on our submission and our subsequent letter, and we are happy to provide clarification on some of the comments made by earlier witnesses.

CHAIR: Thank you very much. Mr Burgess?

Mr Burgess: We would also like to thank the Senate Economics Legislation Committee for inviting the SMSF Association to appear as a witness at today's public hearing. The SMSF Association does not support this new tax on superannuation balances above $3 million. This tax is based on a manufactured calculation of superannuation earnings that bears little resemblance to actual taxable earnings. Treating the increase in the value of an asset as taxable income is, by any measure, a radical departure from existing tax principles and a crude method of addressing superannuation wealth and wealth inequality. It will give rise to many unintended consequences, which we do not believe have been properly considered.

Many impacted individuals, including small business operators and primary producers, will encounter liquidity stress compounded by the erratic and unpredictable nature of the tax that is linked to movements in markets, whether investment or agricultural land. The assertion that a commercial yield should always generate sufficient liquidity for a fund to cover a tax that is linked to movements in the underlying asset value lacks commercial realism, particularly in rural Australia.

SMSFs have historically been a strong source of venture capital, and this is very unlikely to continue in an environment where unrealised capital gains are subject to tax. These are all consequences of a tax on earnings that is not based on actual taxable earnings. This is not a simple tax. Under the proposed manufactured calculation of earnings, complex adjustments will be needed to ensure earnings are not inflated or artificially reduced. A system of carried-forward tax losses will apply, along with debt accounts for defined benefit funds. Some funds with defined benefit interest will face additional valuation and pension reporting obligations.

When the government first began floating the idea and need for this measure, reference was made to the small number of individuals with superannuation balances exceeding $50 million and $100 million. We agree that balances of this size are outside the original policy intent, but they are a consequence of historical policy settings. Importantly, the existing policy framework is designed to address these balances. As a result, they are being progressively removed from the superannuation system.

Despite the original stated objective of this policy, the proposed threshold has been struck at a considerably lower level. The shift from $100,000,000 to $3,000,000 and a measure of earnings that captures unrealised capital gains utterly reframes the policy position, from one that targets ultrahigh net worth individuals to one that starts to capture elements of Middle Australia, small-business owners and farmers. It has a very different policy intention and outcome. The lack of indexation of the threshold will, over time, see this measure impact many more average Australians, and we strongly encourage government to cease the progress of this bill and instead continue to engage with stakeholders and the industry to ensure that the resulting policy and legislation delivers the right outcomes. We thank you and are happy to answer any questions.

CHAIR: Thank you very much, Mr Burgess. I'll kick off with some questions. I'll start with Mr Linden, from the Super Members Council. You said in your opening statement that you support the intention of the bill, which is around supporting equity and sustainability in the super sector and better targeting the concessions that we have in place today. The bill is intended, as you know, to apply a 30 per cent still-concessional tax break to earnings on the portion of balances that are over $3 million. We heard some evidence earlier today about the indexing issue, and I've put it to witnesses that it's uncommon for personal, individual taxes like this to be subject to indexation. Do you have any evidence on that? What are your views on whether it's common or not to index thresholds like this in the system and whether it's appropriate to be looking forward 40 years and drawing numbers like those that were drawn earlier?

Mr Linden: This is obviously a policy decision of government. They could have indexed the threshold and decided not to. It is the case, however, in superannuation that not all thresholds of this type are indexed. For example, the division 293 threshold—which is, I guess, the closest parallel with respect to taxation of contributions for higher income earners—is not indexed. At the other end of the spectrum, for low-income earners, the low-income super tax offset's relevant thresholds are not indexed either. So there are other thresholds in the superannuation system which are indexed. Some are not. Our view would be that governments would need to review, periodically, the relationship of these thresholds to one another, including, for instance, the transfer balance cap, and ensure that the original policy objectives are being fulfilled.

CHAIR: And it's not unusual for parliaments to be tasked with doing that, and it's not unusual for this to be left for consideration by future parliaments—to consider whether indexation is appropriate.

Mr Linden: As I mentioned before, there are some thresholds in the super system where that is the case. More broadly across the tax system, that's the approach which is taken with the personal income tax scales. Governments make an assessment as to whether or not relevant thresholds are appropriate given movement in real wages in particular. So these are decisions which governments routinely take in relation to taxation matters.

CHAIR: We also heard some evidence about the treatment of unrealised capital gains in super funds. Obviously the policy intent of the bill is clear, to maintain a concessional tax rate but for that tax rate to be 30 per cent at the threshold that we're talking about. The goal of the bill is not to impose unfamiliar or complex new methods on super funds. What is the view of the Super Members Council on that issue about the methods for dealing with unrealised capital gains?

Mr Linden: Obviously imposing taxes does involve some compliance costs. They need to be balanced, obviously, with the revenue which the government is seeking to obtain through the measures and the integrity of those measures. I think that the approach that they have taken is to try to simplify the way in which this additional tax is collected for APRA regulated funds. Most APRA regulated funds, the approach they take for members, from a member perspective, is that capital gains are taxed on an accruals basis, so the relevant crediting rates or unit prices take into account the fact that the fund is withholding tax, including on capital gains, on that basis. That is the approach in respect of most large APRA related funds. It would be a different situation, of course, for self-managed superannuation funds.

CHAIR: I will go to Ms Delahunty. You said in your opening statement that you are supportive of equity and sustainability in the system, and you provided the committee with some analysis that your organisation has done to help us understand who would be implicated in this change to the concessional rate. Would you be able to take us through some of that evidence?

Ms Delahunty: Certainly. We agree with Treasury estimates that around 80,000 people will be affected when the tax will be introduced. Approximately 93 percent of those 80,000 people have a superannuation balance between $3 million and $10 million. Seven per cent of affected individuals have balances between $10 million and $50 million. Approximately 65 per cent of affected individuals are in the retirement phase, with the remaining 35 per cent still in the accumulation phase. Around 10,000 members with defined benefit interests will be impacted, representing about one per cent of the total population with defined benefit interests.

We also found, contrary to some commentary that has been popular, that there are very few primary producers or people who would perhaps be identified as farmers in holding primary production land within this particular cohort that would be affected. We find that most of the affected population, as Treasury estimates, within that 80,000 group are wage earners and potentially business owners as well.

CHAIR: As you said there, when you're obtaining a concessional tax rate, increasing that concessional rate to 30 per cent for earnings on the portion of balance over $3 million affects a very small cohort of people who are fortunate to have those sorts of balances. Do you think that the concessional rates that are still being provided,

which are a significant improvement on the standard marginal tax rates, will still do that important work of encouraging people to invest in their retirement savings?

Ms Delahunty: It is difficult to imagine how this would discourage that sort of investment activity, if indeed that sort of investment activity, as perhaps imagined in venture capital land, is being conducted within SMSFs to begin with. If we take the example that has been much discussed in Australia, and it's a great Australian success story, Canva raised its money through Blackbird Ventures. Blackbird Ventures lists 300 investors in the fund that holds Canva. The majority of these are APRA regulated superannuation funds. The remaining investors, the private investors, by and large are tech professionals, as it says on the Blackbird publicly listed website.

So it is difficult to understand what sort of behaviour this might change, because to do that we need to understand whether that behaviour is happening in the first place. If there is investment that is being done in a venture capital sense within SMSFs, it is difficult to understand that that would stop just because of a particular tax that would be collected on the valuation of those investments that goes above $3 million. Further to that, Senator, as I'm sure you can appreciate, it is difficult to understand that that would be inappropriate. That is probably an appropriate outcome when you hold as a paramount objective equity in the system.

CHAIR: Yes. I guess, for the avoidance of doubt, this bill is affecting a small number of people, including a very small number of primary producers according to your research, and in your view it does support the sustainability and equity of the system.

Ms Delahunty: Yes, that's right. It will affect a small number of people, and it will positively impact a very large number of people and the system as a whole, which touches all Australians eventually.

Mr Burgess: Senator, if I may, we would dispute those findings around—

CHAIR: That's not how it works. I will share the call now with the deputy chair.

Senator BRAGG: Could I ask some questions to the Self Managed Super Fund Association? At the moment this is going to hit 80,000 people, is that right?

Mr Burgess: We have no reason to dispute the 80,000 people, but what I would say is that it has a knock-on effect much broader than that. We are impacting small business owners and primary producers. SMSFs are a very popular for primary producers. We understand that many farming properties are owned by self managed super funds. It is a very popular vehicle for primary producers. We would dispute those findings put forward by ASFA. We believe it's a very common scenario for an SMSF to hold primary production. This tax will have a significant impact on those particular structures.

Senator BRAGG: But it's 80,000, yes?

Mr Burgess: 80,000, but there is the knock-on effect to the broader community.

Senator BRAGG: So it's 80,000, but it goes to 500,000. Do you have any reason to dispute those figures?

Mr Burgess: I don't. I heard the earlier witnesses. I'm familiar with the research that the FSC has put out, so we have no reason to disagree with that.

Senator BRAGG: Does anyone on the panel disagree with that 500,000 figure?

Mr Clare: That 500,000 figure is based on the assumption that the threshold may change over a 40-year period. That's over many parliaments, changes of government, a whole host of other things happening. So as an assumption for forward projection, you could equally say that in 40 years time, if personal tax rates were unchanged, everybody would be on the top marginal tax rate and that would be inappropriate. It comes down to what is a reasonable assumption for a projection. On the arithmetic, you could say that if the threshold doesn't change and the demography is as set out in the Financial Services Council's estimates, then you come up with that number. But how meaningful that number is is a very open question. It's one that many people would question.

Senator BRAGG: You're not disputing the 500,000?

Mr Clare: No, I'm disputing the assumption that nothing will change in 40 years in terms of the threshold. That seems like a very unlikely projection to rely on.

Mr Linden: A normal assumption in terms of doing long-run projections of that type would be to include some adjustment or indexation—maybe periodic. That would normally be the case. The way the analysis has been done is probably contrary to the way in which most long-run projections would normally be done.

Senator BRAGG: So you think it will be indexed in the future?

Mr Linden: I think it would be most unlikely that the threshold wouldn't be adjusted at some point in the future, just as it's highly unlikely that the existing personal income tax thresholds would not be adjusted and increased in the future.

Senator BRAGG: I've been very surprised to have lived through a period where the parliament decided to re-instate a tax bracket that was abolished just a few years ago. It is true that very strange and warped things can happen. As a standing start of where we sit today, you would require a future government to change the arrangements for the projection to be untrue—isn't that right?

Ms Delahunty: Do you mind directing your question? Was that to Super Members Council?

Senator BRAGG: I don't mind directing the question. I'm just being engaging with a witness from Super Members Council. That's my response to the proposition that the indexation wouldn't change. You're saying the projection is unreliable—are you not?

Mr Linden: What I'm saying is that the way in which that analysis was done is not the usual way in which you would necessarily do a long-run projection of that type, just as when Treasury does the IGR and looks at the overall burden of income tax relative to corporate tax, for instance, it will make assumptions in respect of what the reasonable long-term assumptions are. Clearly in this bill it is a matter for the government and future governments to make decisions around this particular threshold. Every single year in the budget there are measures from government to adjust the low-income threshold for the Medicare levy, for instance. They're judgements and decisions which are made in the budget process.

Mr Burgess: This would require a law change. It won't be indexed the way it's drafted. If it is to be indexed in future years, it would require a change to the legislation.

Ms Delahunty: To clarify, I think we're perhaps talking about two different issues here: one of which is whether or not that particular figure can be relied upon because of the basis that it was brought about, and the other is whether or not there is indexation applied to the threshold itself. We agree that if you use the current assumptions that that model is based upon, you come to that number. I guess that's a full stop. Further though, we agree that that's an inappropriate way to arrive at a figure.

Senator BRAGG: That was the question. I was trying to get on record from your organisations, whether you've—

CHAIR: I've got to go to Senator Smith, if that's okay.

Senator BRAGG: I haven't finished my questions, so I'll have to come back—sure.

CHAIR: Okay, Senator Smith.

Senator DEAN SMITH: My questions go to the Self Managed Super Fund Association, in particular to appendix F of your submission, which talks about what I would characterise as the disproportionate harm being done to farmers and, by extension, farming communities, who are already suffering under the cumulative effect of the government's decisions. I noticed that you used some examples from Western Australia—parts of the state that I'm very aware of. How significant is the false Treasury assumption that self-managed super funds have a degree of liquidity to be able to meet these new changes?

Mr Burgess: Based on the research that we commissioned from the University of Adelaide, if this tax had been introduced in the 2021 and 2022 income years, around 13½ per cent of SMSFs that are impacted by this tax would not have had enough liquidity in their fund to pay this tax. We're talking about just under 7,000 individuals, SMSF members, that wouldn't have had enough liquidity in their account to pay this tax.

Senator DEAN SMITH: Can you expand on that point and the consequence of that, particularly for self-managed super funds that might be used by farmers?

Mr Burgess: I think the key point to note here is that the asset value of the land is not correlated with the yield. There is a view that, as asset prices increase, so does the yield, so these SMSFs should always have sufficient liquidity to pay this tax. Now, that is not the case. When it comes to rural properties, the yield is determined by other factors, not the value of the actual land itself. It could be determined by the use of that land. That's a really important point as to why, if you're basing a tax on unrealised gains, you could create significant liquidity problems for these types of funds—because they simply won't have the cash to pay that tax. This is what happens when you have a tax where you depart from taxable earnings, because you start to tax unrealised gains, which has many unintended consequences, as I mentioned earlier on.

Senator DEAN SMITH: Staying with this point that a self-managed super fund may not have the liquidity and staying with the example of farming communities, what would be the next steps that a self-managed super fund would take, assuming that this was the law?

Mr Burgess: Well, it needs to pay the tax. Either it uses the cash it has available in the SMSF to pay the tax or, if it doesn't have the available cash there, it can use cash outside the fund to pay the tax. But they are going to have to call on cash reserves because, obviously, they don't have the income from the realised gain. So they're

going to have to call on their cash reserves to pay this tax, whether they take it from their fund or whether they take it from cash reserves that they have outside the fund. But the assumption is that they will have those cash reserves. Now, we know that's not always the case, particularly when you're looking at how much this tax could be. It could amount to tens of thousands and, in some of the scenarios that we've been looking at, hundreds of thousands of dollars in tax that some of these individuals will incur under this new proposal.

Senator DEAN SMITH: I'm assuming that you've engaged with the Treasury around this. To what extent has Treasury been interested in or concerned about the liquidity stress issues that arise as part of this proposition?

Mr Burgess: We've provided to Treasury all the research that we've commissioned through the University of Adelaide. I think Treasury's assertion is that SMSFs should always have sufficient liquidity. In our view that is not the case, because the value of many of these assets is not linked to the income yield, as I mentioned earlier on. Just because the asset value is going up doesn't mean their rental yield is going up as well.

Senator DEAN SMITH: Mrs Scotchbrook, do you have any comments to add?

Mrs Scotchbrook: The taxation of unrealised gains is taxing a paper or an accounting movement. It's vital for all super funds to value their assets at their market value. It's about ensuring that the members' balances are reflective of what their actual benefits are at a point in time. Our tax system doesn't currently tax unrealised gains, and so this is quite a step away from our existing tax principles.

For farming properties, the difficulty we have around the statistics is that the ATO data doesn't go to sufficient granular detail to really get to the core of what assets are held where. When we look at the SMSF returns, for example, it will list that a fund has a property, and that's classed as either residential or non-residential property. It doesn't go to further granular detail around what is primary production property and what is not. When we look at individual tax returns, we can glean some information, but the reality is that many primary production businesses have complex structures, and the way that income flows to the individual tax returns may not necessarily appear as primary production income. It could appear as wages, it could appear as dividends perhaps, depending on how that has been structured. Indeed, we won't have primary production income on the SMSF return, because that's receiving leasing income. The difficulty we have is that the data is not readily available, but when we engage with our members we see that there are many more primary production businesses that will be impacted. With one firm we've engaged with, around 17 per cent of the SMSF clients have primary production property in their SMSFs that would be impacted by this.

Initially the tax will be imposed on the individuals but they can elect to have that paid by the super fund. As we know with farmers, we've seen in recent years that the various natural disasters—drought, fire, flood—that have occurred significantly impact the earning ability of primary production—so it's quite cyclical, and they can go through extended periods of time without income. But that doesn't necessarily mean we have a decline in value in the assets. There's been a lot of consolidation.

Senator DEAN SMITH: How do you explain to self-managed super fund members the government's motivation for this. Given that this is an unprecedented measure, how do you explain to your members the government's motivation for introducing an unprecedented measure like this?

Mr Burgess: The motivation is to reduce the tax concessions for those with balances over $3 million. Unfortunately, the way this is structured goes well beyond that—so some of these individuals will be paying higher rates of tax in super than they would if they had the money outside of super. It's a difficult one.

Senator DEAN SMITH: Thank you very much.

CHAIR: Ms Delahunty, there was some different evidence given on the involvement of primary producers in this. Your research said that only a small portion of the people affected by the tax have direct or indirect primary production income and that only a small proportion of those would have a farm. Are you able to comment on the disparity there?

Ms Delahunty: Yes, thank you. It is with some interest that I have followed this line of inquiry, as I am from a farm, have grown up on a farm and have never heard a self-managed super fund mentioned around the saleyards at all. SMSFs are permitted to hold real property that is used by a member of the SMSF, but this is subject to strict rules. These include a market level rent or a lease payment being received by the SMSF for use of the property. When we picture the affected cohort here, we're thinking less of the farmer and more of an investor in a farm who may have held it for some reason, put it into their SMSF and is now receiving a lease payment—so typically that lands on adjustment.

Typically the lease payment for a farm lands in the range of three to six per cent of the capital value and could be as high as 10 per cent. This would surely be sufficient to cover any likely division 296 tax liabilities, especially given the threshold for the tax to apply with no need for sale of the real property. The ATO sample file data

indicates that only around three per cent of those likely to be affected by the tax have direct or indirect primary production income, and we think conclusions can be drawn from that that only a portion of that three per cent would have a farm or other primary production held within a SMSF.

Around 50 per cent of those likely to be impacted by the tax live in Sydney and Melbourne. ATO data indicates that some of those with primary production income live in Sydney or Melbourne—perhaps that's me!—and that around seven per cent of those likely to be impacted by the tax live in rural areas. I think there are conclusions that can be drawn from the ATO data that speak to the cohorts actually affected by this tax, and I think it is very surprising that we would find that a number of farmers, as we imagine them to be, will be those who are caught and affected by this tax. Further, if it's useful to the committee—

CHAIR: I think we might have to get you to put that extra evidence you're about to give on notice. Thank you very much. That concludes the time we have for this panel. Thank you all for appearing as witnesses today. If you've taken questions on notice, please provide responses by COB Thursday 2 May.

DAVIDSON, Dr Peter, Principal Adviser, Australian Council of Social Service [by video link]

MITCHELL, Mr Joseph, Assistant Secretary, Australian Council of Trade Unions [by video link]

THOMPSON, Ms Casey, Workers' Capital Manager, Australian Council of Trade Unions [by video link]

[12:24]

CHAIR: Welcome. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. Does the ACTU have a brief opening statement?

Mr Mitchell: We do, thank you. Thanks again for the opportunity to address the committee today. The trade union movement led the campaign to establish universal compulsory superannuation in order to provide workers with dignity in retirement. Workers understand the purpose of superannuation, which is to accumulate and preserve savings to enable them to have a dignified retirement. We did not campaign for, and superannuation was not designed to be, a tax haven for those with far more than adequate retirement incomes, nor a way for the wealthy to receive tax handouts paid for by those with far less retirement savings.

Right now, superannuation tax concessions are deeply inequitable. Superannuation is intended as a vehicle to generate and preserve retirement income, but flat tax concessions allow the extremely wealthy to gain disproportionate benefits from taxpayers and, we believe, risk the sustainability and social licence of the system. Superannuation must be equitable and system settings must ensure this. Whether as public expenditure through the super system either through tax concessions or other measures, it must be equitable and sustainable.

Generally, tax concessions on contributions and earnings are a necessary part of the system. They exist to incentivise voluntary contributions but also mean workers can grow their superannuation balance ahead of retirement faster. But the volume of tax concessions within superannuation disproportionately flows to the wealthy and does not deliver a sufficient benefit to lower-income workers. Higher-income earners receive not only more in real dollars as a tax concession but more as a proportion of their total income as tax concessions.

The only other thing I would say is that superannuation taxes and tax concessions should be fair. The union movement welcomes the government's proposals to lower tax concessions for those with more than $3 million in their superannuation accounts. We note, as many others have noted, that 99.5 per cent of those with superannuation accounts have accounts with less than $3 million. A cleaner will never have more than $3 million in their superannuation. A truckie will never have more than $3 million in their superannuation. They will have to work several lifetimes over in order to get that much money in their super. The idea that this could ever affect ordinary working people is just bunkum. It'll generate $2.3 billion in government revenue in 2027-28, and that $2.3 billion can be better spent improving the lives and retirement of working people, including those who retire with inadequate superannuation. We commend this reform, as it improves the equity and sustainability of the system.

CHAIR: Dr Davidson?

Dr Davidson: We recommend that schedules 1 to 3 be passed. ACOSS supports the proposed 15 per cent tax on investment income of large super accounts and believes the proposed method of raising this tax is the most sensible approach available. Compulsory super has lifted retirement incomes for the majority of workers to a decent level, well above aged pensions. But it's bolted onto a tax system that privileges wealth accumulation and estate planning, to the detriment of people on low and modest incomes.

ACOSS and the University of New South Wales are releasing today our latest research on income and wealth inequality; with permission, I can send you a copy of that report. We find that in 2022 the highest 10 per cent of households ranked by wealth held 44 per cent of all household wealth, averaging $5.2 million for each wealthy household. Thirty-eight per cent of the wealth of the highest 10 per cent was held by people over 64 years old, by older wealthy people—so just four per cent of wealthy older households held 18 per cent of all household wealth. Yet we also found that 38 per cent of those older wealthy households with average investment wealth, assets—not including owner-occupied housing—of at least $3 million paid no income tax in 2019. Thirty-eight per cent paid no income tax in 2019. This is a sign that our tax system, including the taxation of super, is contributing to growth in wealth inequalities.

We believe the tax treatment of super is fundamentally flawed in at least two ways. Contributions on behalf of a woman on $20,000 a year attract less tax support per dollar contributed than those for a bloke on $200,000 a year. Investment returns in the retirement phase are not taxed, an extraordinarily generous tax treatment that prompts wealthy individuals to shift as much of their assets as possible into super before they retire. Meanwhile, government is considering lifting user charges for aged care.

For the better part of 30 years, successive governments of all persuasions have tweaked the system in an attempt to reduce waste and improve equity but without addressing these fundamental problems. While it falls short of the root-and-branch reform we believe is needed, the present bill is a major step forward. It brings an element of progressivity into the taxation of super fund investment income for the first time and it raises over $2 billion a year in additional revenue.

One challenge for the designers of the scheme was how to assign investment income to individual fund members. They seek to resolve this by using the annual increase in individual fund balances as a tax base. This isn't as radical a shift as it may seem. Conceptually the definition of income is essentially the increase in wealth from one period to the next plus any consumption during that year.

CHAIR: Dr Davidson, I might just have to ask you to start concluding your remarks, thank you.

Dr Davidson: Sure. Nor is it unprecedented to tax capital gains as they accrue. We do that in state land taxes and council rates. The two problems, if you're attempting to tax accrued capital gains, are the need for annual valuation—well, that's kind of resolved in this case—and, secondly, the liquidity issues that have been raised in these hearings. I point to the Grattan Institute's submission, which suggests that people with $3 million in super are likely to have significant access to cash beyond super as well as within super and should, for prudential reasons, have it within super.

In relation, finally, to the $3 million threshold and the non-indexation of that threshold, we might be concerned about that if the threshold were a lot lower, but it will take many years before that impacts average workers, as my colleague from the ACTU points out. It comes down to budget priorities. In the lead-up to the budget, ACOSS is pushing for an increase in the $55 a day JobSeeker payment for people who are unfortunate enough to have lost their jobs. Those folk, and people with super accounts of $3 million or more, live in very different worlds.

CHAIR: Thank you. Senator McKim?

Senator McKIM: Thanks to the witnesses today. I'll start with Mr Mitchell and then go to Dr Davidson. Mr Mitchell, in terms of the threshold being set at $3 million balances, are you aware of any policy rationale for setting the threshold at $3 million? Would the ACTU support a lower threshold, of, for example, $2 million or $1 million?

Mr Mitchell: You've got to pick a number. It's really clear that above a certain number—whether it be $3 million, $5 million, $2 million, $1.6 million—you're targeting ever-fewer, very highly wealthy people. We're comfortable with the position of the government to start at $3 million. We think it's clear that those with more than $3 million in their superannuation, just as Dr Davidson pointed out, have assets outside of that and are in no need of government support to help them build their wealth. We saw estimates similarly, prior to the announcement of the $3 million, that $5 million was floated by some segments of industry as a fair starting point. I think that this going further than that is really helpful.

Senator McKIM: Dr Davidson.

Dr Davidson: Three million is an extraordinary high level affecting only a very small number of people. If it were to be indexed, we would advocate for a significantly lower threshold, but we don't have a specific recommendation.

Senator McKIM: The latest ATO data shows that a $2 million threshold would catch 0.6 per cent of people. That 0.6 per cent people own 14 per cent of the total value of superannuation balances in this country. I have the same question for both of you, but I'll start with Mr Mitchell: are you concerned that we're missing an opportunity here by not setting the threshold lower than $3 million?

Mr Mitchell: When it comes to selecting a threshold there are always going to be arguments that pull in both directions: to have a lower threshold that captures more people, raises more revenue and is imposed sooner, or a threshold that's higher and further away. I think, as Dr Davidson pointed out, it not being indexed is a benefit to the measure and improves it over time. Where we start is an important question, but also where we end up is an important one too.

Senator McKIM: Dr Davidson.

Dr Davidson: If we were to advocate for a more far-reaching reform, as we do, we'd turn to the nontaxation of fund earnings in the retirement phase, per se. The Henry report into tax reform recommended removing the distinction between tax treatment of accumulation and retirement phases. We can see no reason that that shouldn't happen, and we would allocate the money raised to an aged-care guarantee rather than lifting user charges.

Senator McKIM: That has neatly anticipated my next question; I'll ask it anyway. Dr Davidson, I think you've answered it in part, but I want to ask what your two main priorities would be. You've mentioned your

advocacy for what I think you called 'root-and-branch reform'. So what would your two major priorities be for root-and-branch reform of the super system?

Dr Davidson: The change I just mentioned, plus replacing the tax treatment of all contributions with an annual refundable rebate so that, regardless of your income level, every dollar contributed attracts the same level of tax support, which unfortunately is not the case in the complex, shambolic system we have at the moment.

Senator McKIM: I'll ask you the same question, Mr Mitchell. I do appreciate it's a question without notice, but, for what it's worth, I offer it to you.

Mr Mitchell: We have some pretty wide-reaching priorities when it comes to reform of the super system. It starts with ensuring that every single worker gets paid super on every dollar earned. That would make an enormous difference to people have compulsory overtime, to women and to young workers that don't get paid superannuation. There are reforms that have just taken place to ensure that gig workers, where they are recognised as employee-like, will be paid super. It's about making sure the system is truly universal.

On the tax side, we need to see reform at the lower end to ensure that those who are on tax-free thresholds and are contributing to superannuation are actually provided with a tax benefit. The fact that the LISTO hasn't moved in several years is something that deeply needs reform and needs reform urgently.

Dr Davidson: This particularly disadvantages women, most of whom are on those lower incomes, and many of whom are in part-time employment and below the tax-free threshold. Their superannuation tax break on contributions is zero.

Senator McKIM: Thank you. Mr Mitchell, you mentioned in your opening statement that the ACTU had campaigned for the establishment of what's now regarded as Australia's superannuation system. It's probably fair to say that you were part-architects—not you personally, I hasten to add—because the ACTU was involved in developing the architecture of the system. I wonder if you'd agree with the proposition that over time the superannuation system in Australia has drifted away from being about providing for a dignified retirement for workers and drifted far more closely to delivering as a tax shelter for wealth accumulation?

Mr Mitchell: I think that's exactly a fair characterisation and a lot of that drift happened under the previous government. Enormous incentives were built into the system that were instituted by the previous government, including the ability to sell an investment property and dump that into superannuation, tax-free, to get an enormous tax advantage; the ability to make significant catch-up contributions, which aren't available to ordinary working people; and the continual preferencing of higher-income earners concerns over lower-income earners concerns in superannuation. This includes a deal done with Pauline Hanson to allow a tax break for high-income earners whose employer contributions exceed the concessional contributions cap, which was a shocking deal done by the former government to exclusively benefit those who earn more than $250,000 a year.

We can't see the erosion of the initial ambition for superannuation to be a universal entitlement which benefits working people happen any further, and this step to ensure that the system is socially sustainable by taxing it fairly is a really important one.

Senator McKIM: Thanks to you both.

CHAIR: That concludes the questions that the committee has for you. We very much appreciate your evidence. Questions on notice are due by Thursday 2 May. You go with our thanks.

ABDALLA, Ms Julie, Senior Counsel, Tax and Legal, The Tax Institute [by video link]

CLOUGH, Mr Michael, Legal Adviser, Private capacity [by video link]

WESTOVER, Mrs Elizabeth, Member, National Superannuation Technical Committee, The Tax Institute [by video link]

[12:42]

CHAIR: I now welcome representatives from the Tax Institute as well as Mr Michael Clough. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you.

Mr Clough: Yes. Can I just quickly add that I'm here as a solicitor representing a large group of retired judicial officers and their spouses and widows.

CHAIR: Thank you, Mr Clough. Ms Abdalla, do you have an opening statement you'd like to give?

Ms Abdalla: We have tabled our opening statement with the committee, so I'd like to take this opportunity to focus on our key concerns. The Tax Institute acknowledges the government's right to tax individuals in different brackets at different rates, in line with the progressive system. Our concern is not the concept of the tax itself, it's the manner of implementation as a tax on unearned income.

We have significant concerns with the core mechanism by which the division 296 tax is proposed to operate. Division 296 proposes to introduce a tax on unrealised gains. Although there are theoretical economic efficiencies with the taxation of unrealised gains, we strongly consider that the practical difficulties taxpayers face outweigh the perceived benefits. The core reason for these challenges arises from the timing mismatch between the taxation of the unrealised gain and the cash flow from the actual gain on the asset. Taxpayers will be required to pay their division 296 liability from either their personal savings or their superannuation balances. This may result in difficulties for some categories of taxpayers, including older retirees who have built large balances and retirement cash flow strategies based on previous announcements and expectations, and taxpayers with low cash balances and illiquid superannuation assets. If the government intends to pursue its proposal to tax unrealised gains in division 296, we consider that it's crucial to limit this approach to the current measure and make amendments to ensure that it will operate fairly and efficiently.

Of note, it's important to ensure that taxpayers have the ability to carry back losses to ensure they receive timely recognition of those losses. Currently, the measure proposes to allow taxpayers only to carry forward losses. This means that taxpayers who incur large losses after paying a division 296 tax liability may be unable to utilise them. This may occur, for example, if there's a significant market downturn and the taxpayer passes away before they can utilise their carry forward losses. In our view, this would be an inequitable outcome that results in asymmetric tax outcomes and is inconsistent with the economic foundations of taxing unrealised gains.

Taxpayers should also have the option to defer payment of their division 296 liability for a set period—for example, five years—to allow taxpayers with insufficient funds or illiquid assets reasonable time to meet their tax liabilities.

In addition to reducing the impact of the difficulties of taxing unrealised gains, there are other changes that are needed to ensure the measure operates as fairly and efficiently as possible. These include indexing the proposed $3 million threshold to reduce the effects of bracket creep and ensure that the measure captures only the intended cohort of taxpayers. They include exempting all taxpayers from being liable for a division 296 liability in the year of their death. Currently, only taxpayers who die on any day before 30 June in an income year are exempt from the tax for that income year, but those who die on 30 June remain liable for the tax for that year. This is an unnecessary and inequitable anomaly that should be removed. They also include removing amounts withdrawn to pay for tax liabilities from the withdrawals used in working out an individual's adjusted total superannuation balance; excluding payments for total permanent disability and terminal medical contributions from the scope of division 296, in line with the proposed treatment of structured settlements; and ensuring that division 296 is administered efficiently by providing taxpayers with access to information used by the commissioner to calculate their tax liability and by providing for instant resolution of disputes.

We'd be pleased to answer any questions. Thank you.

Mr Clough: I extend my clients' thanks to the committee for this opportunity. It will be brief. A number of retired judges filed a submission with the committee, and the purpose of my appearance is, as a practitioner specialising in this area, to highlight what appear to be some very curious results of the proposal as it stands. Let me say that it's just as well there's consultation going on, because there's a great deal of uncertainty as to how the proposed provisions would apply to Commonwealth judicial pensions.

I'll start with the key points. They are that the Commonwealth judicial pension provisions for retired Commonwealth judicial officers do not seem to be even a target, of any sort, of the proposed legislation and policy. For example, there is no 'inheritocracy', there is no wealth accumulation here; this is simply part of the arrangements, agreed between the Commonwealth and the judges at the time of their appointment, as to what the judicial pension would be after they retired. The reason why parliaments, ever since I can remember, have enacted these provisions is to preserve the independence of the judiciary in one of the country's most important courts, which involves the Federal Court and the High Court. The provision of a pension for life as a percentage of a current serving judge's salary is indeed there to preserve that independence.

The judge's pension, unlike just about every other defined benefit fund I have seen, has no power to commute. There is no accumulation of wealth, there is no balance there; it is just a pension. On top of that, and most importantly, the judge's pension is fully taxable at marginal rates, just as if it were salary. It is subject to a small rebate, which goes back in history, of about $11,000 per annum but is otherwise fully taxable. So the consequence of applying it—assuming it's intended to apply, and that is very difficult to work out based on the material so far—would be that, if the 15 per cent tax were imposed on the retired judge in respect of the notional movement in a notional amount that is somehow calculated actuarially from year to year, that would be a tax on top of what they receive as a pension. Clearly, that would be a form of double taxation. It's very difficult to understand why the provisions are even directed towards the Judges' Pensions Scheme.

I can make a couple of simple points. It will serve as a disincentive for people to accept judicial office. This is a retrospective change to the pension which was agreed for a very significant number of judges at the time of their appointment, and it will apply to serving judges when they retire. So the amount of revenue involved may be very small in the overall context of the scheme of these proposals, but it will affect just about every Federal Court judge from here on in. I say all this without knowing exactly what is intended when it comes to valuing these sorts of pension arrangements. It may be that, because they're effectively declining years to which they are entitled to the pension, it was never envisaged for them to apply. Nevertheless, they are not excluded, and, indeed, it's clear from the legislation that even serving judicial officers, when they retire, are not excluded.

My second-last point is that, as I noted earlier, one of the challenges that the legal profession has had for many years, and still has, is the imbalance of males in senior positions and the ability to attract female and other diverse groups to the bench. This will simply serve as a further disincentive. Females in particular are going to the bench earlier than males; that's what the statistics tell us. That will serve as a further disincentive for a female going to the bench at an early age.

The last and most important point, I think, goes to the heart of independence of the judiciary, and, without repeating myself, the judicial pension is a fundamental part of preserving that independence—one which I hope is not intended by the parliament. And, in circumstances where the states are constitutionally protected, after a decision of the High Court, and serving judicial officers of the Commonwealth are protected under the Constitution, it does seem a very strange policy move by the parliament to even consider the judicial pension being subject to these proposals. Thank you.

CHAIR: Thank you. I'll go to the deputy chair. Senator Bragg.

Senator BRAGG: Just so I understand, Mr Clough—you're representing former judges, are you?

Mr Clough: I am. Some of them are named in the written submission, but there are a large group of former judges also and, in some cases, their widows.

Senator BRAGG: And are you effectively asking the parliament to carve the retired judges out of this new tax?

Mr Clough: Yes, I am. In fact, what I am saying is that, if enacted and if it operates in the way that we suspect it will—when further details are released—it will have, to use the constitutional framework in which it will be considered, the substantive effect that you may as well just pass an act of parliament reducing the pension.

Senator BRAGG: Have you had an opportunity to look at the draft regulations?

Mr Clough: I have.

Senator BRAGG: And those would apply to retired politicians in the old scheme as well as retired judges, right?

Mr Clough: That is my understanding, yes. There is a list there and that is one of the listed ones, yes.

Senator BRAGG: So how does it work? Does it apply net present value to the pension and then levy a tax? How does it work?

Mr Clough: I am afraid I can't comment on the parliamentary pension. I am not familiar with the terms of it.

Senator BRAGG: How does it work for retired judges? Is it based on net present value of the pension?

Mr Clough: The way the regulations work under the proposal is that there is an actuarial calculation of the theoretical amount which one would be required to acquire as an annuity to fund the pension, taking into account all the actuarial assumptions from the date of retirement of the judge until under their expected death under the death tables that are part of the regulations. That would require all the usual actuarial inputs, such as investment earnings rates, death rates, spousal death rates and the general discount of earning rates.

Senator BRAGG: So the way it works at the moment is a retired judge at 65 receives X dollars a year in a pension? Is that how it works?

Mr Clough: Currently it is 60 per cent of the serving judges, yes.

Senator BRAGG: So it's 60 per cent of their working income. Is that at their last year or an average of their last five or something?

Mr Clough: It's actually of the current judges. It goes up. The Remuneration Tribunal determines all this, and if they determine that serving judges' salaries increase the pension automatically adjusts.

Senator BRAGG: So at the moment they are receiving a pension which is based on a calculation which is reasonably complex, but at least we can understand in plain English that it is a percentage of something. At the moment, are they paying tax on that?

Mr Clough: The pension is fully taxable for the judges—that is correct—unlike pensions from superannuation funds, to which this is directed. So long as they are within their transfer balance limit, those pensions are entirely tax free. If the balance, whatever the balance is, is taken out as a lump sum after 65 it is tax free as well.

Senator BRAGG: So for a 67-year-old retired judge receiving a pension do you have a sense of what kind of dollars we are talking about here?

Mr Clough: That depends on which court you are talking about, but, if you are talking about the Federal Court of Australia, that would be just shy of $300,000. That's my expectation.

Senator BRAGG: And they pay income tax on that?

Mr Clough: That's correct—it's as if it's salary.

Senator BRAGG: So your argument is that if this proposal goes ahead as, per the regulations—because you're not actually addressing anything in the bill here, such is the ridiculous position we have—there would be an additional 15 per cent on the income tax levy.

Mr Clough: That's correct—15 per cent on the notional earnings from a notional amount in a notional fund which would then be imposed on the retired judge in addition to what they in fact receive, yes.

Senator BRAGG: It's very hard for us as a parliament to do our work when a lot of these elements are not actually in the bill. This is perhaps a deliberate design feature—I'm not sure—but it is very challenging. That is your argument. That's very helpful. Thank you.

Senator McKIM: I have one or two questions for Mr Clough. You said that there is still uncertainty as to how those arrangements will apply to Commonwealth judicial pensions. You have given evidence and you have had an opportunity to review the draft regulations. Does that uncertainty still exist, in your mind, post your opportunity to have a look at the draft?

Mr Clough: Yes, it does, in the sense that it rests entirely upon actuarial assumptions which are completely opaque at the moment. I notice that the Mercer submission was asking for a lot more information as actuaries to be able to do these sorts of things. The judges are simply making the point that it just seems to be a completely ill-targeted approach. The judges' pensions have been fully taxable as if they were salaries. With no ability to call for a lump sum, there is no commutation there. It just seems to be a rather ill-considered attempt.

Senator McKIM: So, just to be clear, if the tax arrangements were changed for judges as is proposed, would that change the remuneration that judges would receive once they have retired?

Mr Clough: After tax, yes.

Senator McKIM: So it would change the remuneration that a judge would receive in their bank account?

Mr Clough: Once they go into their retirement phase and are subject to the pension, this would be a tax in addition to their normal tax on what is effectively a deferred salary, yes.

Senator McKIM: And it would be a reduction in their income?

Mr Clough: In their after-tax income—that is correct. To clarify, that depends on what assumptions the actuaries make. It is conceivable that the actuaries will make a lot of assumptions where it would be almost

impossible to come up with an amount that is subject to the tax, but, at the moment, based on what we have read in the materials, it is very difficult to see how they would do that.

Senator McKIM: Just to be clear, Mr Clough, your evidence is that, absent the actuarial assumptions, it is not possible for this committee, for you or the judges you represent or, for that matter, for the parliament to understand what the dollar implications of this measure would be for retired judges?

Mr Clough: That is correct. That's in addition to the main proposition, which is that it shouldn't be the subject of this proposal because it is a fully taxable pension.

Senator McKIM: Yes, understood. The Tax Institute has raised problems around ensuring liquidity to pay for unrealised capital gains. Are those problems really just confined to self-managed super funds? Wouldn't large super funds have the capacity to manage that quite easily?

Mrs Westover: I believe it would be more relevant for self-managed superannuation funds, because you tend to have a lot of your assets within a self-managed fund, smaller numbers of members and so forth. There are a range of liquidity issues that those funds would have to consider, not just the ability to pay this division 296 tax but more broadly pensions, which is usually a very big one. When you have those lumpy assets like property, liquidity is a huge issue.

Senator McKIM: Are there enough SMSFs in the system with leveraged investments that this change proposes a risk to the stability of the financial system?

Mrs Westover: I believe the numbers around self-managed funds that have leveraged liquid borrowing arrangements is available from the tax office. You could possibly get those numbers from the tax office and Treasury. My experience suggests that they are not necessarily related in the sense that liquidity more broadly goes well beyond just those smaller numbers of funds that have limited liquid borrowing arrangements.

Senator McKIM: You say that the $3 million should be indexed. Why shouldn't, for example, the $1.9 million balance transfer cap for retirement incomes be frozen instead? Don't we want our super system to be more progressive, not regressive?

Mrs Westover: I hadn't actually considered, in the context of this, whether or not that particular measure would be frozen as an option, but I believe indexation across the industry make sense. Wages go up, cost of living goes up, all manner of other provisions are indexed, so it makes sense for transfer balance caps, transfer balances, to be indexed in the same way as we would rightly like this particular measure to be indexed.

Ms Abdalla: If I could add, on the indexation point, while this is currently proposed to affect only about 0.5 per cent, about 80,000 people, we exacerbate the generational inequity by looking at this as a current issue and not a future problem. More and more average Australians will end up within the scope of these rules, particularly if it isn't indexed. We don't want to be in a position where we are putting people in scope of something that they aren't meant to be and that's not policy intent.

CHAIR: Thank you. We've covered some of these issues around the modelling which takes us 40 years ahead and assumes no legislative change in the meantime, which is highly unlikely.

Senator BRAGG: I want to chase up where I was with Mr Clough from the last session. If this section is shown to be unconstitutional, wouldn't it also throw out the arrangements that have been made for politicians?

Mr Clough: I hadn't considered that question, but my initial response is I don't think so, because the constitutionality would depend on both section 72 of the Constitution, which refers specifically to federal judicial officers. The other constitutional point would be what I would call the independence of the judiciary. I'm not aware of a line of cases, at least in the High Court, that would follow that line for members of parliament, parliament being supreme about its own remuneration.

Senator BRAGG: I think Senator Smith wants to take that, so I'll hand over to him.

Senator DEAN SMITH: I have some questions for the Tax Institute around two particular matters that are identified in your submission. One of them in particular is raised in other submissions. How has the Treasury responded to your comments around the treatment of disability, medical and related insurance payments? Is the Treasury alive to those matters? They've been raised by other submitters to this inquiry as well.

Secondly, your proposed deferral mechanism, which you have identified at page 8 in some detail, and the suggestion that payment could be deferred up to a maximum of perhaps five years—how has the Treasury responded to those two particular points that you've raised? What level of engagement and interest have they shown?

Ms Abdalla: We didn't receive specific feedback from Treasury on either of those points. They were included in our initial submission to Treasury and in our submission to this committee. On the treatment of the total and

permanent disability and the terminal medical condition payments, we think that they should be aligned with the treatment of structured settlements. We didn't get specific feedback as to why they would be differentiated. But if you think about the structured settlements—a person who receives a TPD payment needs to deal with an insurer and qualify under strict terms and conditions of the policy and prove that they are totally and permanently disabled and they're unlikely to ever be gainfully employed in the capacity that they were. Individuals that receive TMC payments have been assessed by usually two medical practitioners, one of whom is a specialist. Those payment recipients are also unlikely to be reasonably expected to work in the same job for the remainder of their lives. So we think there should be more parity between the way that those kinds of payments are treated.

CHAIR: Thank you, Senator Smith. If there's anything else there, would you mind taking it on notice. I will have to conclude this panel. We very much appreciate the evidence that you have given us. Answers to questions on notice are due by close of business Thursday 2 May.

Proceedings suspended from 13:10 to 13:36

BLACK, the Hon. Michael, AC, KC, Private capacity [by video link]

CHAIR: I now welcome the Hon. Michael Black AC, KC. Do you have any comments on the capacity in which you are appearing today?

Mr Black: I was the second Chief Justice of the Federal Court, and I'm appearing in an informal representative capacity for my former colleagues.

CHAIR: Thank you very much for being with us today. I now invite you to make a brief opening statement.

Mr Black: Thank you for the invitation. The first thing I really want to say, apart from thank you, is about the constitutional importance of this legislation and these regulations. The fundamental aspect of judicial life is that you have to sometimes make decisions that are extremely unpopular and are very badly looked upon by the executive government, and that you have to do it without fear or favour, affection or ill will. That's the oath you take when you take judicial office. It's a very satisfying part of one's career, but it's also one that is challenging and hard work. Since way back, from the beginning of the 18th century, it's been constitutionally protected, and it's constitutionally protected under section 72 of our Constitution. So anything that interferes with what you have or what you might have in terms of rights and so forth is a serious matter, and these regulations and this legislation don't seem to really comprehend that.

The Federal Court is an extremely important court. I don't think I'm overstating it. It's very busy. It covers a huge range of areas and highly sensitive matters—well, most matters are pretty sensitive. Its independence is highly important, as is that of all courts, and there should be no way in which the rights, the entitlements or otherwise of the judiciary should be interfered with. The Constitution is designed to protect that, and, indeed, there are some dicta, some sayings, in the High Court that would extend that protection to the pension. The critical thing is that this independence is upheld. The fear is that this legislation and these regulations impact upon that.

It also means—and this is very embarrassing—that a challenge, if it goes through, will happen, and that constitutional challenge will have to be determined by the High Court. That is absolutely to be avoided. We do not want to see that. There would need to be, I would suggest, a very strong case for having these changes made and impacting upon the federal judiciary before you even contemplated such a difficult and unfortunate situation. That's the fundamental thing.

My present worry, and the worry of others, is the impact that this will have upon the court's capacity to attract the very best people. It's not easy to attract people to the bench at any level, but particularly at the higher levels of the High Court, the Federal Court and the state supreme courts. Your heart stops when your EA appears at the door and says, 'I've got the Attorney-General on the phone.' That can be a life-changing experience; there's no question about that.

I'll take one case: you're in your 50s, you're thoroughly enjoying your life at the bar, you might not be making as much money as the stereotypes would suggest because you're doing pro bono work here and there, on committees and so forth, but everything is fine and what you're doing is extremely exciting, interesting and satisfying. You appear in some wonderful cases. All of that is then asked to change—the question of duty, what you do.

You go home—I'm talking generally; people go home—and of course one of the things you do is consult your spouse or partner, and, in some cases, family. Should this life-changing thing take place? Should the call of duty be answered? In the course of those discussions, obviously the financial aspects are going to be considered, and those aspects would include the pension. The question that is most likely to be asked is: 'Can it be changed?' The answer would, I imagine, always be: 'No, it can't. It's constitutionally protected.' That guarantee seems to be under some suggested attack at the moment.

Anyway, you make the decision. You change your life, you leave the bar—which, if you've been successful, has been a very fulfilling, multifaceted experience—and you join a court. It's a very welcoming and admirable court. You have entirely new colleagues, entirely new work and entirely new pressures. Part of the conversation that has got you there involves remuneration and the pension, and, underlying all of that, is the notion that whatever you do, according to the law, the Constitution will protect your independence. That's what is fundamentally very concerning about this proposal. I don't know how it would impact upon individuals, but it certainly has the capacity to do so.

Incidentally, looking through the list of former judges, one was sadly reminded of those who died in office. In one year—I think it was 2005—we had four judges, very lovely people, very distinguished people, die in office. In at least two or three cases, their widows appeared on the list of people who the committee was communicating with. That moved me, but it also drew attention to the importance of the judicial pension.

CHAIR: I think senators do have questions, so I'll proceed to questions now, where you can also flesh out some of your thoughts.

Mr Black: Of course.

CHAIR: Thank you.

Mr Black: If I might just be permitted to say one thing—

CHAIR: Yes.

Mr Black: it would be absolutely dreadful if the High Court had to decide this. It just shouldn't be.

CHAIR: I'll go to Senator McKim.

Senator McKIM: Thank you very much, Justice Black. I hope you'll indulge me briefly reflecting on the irony of a group of legislators being in a position to adjudicate on an application from a group of justices! I want to go to the matter that you raised early in your submission and then right at the conclusion. Just to be clear with you, I'm not asking you how the High Court might find, but is there an argument that this matter is unconstitutional and therefore it could potentially be heard by the High Court?

Mr Black: Yes, absolutely there is. There is a case in which, in lawyer's terms, we find a victor. I can give you the reference. It's Forge v Australian Securities and Investments Commission. It's in 2006. It's in volume 228 of the *Commonwealth Law Reports* 44, at 76. Justices Gummow, Hayne and Crennan say:

> Further, if attempting to state comprehensively the measures that have been taken to support judicial independence, it would be necessary to take account of not only the arrangements for remuneration of judges while in office but also the provision made for payment of pensions on retirement. The "remuneration", which s 72(iii) of the Constitution states shall not be diminished during continuance in office, includes non-contributory pension plan entitlements which accrue under the federal judicial pensions statute.

In an advisory note here, it says that the drafters of the bill have sought to get around that prohibition by imposing the diminution of remuneration at or after the point of a judge's retirement from office. This commentary then goes on to say that you can't do indirectly what you can't do directly—not in any virtually any legal aspect but certainly not in constitutional law. You can't go round the back door with clever tricks. It doesn't work that way. So the answer is that. There may be more, but it's not something that I've personally researched.

Senator McKIM: Turning now to the position that that would put the court as a whole in, and also the position that that would put the individual justices of the High Court in, it would be right to suggest, would it not, that, if they were asked to adjudicate on this provision, each justice would have a direct pecuniary interest in this matter, would they not?

Mr Black: Yes, they would. I just can't see any other answer. In walking around thinking about this, I said, 'Well, what could you do?' You'd just have to hear it. I obviously can't speak for them, but the High Court would have jurisdiction to hear it. If it had been challenged as to constitutionality, where else could it go? I don't know. That's the situation that should absolutely be avoided.

Senator McKIM: That's right, and you've anticipated my next question. But, just for clarity, it's only the High Court that could hear that matter, is it not? And therefore wouldn't the court find itself in a situation where it would be not able to recuse itself, and each individual justice wouldn't be able to recuse themselves, because, at the end of the day, if one justice were going to recuse themselves on the basis of pecuniary interest, all would have to do it, and therefore the High Court couldn't hear the matter, and there's nowhere else for that matter to be heard. Is that a reasonable argument?

Mr Black: That is a reasonable, if frightening, hypothesis. It would have to be out in the open. It would be highly unsatisfactory and should be avoided. If there were some superimportant, overriding reason why you had to go to that situation, maybe, but it would be awful, and I can't think of any other way in which it could be done under the Constitution.

Senator McKIM: Therefore, what could the implications be of such a scenario, firstly, on the reputation of the High Court and, secondly, on public confidence in Australia's judicial system?

Mr Black: I think it would be an extremely challenging and dreadful situation, and if there is a reasonable argument—as I would contend there is—that this would offend the protective provisions of the Constitution, it should not be done. It's hard to think of what would justify such a difficult case—perhaps if national security was on the line—but if its benefits are, at the best, marginal, then for that reason it should not be proceeded with. There's no doubt there would be a challenge in my view. I can't say that with complete certainty, but I can't imagine that there wouldn't be.

Senator McKIM: Just to be clear, Justice Black, specifically would such a scenario have the potential to reduce public confidence in the independence of Australia's judiciary?

Mr Black: I would hope not. I would hope that the High Court would handle it in such a way that the difficulties would become apparent and that fair minded people would realise what they had to do, but it would be something that should absolutely be avoided.

CHAIR: Justice Black, the intention of this bill is just to change the concessional super rate for balances over $3 million, for income earned on the portion of balances over $3 million from one concessional rate of 15 per cent to another concessional rate of 30 per cent. There's been Treasury consultation on the bill and some consultation around the defined benefit structure.

We know that there's been interaction on the sort of legal questions that you're raising as well, and that the treatment of judiciary and state office holders would be set out via regulation to try to deal with some of the issues that you're raising. Do you support the idea of the government being able to set a broad tax in the way that the government is seeking to do, rather than this bill having carve outs for people like retired judges and politicians.

Mr Black: I don't have any argument with broad questions of policy to achieve whatever ends that the parliament and the government think appropriate. It's just that in this instance it collides with something that is constitutionally guaranteed and with a pension on which judges pay the full marginal rate of tax.

I can understand why people would use superannuation for financial benefit or financial security—depending on which way you look at it. That's fine. I understand also that that can be and should be, indeed, regulated so that people don't take advantage of it, and that there are all sorts of community balances that have to be into account.

The judicial pension system is outside that. You pay the full marginal rate and it's part of the understandings that exist when you change your life, become a judge and serve the community in that way. That's not an entirely simple answer, but I hope that answers the question.

CHAIR: If it were the case—there are regulations involved and we have the opportunity to ask the Treasury questions later today—that, effectively, the treatment of judicial pensions in this measure is equivalent to the treatment of a regular, albeit rare, super balance of over $3 million, would you have any concerns?

Mr Black: It's just not. A super balance—you can take it out, you can put it in other investments and you can do all sorts of things with it. The judicial pension is fixed. It's fixed by the legislation. If tragedy happens and a judge dies, his or her spouse gets a proportion of it. In instances where there's a dependent child, it will go to the dependent child. It's a protective measure. It's quite different from superannuation, which you can move about. Some people do; some people don't. It's a different thing. This is part of a constitutional arrangement, and it underpins the independence of the federal judiciary.

I don't think judges should be seen to be trying to get out of something. They pay the full marginal rate of tax on the pension and, of course, on their judicial salaries. It's just that it conflicts, I think. Before I see someone pointing at the clock, there is one point—I'm sorry; does that answer your question as well as it can be answered?

CHAIR: I think so. I was just going to add that your concern is not, in effect, paying an extra 15 per cent on earnings above an amount—

Mr Black: No.

CHAIR: if, in fact, it could be legislated in a way that you were comfortable with. Is that correct?

Mr Black: If the top marginal rate of tax increased from whatever it is to, say, 50 per cent, everyone would be upset but it would apply equally to the judicial pension. So that's the way it is. You could argue against it, but it would apply equally. That's not the concern. The concern is that this interferes with something that is fundamental to the decision that people make at different stages of life—and I'll come to, if I may, women and people of diverse backgrounds in just a second. It impacts upon a decision they make when they take judicial office, when they undertake to do that work according to the oath they take—without fear or favour, affection or ill will—often engendering ill will, and they do it. The Constitution protects their position, their remuneration and, I would argue, their pension. It's a different thing.

CHAIR: You're saying it's less advantageous, so fewer people would want to do it because it's a less advantageous tax arrangement?

Mr Black: What I'm saying is that the interference, if it were to occur with the judicial pension—this has already caused considerable concern amongst those who might be asked to accept judicial office. That has happened. It's also happened with existing judges who are concerned about it, and that's an undesirable state of affairs. If the marginal rate of tax were to be raised, that would be everyone's business. If it's directed at people with superannuation balances that they can change and move to other investments, and it's done for policy

reasons, that's okay. But this is something that judges can't move. It's there to protect them, and it's part of their independence.

CHAIR: It's an interesting case and argument. Senator Bragg?

Senator BRAGG: Have you had an opportunity to look at the regulations?

Mr Black: I have. I find them very hard to understand and I don't have a clear view of them.

Senator BRAGG: Do you think that they apply to former members of parliament?

Mr Black: I don't know the answer to that. I hadn't turned my mind to it. They are very difficult to understand.

Senator BRAGG: Yes. I think we've found that today. Is there an easy way to explain how the calculation will apply to a retired judge?

Mr Black: No, there's not. I asked Mr Clough, who's brilliant in this field, amongst others, and he said, 'You'd need an actuary. You'd need an actuarial calculation to work out what the impact would be.' One hears all sorts of theories that it could be large or it could be minimal. I just don't know. As I say, I asked yesterday, because I'd like to get some indication, and I was told that we'd need to get an actuary. That's how doubtful it is.

Senator BRAGG: I imagine, from your point of view, it would be far better if the regulations were included in the bill.

Mr Black: Yes. Then we could see them. They would be, as it were, out in the open. It may be that some of my former colleagues can understand them. If I sat down with a cold thing on my forehead for long enough I no doubt would have to work it out, but I'm told it is almost impossible and you'd need an actuary. That was the direct advice I received yesterday.

The other problem with this, of course—and this is a point I really do want to make—is that this is creating uncertainty amongst judges and amongst those who the Attorney would no doubt like, in due course, to invite to accept appointment to the Federal Court and the High Court, and that is a very serious matter. It doesn't apply to the states. It's clear that the state supreme courts would be exempt on that. And I can tell you: there is definite competition for the best people. Competition is not nice word. Each court wants the best people. And this is impacting very badly. Just the uncertainty and the possibility are impacting.

CHAIR: Thank you. We have a final question from Senator Smith.

Senator DEAN SMITH: Thank you very much for your evidence. It's been very compelling. Are you of the view that the Commonwealth has a different legal position to the one that you've articulated to us today?

Mr Black: I don't know, is the answer to that. I just don't know. Put it this way: I was Chief Justice for 19 years, and we were supported by successive attorneys-general. There were arguments about funding here and there, but the court received strong support. It got excellent appointments. And, from time to time, we made decisions that the Commonwealth absolutely did not like, but life went on and courtesies were maintained. The court grew—its workload and jurisdiction grew. And it is a good system. But I just think this is a dreadful intrusion into it, if I can put it rather bluntly. I wouldn't have put that in a written submission! But that's the way I and others feel. I would also like to speak on behalf of those names that I saw, with some emotion, of the widows of judges who'd died in office. It feels like an obligation to speak for them too.

Senator DEAN SMITH: Do you agree that, if the Commonwealth did have a different position to the one that you've articulated, it would be gross recklessness on its part to put the High Court in such a position, with the tensions that Senator McKim had, I think rightly, identified?

Mr Black: I'd moderate my language slightly, but to—

Senator DEAN SMITH: You're a judge and not a politician.

Mr Black: exactly the same effect. I think it would be quite wrong. If there were some overriding, clear, national interest super policy reasons to do so, well, you'd have to consider it carefully. Even then I don't think I'd like to see it happen. But not here, and also not, if I may say so, in an extension of something that really doesn't naturally affect the judicial pension, which is constitutionally protected, and that also impacts adversely upon what is certainly one of the most important courts in the country, given the range of its jurisdiction—native title, everything. It's a court that should be supported, as it always has been, and not interfered with in this manner.

Senator DEAN SMITH: Thank you for your evidence.

CHAIR: Thank you very much, Justice Black, for coming and giving us your evidence today. That concludes the time that we have with you. We thank you for appearing today. We ask you to disconnect from the videoconference, and you go with our thanks.

Mr Black: Thank you very much.

CONNOLLY, Mr Ellis, Head, Payments Policy Department, Reserve Bank of Australia [by video link]

GILL, Mr Troy, Senior Manager, Payments Policy Department, Reserve Bank of Australia [by audio link]

[14:05]

CHAIR: I now welcome representatives from the Reserve Bank of Australia. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. Do you have a short opening statement that you wish to give?

Mr Connolly: I'm happy to answer your questions and waive the opening statement.

CHAIR: Thank you very much. We'll proceed to some questions. You're appearing to answer questions in relation to the payments system and the proposals in the bill for a small but significant extension of your regulatory powers. How has the way that people make payments changed over time, and how will this bill support your role to give appropriate oversight to the payments system?

Mr Connolly: The way that people make payments has changed significantly since the Payment Systems (Regulation) Act was originally introduced, in 1998. Back at that time most retail payments were made in the form of cash, and there were card payments as well. It was a relatively simple system back then, where there were simply card systems and there were acquirers and issuers, and the Payment Systems (Regulation) Act in that form was effective for regulating those players in the payment system. Since then we've seen a lot more new platforms and intermediaries come into payments. There's a lot more use of electronic payments than there was back in the 1990s, and we've now seen fintechs and big techs getting into the space. These reforms really help to bring that broader range of players within the scope of the act, which will enable the RBA to promote the efficiency, competitiveness and safety of Australia's payment system and help to provide a level playing field across all the players in the payment system, not just those that are currently covered by the legislation.

CHAIR: Consumers have a range of issues in relation to these newer payment systems. How will these changes support the broad, protective umbrella for consumers with new and emerging payment systems?

Mr Connolly: There's a much broader range of players in the payments system at the moment than there was several years ago. It's important for consumers and also particularly for merchants that there's the potential for the RBA, or another regulator as assigned by the government under the legislation, to be able to regulate those players. In the case of the RBA, that mandate is for efficiency, competitiveness and safety. But the act does also provide the government with the capacity to assign a regulator in the national interest. For instance, if there were to be consumer protection issues, although that's outside the direct mandate of the Reserve Bank, it would be possible for the government, under the national interest test, to be able to assign a regulator, which could be the Reserve Bank, ASIC or the ACCC, to be able to deal with issues that relate to consumer protection under the legislation. That's not currently possible, so it would be a significant improvement in Australia's regulatory framework for payments.

CHAIR: Finally from me, the bank has generally taken a self-regulation approach to the payments system. Is it the intention of the bank that that will largely continue under these changes?

Mr Connolly: That's correct. The bank's regulatory approach would not change under this legislation. The actual tools that the Reserve Bank or another regulator could use, which is setting standards or access regimes, are largely maintained in the new legislation, so there's no need for a direct change in the Reserve Bank's approach. We look to work cooperatively with industry to resolve issues affecting the competitiveness, safety and efficiency of the payments system. It's only where it's not possible to be able to constructively resolve those issues with industry that the Reserve Bank then considers using its formal regulatory powers under the act.

CHAIR: So digital-wallet providers and BNPL services could expect a consistent approach from the bank?

Mr Connolly: That is correct. Something we would intend to do, assuming the legislation passes, is we would start by running a review of retail payments regulation, which would be a public consultation, enabling all the players in the system, all stakeholders, to share with us their perspectives on what the issues are and to help us to shape what the priorities should be in terms of promoting efficiency, competitiveness and safety in the Australian payments system. We have a very similar approach to those players as we have been taking to the card schemes over the years.

CHAIR: Thank you very much. They are all the questions I have. Deputy Chair, do you have any questions? If not—

Senator DEAN SMITH: I do, if I may.

CHAIR: Senator Smith.

Senator DEAN SMITH: You will have—or you may have—seen that we have had a submission to the inquiry raising concerns in regard to this particular amendment. Do you have any commentary in regard to the issues that have been raised in that submission?

Mr Connolly: I haven't seen that submission. Could you briefly mention what those concerns are, and I would be happy to attempt—

Senator DEAN SMITH: The submission was provided to us by Block and the head of their international public policy division. I was particularly interested in the final comments in their submission which talk to the need of safeguarding against any unintended consequences from this proposed amendment. Are either of you aware of the submission?

Mr Connolly: I'm not aware of the submission, but we regularly engage with participants in the payments industry, including with Block, so we're generally aware of some their views—in particular around issues of surcharging. Surcharging has been a reasonably hot topic this year.

The Reserve Bank's current arrangements for surcharging have been in place since the early- to mid-2000s, and we think it's time for a review of those arrangements. As part of the upcoming review of retail payments regulation, we would intend to conduct a holistic review of surcharging and whether it still remains an appropriate way of regulating the payment system. That would include the issues with regard to the surcharging of buy now, pay later—which I understand to be an issue of concern to some players in the system.

Senator DEAN SMITH: What I'm particularly interested in are the six points that are made at the end of their submission, when they talk about particular factors that should be considered by the RBA before considering any regulatory impositions. Could you review that submission on notice and provide any commentary to the committee?

Mr Connolly: Happy to do so.

CHAIR: Senator Bragg?

Senator BRAGG: As a central bank likely to be granted additional power to deal with payments, do you effectively accept the argument that you would become a rule maker or a quasi lawmaker?

Mr Connolly: The act does empower the Reserve Bank and the Payments System Board to set standards or access regimes that are in the public interest, so there is a power there to make—I guess you could say—subordinate legislation. These do end up being legislative instruments that go through the usual processes, equivalent to some of the standards that other regulators in the Australian regulatory ecosystem, such as APRA and ASIC, put in place.

Senator BRAGG: Effectively you will be regulating the payment system with more power.

Mr Connolly: The power of the Reserve Bank is quite similar, in that it's the power to set standards and access regimes. The scope is what is broadening. The scope of the previous legislation was interpreted by the courts to be quite narrow and to really only apply to payment systems with multilateral rules and just the direct participants in those payment systems, so it ended up being quite narrow to just the card schemes, the issuers and the acquirers. That's quite limiting.

It's hard for the Reserve Bank to be able to help set a level playing field across the industry when you have, say, three-party card schemes not necessarily within that scope and when you have buy now, pay later providers and mobile wallets not within that scope. Also when you have, say, in online commerce now, there's not just the acquirer involved. There could be gateways and there could be payment facilitators. Really, to be able to effectively promote efficiency competitiveness and safety in the system, those participants in the system also need to be covered. But my understanding is that the RBA's essential powers, which are to set standards and access regimes, are largely unchanged by the legislation.

Senator BRAGG: It's designed to address regulatory arbitrage, so I guess my question to you is: do you foresee a situation where the RBA would be setting rules to regulate conglomerates which may be operating across different jurisdictions—like Apple, for instance, which could be running a vertically integrated model? It could be a bank, it could be a payment system itself or it could be a buy-now pay-later product itself. Wouldn't it fall on the RBA to regulate something like that from a payments perspective?

Mr Connolly: Those are the sorts of participants and systems that I think the explanatory memorandum highlights would be brought within the scope of the legislation. I would say that, in terms of the scope of the existing legislation, there are already many substantial international players that are in Australia's payment system that we're already used to engaging in regulation of.

Senator BRAGG: This is a significant expansion because you will be able to regulate these very significant components of our economy going forward as a rule maker. So my question is: given we all agree that's going to happen in some form and given you're not a parliament or a minister but operating with significant delegated authority from the parliament, what process do you go through to consult?

Mr Connolly: We go through comprehensive consultation processes. The very first thing we're planning to do, assuming the legislation passes, is to launch a comprehensive review of retail payments regulation. We'll publish an issues paper to ask all stakeholders in the Australian community what the issues are that they are seeing in Australia's payment system. There are a few that we're already aware of, such as the issues around efficiency and competitiveness in mobile wallets, the issues around surcharging, which I already mentioned, and also the concerns out there around the costs of payments for small businesses. These are some of the issues that we're really looking forward to engaging broadly on and hearing everyone's views on. If the Payments System Board came to the view that it was necessary to put in place a standard or an access regime, there would then be a subsequent round of consultation on the specifics of that standard or access regime as well.

Senator BRAGG: And would that be disallowable?

Mr Connolly: My understanding under the existing legislation is that RBA standards are not disallowable, but could I just invite Troy Gill to speak.

Mr Gill: That's my understanding as well.

Senator BRAGG: I don't want to take up any more time, because I know that the chair is being generous and wants to move on to other things. But maybe I'll just leave this with you—and you can maybe take it on notice: I think it's going to be a problem for everyone if you're going to be making various material rules as a body with delegated authority. If you're going to be making rules under delegated authority which are very material and they're not disallowable, can I just suggest that you take on notice and provide the committee just exactly how you're proposing to consult and engage with the economy and society on these matters. I would be grateful if you could do that.

Mr Connolly: We'd be very happy on notice to provide further details on our consultation processes.

Senator BRAGG: Thank you.

CHAIR: Thank you very much to the witnesses from the Reserve Bank for answering our questions. You go with our thanks today. Questions on notice are due Thursday 2 May at COB.

SAADAT, Mr Michael, Head, International Public Policy, Block [by video link]

[14:24]

CHAIR: I now welcome a representative from Block. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. I invite you to make a short opening statement, Mr Saadat.

Mr Saadat: Thank you for the opportunity to appear before you today. Block is a technology company that in Australia includes the buy-now pay-later provider Afterpay and Square, a payments technology company which helps merchants more easily run and grow their businesses. We serve tens of thousands of small businesses across the country and 3.5 million Australian consumers. My remarks today focus on the proposed changes to the Payment Systems (Regulation) Act, or PSRA, which seek to modernise the regulatory powers of the Reserve Bank for payments in the Australian economy.

We welcome the proposal to modernise the RBA's payments powers; however, expanding the ability of the RBA to designate and regulate a wide range of payment systems should be done with appropriate guardrails and avoid unnecessary and highly interventionist regulation. This is especially true for sectors that are competitive and innovative and deliver positive outcomes for consumers and merchants. In this context, we are concerned with the lack of guardrails over the proposed expansion of the RBA's remit to include buy-now pay-later products and, in time, the overriding of Afterpay's ability to prevent surcharging.

Afterpay is built on bilateral contracts with tens of thousands of merchants. For an agreed fee, we provide merchants with a range of services that provide them with significant value. Merchants get access to more customers, including millennial and gen Z customers, who are more likely to make a purchase and more likely to make repeat purchases. When consumers use Afterpay to make a purchase, we pay the merchant the next day and assume all risk. Our business model is built on providing a service that is free for consumers that pay on time, and we continue to see 95 per cent of payments being made on time and 98 per cent of all purchases incurring no late fee. Other buy-now pay-later business models make money in different ways, including by charging consumers regular monthly fees. Credit cards make money by charging 20 per cent interest and annual fees. A diversity of business models creates competition and provides choice for merchants and consumers, but Afterpay's core product is designed deliberately to be free for consumers, and we believe we should continue to have the ability to offer our customers a free service that does not include a surcharge at the point of sale.

Surcharging policy in Australia came about in the early 2000s due to the role played by the international card schemes. The RBA determined that the market dominance of the card schemes warranted regulatory action to address specific market characteristics, including the existence of a natural oligopoly; their status as must-take payment methods; rising merchant fees, which were associated with a regressive cross-subsidy between lower-income consumers and welfare consumers; and little product or price differentiation, all of which led to higher prices for merchants.

The market dynamics between the buy-now pay-later sector and traditional credit are starkly different, and so we believe that it is inappropriate to rely on the same policy rationale to impose highly interventionist regulation on the buy-now pay-later sector. Unlike the card schemes, Afterpay is not a must-take payment method. There are many merchants that do not accept buy now, pay later. Merchants can choose one, more or no buy-now pay-later partners. In fact, almost half of all Afterpay small- to medium-sized merchants offer at least one other buy-now pay-later provider, and the majority say that they would remove a buy-now pay-later provider if it were not providing sufficient value.

Unlike the card schemes, buy now, pay later is not a dominant form of payment. We represent just 0.7 per cent of payments in Australia and three per cent of the entire consumer credit market. In contrast, card purchases make up 76 per cent of consumer payments. Unlike the card schemes, the buy-now pay-later sector is diverse, with more than 15 providers in Australia offering different products to serve different consumer needs. Unlike credit cards, Afterpay does not involve a regressive cross-subsidy. Unlike credit card schemes, whose merchant fees were rising before regulatory action, RBA data has shown that buy-now pay-later fees have steadily been decreasing over the past few years.

At the same time, buy now, pay later creates significant value for merchants. Last year alone, Afterpay generated $5 billion in net merchant benefits through new customer exposure and better conversion rates and $711 million in cost efficiencies, and all contributing to $2.2 billion in economic activity generated by Afterpay retailers. These benefits are the product of genuine innovation and strong competition and only possible by offering buy-now pay-later customers an alternative to the traditional credit card model.

Applying policy levers designed for non-competitive environments to highly competitive sectors has the potential to increase the cost of living for millions of consumers, reduce competition in financial services and harm the Australian fintech sector, which already faces many barriers, competing in a highly concentrated market. With small amendments to the PSRA reforms, the parliament can safeguard against these outcomes by ensuring that any regulatory intervention is designed to address a market failure. This will protect competition, innovation and the interests of consumers and merchants. The RBA has, by design, a narrow regulatory focus when it comes to payments policy. In the case of buy now, pay later there are significant and broader policy implications associated with the RBA's position that Afterpay's merchant contracts should be overwritten by regulation, including competition in the market for consumer credit products and Afterpay's role as a marketing platform connecting consumers and merchants.

The payments ecosystem and corresponding regulatory frameworks have long been designed for business models that favour the size and scale of the major banks. Afterpay is a merchant-revenue-driven business model and is designed to be free for consumers. We create considerable benefits for the businesses we serve, and we've created a credit product focus on the consumer, giving them a choice, financial access and a genuine alternative to high-interest credit cards. Thank you, and I look forward to your questions.

CHAIR: Thank you very much.

Senator DEAN SMITH: Could you give us a sense of how you expect buy-now pay-later products to become a larger proportion of the financial tools that are available to Australian consumers?

Mr Saadat: Certainly buy-now pay-later services have become more popular over the last couple of years, but, as I mentioned in my opening remarks, they constitute 0.7 per cent of payments in the economy as of last year—so they're still a very small proportion of overall payments. When you look at the share of payments that buy now, pay later takes up within the market for consumer credit products, it's three per cent of that submarket within the payment sector. We're seeing continued growth, certainly, in consumers using buy now, pay later, but it continues to be off a very, very low base.

Senator DEAN SMITH: What is the rate of that growth, do you expect?

Mr Saadat: I can speak for Afterpay. We released our quarterly results a little while ago, and year-on-year volumes on the Afterpay platform globally grew by about 25 per cent as of about six or seven weeks ago.

Senator DEAN SMITH: Did you say global growth? What's the Australian experience?

Mr Saadat: It is quite similar to that number.

Senator DEAN SMITH: So 25 per cent?

Mr Saadat: Yes.

Senator DEAN SMITH: In some questioning to the RBA just a moment ago, they talked about a review process that they would be undertaking. Is that familiar to you?

Mr Saadat: Yes, it is.

Senator DEAN SMITH: Have you been involved in review mechanisms that the RBA has undertaken previously?

Mr Saadat: Yes. The RBA completed its last review of retail payments back in 2021. It was in that review that they outlined their position that buy-now pay-later providers should be prevented from disallowing merchants from imposing a surcharge at the point of sale.

Senator DEAN SMITH: How would you characterise the RBA's approach to consultation?

Mr Saadat: I think the RBA does a good job in consulting with stakeholders. It does consult widely, and the last review was a good example of that. We expect them, again, to consult widely as part of the upcoming review of retail payments that Mr Connolly mentioned in his comments. For us, I suppose the concern is not that they will not consult extensively; I think we're confident that that will happen. It's more that they have a narrow focus when it comes to the exercise of their powers under the PSRA, and the focus that they have in deciding how to apply new standards in the payments industry.

Senator DEAN SMITH: Am I right to characterise that as the RBA coming with a fixed view to the consultation process, or are they genuinely interested in hearing industry views and industry perspectives and perhaps modifying their position where required?

Mr Saadat: We've certainly heard from the RBA that they are genuinely willing to hear stakeholder views. On this particular issue that we're concerned about, they came out definitively with a position in 2021. We would certainly submit that, notwithstanding that existing view that the market has evolved, the reasons to proceed with

that position are less strong than they were if you accepted the RBA's arguments on that issue. But certainly, if you look at the conclusions that were made by the RBA at the end of 2021, they did come out firmly on this position.

Senator DEAN SMITH: At the end of your submission, you made six suggestions in terms of the factors that should be considered prior to any regulatory intervention. Do you just want to speak to those briefly?

Mr Saadat: Yes. We think these are the threshold questions that need to be considered before the application of regulation. We think regulation is important, but it should only come into play when there's a market failure that needs to be addressed and where there's clear evidence of that market failure. The powers that the RBA has can be highly interventionist, potentially overriding the commercial arrangements that private sector players have put in place and even going as far as regulating price in some cases. So we think these are the matters that need to be considered before you start regulating a new industry like buy-now pay-later: What proportion of payments does that new sector take up in the economy? Is it a dominant form of payment? What is the level of competition like? What other role do these players play in the market for payments?

I think one issue that has become quite evident recently is that payment systems are no longer operating in as narrow a way as perhaps they used to. An Afterpay business, for example, operates like a marketing platform. We're competing with other marketing platforms like Google, Facebook and Instagram—other platforms that also send consumers to businesses to make purchases. So the role that we play is much more diverse than a traditional payment system, and therefore some of the policy issues that are related to that mean that it's much more than just a question of payments regulation, in terms of how we operate. When you've got a regulator like the RBA, which only considers the payments aspects, we're concerned that that will lead to unintended consequences.

Senator DEAN SMITH: Your concern is that a heavy-handed regulatory approach might undermine or reduce the competitive or downward pressure that buy-now pay-later products have brought to credit arrangements in the Australian market? That's your primary concern?

Mr Saadat: Yes, that's right. I would highlight that within Australia we have a credit card industry, for example, where the big four banks have 93 per cent of the market share of all credit cards in Australia. It's a highly concentrated market, and it's a much more concentrated market relative to comparable economies. The level of concentration in the UK economy, for example, is around 45 per cent by the major banks, versus 93 per cent in Australia.

Buy-now pay-later has really been a bright spot of competition in recent years when it comes to competing with this traditional credit card business model. We think the risk is that the kind of regulation that the RBA has contemplated and had a position on really reduces the scope for that competition and really provides an advantage to those large institutions that are already dominant in this space.

Senator DEAN SMITH: Thank you very much for your participation.

CHAIR: Thank you very much for appearing before the committee today. That concludes the questions we have for you. If you've taken any questions on notice, please provide any responses by COB on Thursday 2 May.

ETHERINGTON, Ms Sally, Director, Payments Strategy and Policy Unit, Financial System Division, Department of the Treasury

HAWKINS, Mr Adam, Acting First Assistant Secretary, Retirement, Advice and Investment Division, Department of the Treasury

LE, Ms Vicki, Director, Regulators and Capital Markets Branch, Department of the Treasury

PHILP, Mr Brenton, Deputy Secretary, Markets Group, Department of the Treasury

THOMSON, Mr James, Director, Tax and Transfer Branch, Department of the Treasury

[14:38]

CHAIR: I now welcome representatives from the Department of the Treasury. I understand that information on parliamentary privilege and the protection of witnesses giving evidence to Senate committees has been provided to you. Did you have any opening remarks, or are you happy to proceed to questions?

Mr Philp: We have no opening remarks. We're happy to proceed to questions.

CHAIR: Could you give us a brief outline of how this tax change will operate.

Mr Philp: I'll ask Mr Hawkins to take that question.

Mr Hawkins: The division 296 tax reduces the tax concessions that are available to superannuation members with a balance in excess of $3 million. It achieves this by applying an additional 15 per cent tax on the portion of earnings these members receive that are attributable to the margin of the balance that exceeds that $3 million figure. This results in there being a combined headline rate of 30 per cent tax on this proportion of earnings. Earnings themselves are taken by measuring the movement in the total superannuation balance of the member from the start of the financial year to the end of the financial year. This approach minimises the complexity of the tax, and the compliance costs that are expected to be incurred by superannuation funds, as existing tax arrangements that apply to superannuation funds apply at the whole-of-fund level. It would involve a fundamental overhaul to how large superannuation funds currently account for tax and apply investment returns to their members if they were required to calculate earnings at an individual level. The division 296 tax is applied to work with the existing tax arrangements in the lowest possible compliance cost approach.

CHAIR: What is the broader policy intent of super tax concessions, and what can Treasury tell us about how that cost will grow into the future if this change isn't made?

Mr Thomson: The intent of super tax concessions is fundamentally to help people save for their retirement. Tax on contributions and earnings are therefore set at a concessional rate of 15 per cent, and withdrawals from super are generally tax free in retirement. These settings essentially recognise that these super savings are preserved until retirement and aren't available for consumption today.

The recent *Intergenerational report* showed that, in terms of the cost of these concessions, super tax concessions as a proportion of GDP are expected to increase from around 1.9 per cent in 2022-23 to 2.4 per cent in 2062-63. These concessions are projected to overtake the age pension expenditure in the 2040s. Increases in these expenditures are primarily driven by earnings tax concessions in particular, which will rise from around one per cent of GDP in 2022-23 to around 1.5 per cent in 2062-63. Essentially, the measure will assist in better targeting the system by slowing the rate of growth in the cost of the concessions and reducing the overall impact on the budget going forward.

CHAIR: Are you able to tell us how much of the benefit of super tax concessions is currently enjoyed by higher income earners?

Mr Thomson: The 2024 *Tax expenditures and insights statement* went to this. It said that, from contributions tax concessions, around 90 per cent of the benefit accrues to people with above-median incomes, and around 30 per cent of the benefit goes to people in the top income decile specifically. For earnings tax concessions, people with above-median income received around 81 per cent of the benefit, while those in the top decile received around 40 per cent.

CHAIR: We've had some discussion today around the expected number of taxpayers who will be impacted by these proposed changes. Can you confirm the number of taxpayers who would be affected today, or in 2026-27 when it takes effect.

Mr Hawkins: We have estimated that, in the first full financial year that the tax applies, 2025-26, this tax will apply to 80,000 individuals or around 0.5 per cent of all Australians with a superannuation balance.

CHAIR: Eighty thousand?

Mr Hawkins: Correct.

CHAIR: You would have already been aware of, but also heard today, the discussion around indexation. We've heard evidence today about how many people might be attracting the 30 per cent concessional rate in about 40 years time. Would it be normal and expected that future parliaments might make changes to this threshold in the normal way?

Mr Hawkins: I'd expect that that would be the case. In fact many of the thresholds that exist in the superannuation system today are fixed by legislation. Examples of that are the division 293 threshold and the thresholds that apply to the lower income superannuation tax offset. In both those cases previous parliaments have seen fit to change those thresholds. In fact previous parliaments have lowered the threshold that applies to the division 293 tax.

CHAIR: I missed the last sentence there. It was an audio issue.

Mr Hawkins: I might just repeat the answer. Many of the thresholds in the superannuation system are fixed by legislation, notably the division 293 tax threshold and the threshold for the low-income superannuation tax offset, and previous parliaments have seen fit to shift those thresholds. Notably the division 293 tax threshold has in fact been lowered by previous parliaments.

CHAIR: You've pointed to indexation occurring by legislation, and that being the regular way in which it's done. Even without any indexation into the future, is it correct that a young person would have to be on a fairly generous salary even in 40 years time to be captured by the 30 per cent concessional rate?

Mr Hawkins: I think that's a fair assessment. There has been a cameo that was discussed at the time of the original announcement, where a young person who earns average wages through their entire working life might be captured by this tax. We haven't assessed that type of cameo but I would point out that that's not the usual experience of someone in the labour market. In fact someone who commences in the labour market at the ages of 19, 20 or 21 is far more likely to be earning well less than the median wage across the rest of the population, which is around $90,000. Those early earnings in the early years of someone's working life will make a significant impact on their end balance. Previous cameo examples which are illustrative—the one I highlighted isn't necessarily representative of what might be the experience of a young person entering the labour market today.

CHAIR: We've had some discussion today around the issue of taxing unrealised capital gains. There's been some evidence given by some witnesses who have said people would be forced to sell their assets if they couldn't meet the tax bill, and others have pointed to liquidity requirements, to the fact that other sources of income would probably be available to people with those sorts of balances and to the carry-forward measures. Can you take us through how Treasury sees the unrealised capital gains working and what mechanisms are available to assist people to meet their tax obligations.

Mr Hawkins: The formula itself contained within the bill, as I mentioned earlier, aims to apply a consistent approach to the calculation of the tax across all members, regardless of the type of fund they belong to. Large APRA regulated funds do not currently calculate tax at the individual member level. Therefore, the tracking of earnings by taking the total superannuation balance from the start of the year to the end of the year can be equally applied to all members. I would note that that means, if within the fund there is a movement in the value of a capital asset, that would be reflected in that change in balance over the course of the year; however, it allows for that consistent treatment regardless of what type of fund someone belongs to and that will reduce the compliance costs that apply.

There are a number of other elements to the bill which provide flexibility in the event that someone does not have liquidity to meet their tax liability, which they should because they have to manage the fund to have liquidity to meet all their obligations. But, in the event there is not that liquidity, an individual has the option of paying the tax through their personal resources. They can use their personal resources instead of releasing money from their superannuation fund. They also have 84 days in which to pay the tax liability, which is a substantial increase over what is available elsewhere in the tax system, which is 21 days. Then, if the tax remains unpaid, that will be carried forward at the shortfall interest charge rate, which is a substantial concession over the general interest charge rate that would usually apply to unpaid tax debts.

CHAIR: Can you explain the carry-forward mechanism.

Mr Thomson: The carry-forward approach will allow losses under the measure to be essentially carried forward to offset future earnings. There are a couple of examples in the explanatory material—examples 1.6 and 1.7—that illustrate how that works. In example 1.6 the individual has a total super balance of $3.2 million in one year which then falls to $2.8 million in the second year. That means for future 296 purposes the basic earnings are

$3.2 million minus the $3 million threshold, so $200,000. That individual can then carry forward the $200,000 to offset the future liabilities of 296. It is similar in some ways to the arrangements that currently apply to capital gains tax; however, there is an important distinction in that, outside of super, the capital losses are generally quarantined so that they can be used to offset future capital gains. But for 296 any decline in the capital assets that an individual experiences within their super will offset future revenue gains as well—for example, interest and dividends.

CHAIR: I will go to the questions raised by the retired judges and their solicitor as well. What approach has been taken in relation to the treatment of judges and the judicial pension in the design of the measure and why?

Mr Hawkins: The legislation has been designed in such a way that the tax applies as broadly as possible to those individuals to which it can apply within constitutional limits. There are some individuals who are excluded from the tax because of those constitutional limits. We have based the drafting of the legislation on advice that we received from the Australian Government Solicitor in order to craft those exclusions. The reason for that is that all individuals who have a superannuation interest and have very large balances should appropriately have this tax applied to them to ensure it's an equitable approach to people regardless of the type of superannuation interest they happen to hold.

CHAIR: They appeared to raise a couple of issues, one being the constitutional issue. You have gone to legal advice there. I might get you to expand on that to the extent that you can. The second issue is that there seemed to be a view that, while they weren't concerned about paying extra tax, they said, and wouldn't be concerned about judicial pensioners being treated in an equivalent way to other superannuants with a large balance, they just couldn't understand the way in which the judicial pension could be treated in an equivalent way. I wonder if you could expand a little bit on how Treasury has dealt with both the constitutional issue and the equivalence issue.

Mr Hawkins: To expand on the first issue, I did watch the earlier evidence from witnesses on these constitutional issues, and I would say that the legal advice we sought specifically went to the provisions of the Constitution that have been raised by those witnesses. The application of the law aims to reflect the best possible interpretation of how those provisions currently apply. The application of the provisions excludes sitting judges. However, it does include retired judges on the basis that it doesn't reduce their remuneration during the period of their service, and that's based on the government's intent to apply this tax as broadly as possible. Could you just repeat the second issue you'd like me to expand on?

CHAIR: The second one was that they made an assertion, I think, that they weren't necessarily concerned about being asked to pay more tax, but they couldn't see how the judicial pension could be treated in an equivalent way, technically, to a self-managed super fund or an APRA-regulated regular fund.

Mr Hawkins: The draft regulations set forth the approach for calculating the valuation of defined benefit interests. It applies to judicial pensions in the same way as it applies to any other form of defined benefit interest. That applies to parliamentarians and public servants. So the approach there is the same.

Now, in a sense, an approach needs to be taken to allow for a commensurate approach to be applied to defined benefit interest members, and that's the actuarial valuation that will be applied to these interests throughout an individual's working life and their retirement. That actuarial value aims to produce a commensurate outcome to the outcome for someone who's accumulating a balance in an accumulation fund. So the application of the tax to defined benefit members aims to have approximately the same outcome for a defined benefit member as for an accumulation member.

CHAIR: Okay. Changing to schedule 5, we had some evidence in relation to the review cycles for ASIC and APRA. There was an assertion that a reduction in the frequency of the review cycle could result in less oversight. Is that right, and what's the policy intent of going to five years?

Mr Philp: The intention of moving to five years is that for the first statutory review by the FRAA, the Financial Regulator Assessment Authority—in the time frames they had to do assessments of APRA and ASIC they were quite confined to certain aspects of the operations of those agencies, and that short period of time didn't give the agencies the opportunity to implement any of the findings of those reviews. By expanding it out to five years, it gives you an opportunity to do a much more thorough inquiry into the operations and effectiveness of those agencies and a greater opportunity for the agencies to implement any findings.

CHAIR: Great. Thank you. I'll go to the deputy chair.

Senator BRAGG: I want to firstly go to the issue of defined benefit schemes. The regulations have been disclosed for public comment. Have you had many submissions yet?

Mr Hawkins: We've had a couple of meetings with interested stakeholders, but we haven't received a significant number of submissions as yet.

Senator BRAGG: Have you met with any of the former politicians that are going to be subject to this new tax?

Mr Hawkins: Not to my knowledge, no.

Senator BRAGG: You haven't?

Mr Hawkins: No.

Senator BRAGG: How is this tax going to apply to Mr Albanese and co?

Mr Hawkins: To the extent that the Prime Minister is a member of the parliamentary contributory scheme, it will apply in the same way as it does to any other defined benefit member. A valuation would be applied to their benefit using the family law regulation approach. To the extent that that valuation exceeds $3 million, the tax would apply.

Senator BRAGG: How much do you think he might be up for in his first assessment?

Mr Hawkins: I really can't comment on the circumstances of any particular individual. I don't have any knowledge of what his superannuation entitlements may be.

Senator BRAGG: And will it all commence on the same timetable?

Mr Hawkins: Yes. The tax applies to all of those who are captured from the commencement date.

Senator BRAGG: Of the regulations or the bill?

Mr Hawkins: The tax itself commences from the 2025-26 income year, for all types of members, whether they are accumulation members or defined benefit members.

Senator BRAGG: What gap, if any, do you expect there will be between the passage of the bill, if it's supported, and the tabling or the making of regulations?

Mr Hawkins: That's a matter for the government as to when they might table those regulations. Obviously, after we consider submissions that are made to us we will give some advice to government around those regulations, and then it will be up to the government as to when they may decide to table it. But our expectation is that that would be well in advance of the commencement of the tax on 1 July 2025, to give certainty to individuals as to the arrangements that will apply to them.

Senator BRAGG: What is the formula, exactly, that will apply to former politicians and current politicians like the Prime Minister?

Mr Hawkins: Broadly it's the same formula that's within the legislation. But there are some modifications that are required for defined benefit interests. We have spoken a little bit about the valuations. The total superannuation balance that is calculated for a defined benefit member is using an actuarial calculation of what that benefit is worth to that member at that particular point in time. There are also modifications required for contributions. Typically many defined benefit funds have no contributions. There are provisions that allow for, again, an actuarial calculation of the notional contributions that member is receiving from their employer. That's a further modification for defined benefit members. But, broadly speaking, the formula that applies in the bill to all accumulation members, the same approach applies to defined benefit members.

Senator BRAGG: I want to ask you about the issue of indexation. Has Treasury built indexation of this proposed tax measure in the IGR?

Mr Hawkins: Within the IGR, the approach we take to assessing concessions over a longer period of time is more of a top-down approach. We take the whole population of individuals and then apply some very broad assumptions over that 40-year period. As a result of that, we can calculate what the concessions might be across the broader population. We don't, as part of that exercise, look at any particular cohort of members. So we haven't separated out the cohort of members that this tax might apply to and modelled them individually as we would to develop an estimate of who would be affected. They're two different exercises. Within the IGR—

Senator BRAGG: Sorry to interrupt, but I want to be precise on this point. You publish a cost of the super system and the retirement tax concessions in the IGRs. I'm trying to work out whether you index this measure or not.

Mr Hawkins: As a technical assumption, a number of measures that aren't indexed at a point in the medium term are assumed to move. I would have to take notice on what basis that moves, but it is expected that thresholds that are fixed—that's not only thresholds within the superannuation system. Those technical assumptions—

Senator BRAGG: So the threshold is fixed. Fine. Take it on notice if you need to. I'm not trying to be unreasonable here. If the threshold is fixed then the modelling produced by industry would be accurate, wouldn't it?

Mr Hawkins: We haven't reviewed the modelling that industry have done.

Senator BRAGG: You haven't reviewed it?

Mr Hawkins: We haven't undertaken a detailed review of modelling that industry have done. There are a number of organisations who have suggested numbers of individuals that may be affected at some point in the future. We haven't made a detailed review of all of those assessments.

Senator BRAGG: Have you done any internal analysis of the 500,000 projection?

Mr Hawkins: We haven't done a detailed review. My initial reaction to the modelling that the Financial Services Council has done is that it is done in a way that is markedly different to how Treasury would undertake that type of exercise, if we were to. But we haven't undertaken a detailed review of that number.

Senator BRAGG: So what do you think the number is, then?

Mr Hawkins: We haven't undertaken an exercise to forecast the number beyond—

Senator BRAGG: You said it would be markedly different, so you must have some idea.

Mr Hawkins: No. What I say is that the methodology that's used in the FSC analysis is markedly different to the approach that we would take, were we to do the same. That's not to say that if we were asked to do some analysis we wouldn't come up with a number that might be similar. But I can't say what that number would be, because we haven't undertaken that type of analysis.

Senator BRAGG: So is your position that there would be 80,000 people worse off now?

Mr Hawkins: In the 2025-26 financial year 80,000 individuals would be affected by the arrangements at that point in time.

Senator BRAGG: And you're saying you've done no work to ascertain how many people would be affected in the future?

Mr Hawkins: As is typically the case when we're costing policies of this type, we look at the forward estimates period and the commencement of the tax. At the end of the forward estimates period, we've done no analysis beyond that point in time.

Senator BRAGG: Your view is that industry modelling is wrong, but you won't say what your number is?

Mr Hawkins: I'm not saying it's wrong, I'm saying that the methodology that's used is quite different to the approach we would take were we to do this type of analysis.

Senator BRAGG: This is very confusing from my point of view. Do you have any sense of how many people will be affected by this new tax in the long run, given there are considerable concerns here about how this will affect millennials and Gen Zs?

Mr Hawkins: As I said, we haven't got a precise number, but it's a fair assumption that without indexation the number of individuals affected or a proportion of the population affected will rise over time. As the Treasurer said when he announced the measure, this measure will contribute to the sustainability of the system over time, and the non-indexation contributes to that over time.

Senator BRAGG: So it might be half a million people, then?

Mr Hawkins: As I said, I can't comment on the figure that the FSC have put out there in the public domain because we haven't done a detailed analysis of their methodology.

Senator BRAGG: Can you do some analysis and try to work out how many people your new tax is going to affect?

Mr Hawkins: I'm happy to take on notice if there's any further information we can share in relation to the FSC exercise.

Senator BRAGG: That would be very helpful, thank you.

Senator DEAN SMITH: There has been some commentary, which you would have seen in submissions, about the unprecedented nature of this particular initiative, the unrealised capital gain. What is your response to that?

Mr Hawkins: As I said in the initial answers, the design of the formula is so that the tax applies equally across all types of superannuation funds. We would accept that means that changes in the value of capital assets that have yet to be realised would be reflected in that. However, there are examples elsewhere in the Australian tax system where unrealised gains are subject to tax. One example is that when an Australian tax resident decides to leave Australia, as their home tax jurisdiction, they would incur a capital gains tax event at that point in time.

Another is that taxation of financial arrangements legislation allows for taxation of unrealised gains as well as carbon credit units. So there are a number of examples where taxation of unrealised gains already occurs.

Whilst it's very difficult to make comparisons of tax systems across jurisdictions, particularly given that Australia has a taxation regime for our system that taxes contributions at the earning stage, whereas most pension systems have taxation at the withdrawal stage, I would note that there are examples internationally where there is taxation of unrealised gains within pension systems.

Senator DEAN SMITH: But we don't necessarily want to rely on international experiences, because that would leave the government open to accusations around death taxes, inheritance taxes and the sorts.

Mr Hawkins: Are you expecting a response to that, Senator, or will I take it as a comment?

Senator DEAN SMITH: You're welcome to respond, but I suspect you'll take it as a comment.

Mr Hawkins: I'm happy to take it as a comment.

Senator DEAN SMITH: The Tax Institute and others have drawn to the committee's attention the treatment of disability, medical and related insurance payments. Could you explain the Treasury's perspective on those particular matters.

Mr Thomson: The distinction is drawn between structured settlement contributions versus total permanent disability insurance proceeds. Structured settlement contributions are essentially exempt from the measure. Individuals who have made these settlements and contributed them to super will be exempt, and that's expected to impact a very small number of individuals. These really are contributions that are large amounts of money paid to an individual to compensate them for loss resulting from serious injury and to provide ongoing medical care. This exemption is consistent with existing treatments, such as under the transfer balance cap.

On the other hand, total and permanent disability proceeds are included in the measure. They're counted as a contribution in the first year, and then, if the individual chooses to keep those proceeds within their super fund, they benefit from the concessional treatment in the super system. That's subject to the tax on their earnings in future years.

Senator DEAN SMITH: So the argument from the Treasury's perspective is that the way this proposed legislation deals with those matters is consistent in keeping with the arrangements that currently exist, so there's a sense of continuity in regard to the proposed law and that which currently exists?

Mr Thomson: That's correct.

Senator DEAN SMITH: The Tax Institute also proposed that taxpayers be given an extended period, possibly up to five years, to meet their liabilities. What's the Treasury's perspective in regard to that? Why is it not a suitable mechanism to address some of the concerns around liquidity stress that have been identified in submissions?

Mr Hawkins: The ability to defer over a period of time would be an additional concession—in effect, a tax concession—to those individuals. I would note that the current bill provides some flexibility for individuals who might find themselves in the circumstance where they have insufficient liquidity, and that flexibility relates to the period of time they have to pay the tax liability, up to 84 days. As well, any unpaid amount will be carried forward at the shortfall interest charge, which, historically speaking, is broadly around the rate of a small-business loan. Individuals in those types of circumstances, essentially, are unduly penalised; however, it avoids providing a large further concession by spreading the tax liability over a large number of years.

Senator DEAN SMITH: And how was the decision to land at 84 days and not another time period determined?

Mr Hawkins: Eighty-four days is roughly three months. I guess there is no science behind that; it's a somewhat arbitrary choice. It's roughly three times longer than what's currently allowed for other tax debts.

Senator DEAN SMITH: But it could be six months, for example?

Mr Hawkins: If parliament was to decide that it should be six months, it could be six months.

Senator DEAN SMITH: If it is six months, that's not a significant deterioration in what the bill is seeking to achieve?

Mr Hawkins: It is appropriate that taxpayers pay their obligations in a timely manner.

Senator DEAN SMITH: Yes.

Mr Hawkins: There is always a trade-off involved in the period of time taxpayers are allowed to meet their tax obligations. A longer period, whilst not as large a concession as would be implied by giving taxpayers five years to meet that liability, there is a cost there. There are trade-offs in that judgement.

Senator DEAN SMITH: Turning to the matter of schedule 5, how was it determined that the review period should be five years and not three, four or five years?

CHAIR: I just note, Senator Smith, that we have dealt with that question. It can be answered again, but I'd also draw your attention to Senator McKim, who also has questions.

Senator DEAN SMITH: I respect that others may have answered, but I'm looking for a slightly nuanced answer to my question. Thank you very much.

Mr Philp: I'll be brief on this one. It was considered appropriate that a five-year cycle was the right balance so as to give the opportunity for the regulators or the agencies involved to implement the recommendations from the previous review, and for the review to be conducted appropriately without too much time to expand. That was the balance that was sought.

Senator DEAN SMITH: What's are the competing issues?

CHAIR: Final question.

Senator DEAN SMITH: 'In the balance' suggests a subjective decision, a subjective call. Perhaps you could illuminate the committee on what the considerations were that weighted it in favour of a three- or four-year mechanism?

Mr Philp: As part of the statutory review of the FAR, it was the time required for the agencies to properly implement the recommendations that had been made on the previous review as well as the breadth of the review that could be conducted. The previous reviews had to be limited in their scope to be conducted in a timely way and for the recommendations to be implement by the agencies.

CHAIR: Thank you, Senator Smith. Senator McKim.

Senator McKIM: Thank you, Chair. I know we're running short of time, so I will really try to be brief here. Mr David Murray did a review of the financial system in 2014 and concluded that limited recourse borrowing arrangements increase financial system risk because self-managed super funds are borrowing to buy property in particular. Is that a reasonable interpretation of one of Mr Murray's conclusions?

Mr Hawkins: That's my understanding of the recommendation from the *Financial system inquiry*. I would just note that at the time the government's response was for the Council of Financial Regulators to undertake a review of limited recourse borrowing arrangements. There have been two reports undertaken by the Council of Financial Regulators. They have found that these do not pose a systemic risk to the financial system; however, they may, in certain circumstances, present a risk to a particular individual's retirement savings.

Senator McKIM: Thank you. That's helpful. But with regard to Mr Murray's conclusion, his conclusion was that the risk arises because allowing SMSFs to borrow to buy property magnifies the gains and losses from fluctuations in assets held by funds; that it forces trustees to sell other assets of the fund to pay the borrowing costs, particularly as interest rates go up; and that in downturns like the GFC, which I do note was before limited recourse borrowing was allowed, super funds weren't forced to sell assets, so the super system was a stabilising influence on Australia's economy. Are you suggesting that the two subsequent reviews that you mentioned debunked those points or didn't accept those points?

Mr Hawkins: No, I'm not suggesting that. I'm suggesting that those reviews noted that, where those risks do exist, within individual superannuation funds they don't pose a systemic risk, a broader contagion risk, to the financial system. However, it's fair to say that, whenever you're using leverage or borrowing against assets, that increases the risks that the individual is taking. As I noted, those CFR reports noted that those super funds that have very high levels of leverage are exposed to a much higher level of risk. However, the design of the limited recourse borrowing arrangement provisions means that any recoupment by a lender of their outstanding debt is limited to the particular asset that the borrowing was taken out against. So, in the example of property, they'd only have recourse against that property and not the other assets that are held by the self-managed superannuation fund, somewhat insulating the risks to their retirement savings.

Senator McKIM: That's very helpful. Borrowing in self-managed super funds has increased from $8.7 billion at the time of the Murray review to over $21.6 billion today. When was the last of those two subsequent reviews that you mentioned done?

Mr Thomson: The most recent one was, I think, published in September 2022.

Senator McKIM: Okay. So it was relatively recent. Has Treasury done any modelling looking at or any assessment of any risk that this bill would amplify SMSFs being forced to sell assets to pay this tax?

Mr Hawkins: No, we haven't undertaken any analysis or modelling of, I guess, the liquidity arrangements within funds, noting that there is a legislative requirement that funds manage their liquidity such that they are able

to meet their obligations, including their tax obligations. Management of liquidity may very well change, leading up to the commencement of this tax, so that funds are in fact ensuring their liquidity is sufficient to pay the tax. Understandably, liquidity comes at a cost to a superannuation fund. They would otherwise probably like to invest that in an asset to make a return. So I'd expect to see some change in behaviour in how funds manage their liquidity so they can in fact meet the tax obligations that they'll have.

Senator McKIM: For the record, I'm not concerned about the bill's impact on SMSFs in particular, but I am concerned that this might unintentionally increase financial system risk because so much of that borrowing is actually going into liquid property. Do you think this combination could have cascading effects, in a time of economic downturn?

Mr Hawkins: As I said, funds have the responsibility of managing their liquidity to meet their obligations, and so they should be adjusting, if necessary, their approach so that they have that necessary liquidity. As I said, the Council of Financial Regulators report looked at where there was any systemic risk, and they would naturally be looking at situations where funds or the financial system was under stress in order to make that assessment, so I'd just point back to those reports.

Senator McKIM: Finally, on another topic, did Treasury consider the potential for an appeal based on section 72 of the Constitution as you were preparing this bill? That's the section that prevents a diminution of judicial remuneration while judges are in office. Did Treasury consider the potential for such an appeal, and did Treasury consider the impacts on the High Court of having to hear a constitutional matter when every single judge of the High Court has a direct pecuniary interest in the matter?

Mr Hawkins: We sought legal advice which goes to the provisions of the Constitution and so have considered the risks associated with there being a potential case being brought forward. The design of the legislation is underpinned by that legal advice. We haven't considered the hypothetical scenario of if there happened to be a case brought before the High Court and what might occur in that circumstance, but the bill is designed to be underpinned by a robust assessment of the legal risks associated with the Constitution.

Senator McKIM: I will put some questions on notice to save time. I anticipate that you may wish to take this question on notice, which is, of course, fine. You have said that legal advice was sought around the constitutionality of this. I understand that privilege accrues to legal advice. That doesn't necessarily mean that that advice can't be released publicly, by the way, but that's not your decision. I'm asking whether there is a view that the changes are not diminishing the remuneration, merely increasing taxation, or is the view that it's constitutionally permissible to do what this legislation is doing based on the fact that the judges actually receive the benefit while they are not in office?

Mr Hawkins: I might have to take you up on your offer to take this question on notice because it does go to some of the details of the legal advice itself.

Senator McKIM: Okay. I'll put that and some other questions in writing on notice. Thank you, officials.

CHAIR: Thank you, representatives of Treasury. That concludes today's hearing. Thank you to all witnesses who appeared and to Hansard and Broadcasting for their assistance. If anyone has taken any questions on notice, please note responses are due by COB Thursday 2 May.

Committee adjourned at 15:27