23 February 2024

Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam,

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

The Institute of Financial Professionals Australia (**IFPA**) welcomes the opportunity to provide this submission on the *Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023* (**the Bill**) and the *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023.*

Our submission is confined to Schedules 1 to 3 of the Bill which works with the *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023* to reduce the tax concessions on superannuation balances that exceed $3 million.

We have examined the Bill and explanatory memorandum (**EM**) materials and remain opposed to the government's proposed Division 296 tax on superannuation balances above $3 million. Our reasons for reaching this conclusion remain the same as our previous submissions made to Treasury on 18 October 2023 and 17 April 2023.

For ease of reference, we have summarised our key concerns and our recommended alternative proposals below.

Superannuation balances should not be capped

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

- Larger balances represent a small cohort of individuals (ie, less than 2% of SMSF members). This small cohort of large account balances are the exception rather than the norm. They exist due to the superannuation policies that were around in the past. Changing the law and applying the change on a retrospective basis will penalise individuals who adhered to the rules that existed at the time.
- Changing the rules due to a small cohort of individuals will only create further complexity and uncertainty, causing individuals to second guess whether they should put money into their superannuation. More complexity also increases the need for superannuation members to obtain more complex advice (noting the additional cost and time associated with this).
- The issue of extremely large superannuation balances will not continue into the future as a result of the 1 July 2017 changes which placed further limits on contributions. Further, the limit on amounts that can be held in the tax-free retirement phase has helped reduce the number of large balances that exist.
- Most individuals with large balances are held by older Australians and considering death benefits must be compulsorily cashed out of the system, it is only a matter of time before large balances will eventually leave the superannuation system.

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

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Our concerns with Division 296

The proposed Division 296 tax is largely unchanged from when it was first announced by the government in February 2023. This means the same key issues remain unresolved, such as:

1. Unrealised gains will be taxed

The Bill proposes to tax unrealised capital gains as the calculation of 'earnings' is based on movements in a member's total superannuation balance (**TSB**), rather than actual taxable income generated by a superannuation fund. As such, this new tax is a fundamental shift from the way the existing Australian tax system works as it goes against the general tax principle of paying tax on income that has actually been derived or on actual realised gains.

Furthermore, the proposed Division 296 tax proposal does not deliver what the intention of the policy is. According to the 31 March 2023 'Better Targeted Superannuation Concessions' consultation paper, this reform is intended to bring the headline tax rate to 30% up from 15% for earnings above $3 million. As conceptually simple as the formula may be, it does not deliver this policy outcome as the definition of 'earnings' is unrelated to the actual taxable income generated by a superannuation fund and does not deliver a headline tax rate of 30% on the proportion of 'earnings' above $3 million.

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

2. The carry forward loss measure is inequitable and complex

There is no refund of tax paid in years when earnings are negative and a member's TSB drops below $3 million. Although negative earnings/losses can be carried forward and offset against Division 296 tax in future years' tax liabilities, some members may never recoup tax previously paid if their account balance does not exceed $3 million again. This may be due to markets falling which causes a member's balance to drop below $3 million and not exceeding the threshold again, or could also be due to members drawing down on their balance because they are receiving pension payments to meet their living expenses. That is, they'll pay Division 296 tax on amounts (unrealised gains) that they never actually receive.

For example, if we look at what has happened over the last few years, many funds in 2021 experienced large gains followed by a huge year of losses in 2022 and then levelling back up in 2023. Had this proposal been in place over this period, there would be many members who would be disadvantaged due to the peak and the fall of the market. For some members, they may never experience the peak again and won't see their balance exceed $3 million due to the above mentioned reasons.

Taxing unrealised gains but not providing refunds for unrealised losses is inequitable, that is, in good times cash is paid out but in bad times there is no corresponding relief. It is only fair that if members pay tax on unrealised gains, they should receive a refund of the tax they have already paid to offset any tax liability. We also believe the examples provided in the explanatory memorandum materials illustrate that the system of carried forward negative losses is overly complex and can lead to inequitable outcomes. In our opinion, there are simpler solutions that the government could consider that ensure equitable outcomes (discussed later).

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3. Cashflow and liquidity issues with volatile and illiquid assets

The inclusion of unrealised capital gains will have a greater impact on SMSFs with exposure to direct property assets. In particular, farmers and small business owners who have legitimately contributed their farms or business properties to their SMSF may struggle to meet this new tax impost where there is no cash available from a sale or if members have little to no wealth outside of superannuation.

As lumpy assets generally cannot be partly sold to pay this proposed new tax, restructuring such assets to generate cashflow may require such properties to be sold which may cause business disruption, impact members livelihoods and lead to substantial transaction costs. Further, forced restructures/disposals may occur when the market is in a downturn and therefore the full, real value of the asset may not be realised. As such, members who are asset-rich but cash-poor will be impacted greatly as they will need to find the cashflow to pay the tax in any given year even though there has been no actual realisation of the asset which will further diminish liquidity of the fund.

While the EM to the Bill refers to potential relief in such circumstances, the Bill does not contain such relief, rather members will be at the “mercy” of the ATO’s debt recovery section. This is to be contrasted with the rules relating to defined benefits which do allow deferral.

4. The $3 million threshold is not indexed

An unindexed threshold will capture more people over time through bracket creep and will therefore be worth far less in future dollars. Furthermore, the long-term impact of the $3 million threshold not being indexed to inflation will lead to intergenerational inequity between the different generations over time.

Our recommendations

We recommend the government considers making the following changes to the Bill to ensure a fair and equitable outcome for all Australians, including:

1. Tax actual taxable income above $3 million

Removing unrealised capital gains from the calculation of earnings and using actual taxable income/earnings as a measure of earnings is a simpler and far more equitable solution. It will also enable the government to achieve its objective of ensuring a fairer superannuation system for all Australians. This solution will not only avoid taxing unrealised gains, but it also rules out the need to calculate an individual’s modified TSB by adding back withdrawals and reducing it by contributions received by the fund and eliminates the need to track carried forward negative earnings. Taxing actual taxable income will also mean that funds will not have to undertake tax-effect accounting, which they may be compelled to use under the government’s proposal.

For superannuation funds, such as SMSFs, that can already identify a members’ TSB and can calculate actual earnings for each member of a fund, these funds should be given the option to apply Division 296 tax to actual taxable income/earnings above $3 million. This would be a fair outcome considering Division 296 tax is expected to have a greater impact on SMSFs than on members of large APRA-regulated funds.

Conversely, large APRA-regulated funds that cannot easily work out actual earnings for members could rely on an alternative method, such as the formula-based approach proposed by Treasury. Although this would result in a two-tiered approach where different calculations would apply across superannuation sector, this approach would limit the proposed approach of taxing unrealised gains to a smaller population of taxpayers. We already have different approaches for large and small funds, such as transfer balance account reporting and the pending legislation[1] that aims to treats SMSFs

[1] *Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023*

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differently to APRA-regulated funds when it comes to non-arm's length income provisions, so there is already precedence for having alternative approaches to achieve a policy intent outcome. Provided the outcome delivers on the policy goal, then having two options as solutions for large and small funds should be permitted.

2. Refund losses

Losses should not be a carried forward measure, rather members should receive a refund of the tax they have already paid to offset any current tax liability. This is preferred rather than carrying forward the loss that may or may not be used at a future date.

In default of having a non-refundable loss regime, losses should be refundable in certain circumstances, such as where a member has been under $3 million for a period of time, or if a member dies.

3. Introduce a permanent tax deferral regime for all funds

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

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

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

4. Index the $3 million threshold

It is our view that the $3 million threshold should be subject to indexation. This will ensure the $3 million threshold reflects true market conditions and keeps pace with inflation, salary/wage increases and cost of living increases. Without indexation, more Australians will inadvertently be caught by the unindexed threshold and it won't be too long before the $3 million threshold may not be considered that significant as a way of being ready for retirement. It is worrying that the consultation paper seeks to justify an unindexed cap on the basis that other superannuation caps are unindexed. All superannuation caps should be indexed to keep up with inflation and to avoid bracket creep.

As such, we propose that the $3 million threshold be indexed in line with the general transfer balance cap (**TBC**) in increments of $100,000, depending on the consumer price index (**CPI**)[2].

[2] Sections 960-265, 960-280(1) and 960-285(7) ITAA 1997

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5. Exclude certain amounts from a member's adjusted TSB permanently

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

Amount	Issue and recommendation
Reversionary or death benefit pensions	In practice, there may be couples that have TSBs of less than $3 million each, but the moment they inherit their spouse's superannuation as a death benefit pension will mean their TSB will increase. This may cause someone who never expected to be included in this measure to be subject to the new tax. Although any reversionary or death benefit pensions will not count towards the inheriting spouse's TSB in the year of death/receipt, these amounts will increase a member's balance in the next year. This means should these amounts push a member over the $3 million threshold and have earnings in future years, these earnings will also be subject to Division 296 tax. We propose that reversionary or death benefit pensions be permanently excluded from the inheriting spouse's TSB as receiving the payment is beyond the beneficiary's control if they are nominated as a beneficiary of the deceased member.
Disability benefit pensions	Disability benefits should also be permanently excluded from a member's TSB altogether, like structured settlement amounts. Although any total and permanent disability (**TPD**) payments will be excluded in the first year of receipt from the member's adjusted TSB as a contribution, these amounts will also increase a member's balance in the next year and may therefore mean a member may be taxed in future years on the earnings from the TPD proceeds. Considering structured settlements and TPD benefits are both payments made to individuals who have suffered a serious injury or disability, one-off lump sum payments, such as TPD insurance proceeds and any earnings on such amounts should be excluded from Division 296 tax in the same manner as structured settlement payments. An alternative solution is that not only could a TPD payment be considered a contribution in the year it is received, but it could also be considered an annual excluded contribution so that it is excluded from a member's TSB completely. This means if the TPD payment amount pushes a member over the $3 million threshold, they won't be subject to Division 296 tax on these amounts.
Amounts withdrawn under a release authority and associated earnings	Amounts withdrawn under the law for the payment of superannuation related taxes (such as excess non-concessional contributions) and the associated earnings should not be added back to a member's TSB so there is no double taxation. As a member's associated earnings attributable to their excess non-concessional contributions are already taxed at the member's marginal tax rate (less a 15% non-refundable tax offset), adding back associated earnings as a withdrawal to a member's adjusted TSB is akin to applying a double tax on the same amount if it also is subject to Division 296 tax. We believe it is unnecessary to include such amounts back in as withdrawals as the excess tax regime already reduces the tax concessions for individuals who exceed the contribution caps.

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Minimum pension payments	As minimum payments are a mandatory requirement to be drawn down, they should not be added back to a member's TSB. Instead, any discretionary or voluntary withdrawals that a member may choose to take in addition to statutory requirements (ie, lump sums or pension payments drawn over and above minimum pension payments) could be added back rather than the mandatory payments that a member must take out. We suggest that any statutory amounts that must be drawn from superannuation and/or pensions should not be added back to a member's TSB.
Other remediation payments	It is pleasing to see that a member's TSB will be reduced by remediation payments or compensation received as a result of fraud or dishonesty. That said, we believe other remediation payments should also be excluded from a member's TSB, particularly where an amount of compensation from a financial service or insurance provider is received by a member's superannuation fund and allocated to their account. This can typically occur where a member received inappropriate financial advice, or if the member paid fees but did not receive advice. As per the ATO's guidance on compensation arising from financial advice[3] where a member or superannuation fund has engaged a financial service or insurance provider and has a right to compensation, the treatment of compensation in the financial year it is received by the fund should not be considered a contribution and therefore not affect the member's contribution caps. This is because the purpose of a remediation payment is to put a member back into the position they should have been in had the event not happened, but if a member pays tax on this amount, it defeats the objective of a remediation payment.

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

Members who meet a condition of release have the option to move money or assets outside of superannuation if they expect to pay a large tax bill every year under this new proposed tax. We believe a large number of members who have large superannuation balances are typically older and fully retired, however there may be a small cohort of younger members who also have large superannuation balances due to other reasons, such as making the right investment decisions, making extra contributions to superannuation due to receiving an inheritance, etc. These members will be impacted as they will not be able to withdraw excess funds from the superannuation system as they are yet to meet a condition of release.

The government should consider amending the condition of release rules to give individuals the choice to either keep funds over $3 million in superannuation or to withdraw amounts in excess of $3 million out of the superannuation environment before the measure takes effect. These changes should be temporary which will allow impacted individuals to transition to the new Division 296 tax regime by restructuring their affairs without added taxes. Individuals should have a choice to move their money, rather than being forced to keep funds/assets in an environment that is taxed differently than at the time the investment choice was made.

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

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

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7. Holistic review of the superannuation system

IFPA appreciates that the superannuation system must be sustainable, however if the policy intent is to reduce the tax concessions afforded to members with large balances, other options must be considered by the government to fix the Division 296 tax measure. Rather than applying another piecemeal change to the superannuation system, we propose the government conducts a holistic review of the superannuation tax concessions so we end up with a system that is fair and equitable for everyone. After all, continual changes not only targets retirement savings but promotes instability and uncertainty in the sector, which in turn may discourage investment.

Other alternative solutions the government could consider instead of the Division 296 measure may include:

- **Tax on withdrawals over $3 million** – rather than applying Division 296 tax on a proportion of earnings over $3 million which includes taxing unrealised gains, an alternative option is to apply a 15% tax on all taxable component withdrawals from accumulation phase for those with TSBs greater than $3 million regardless of a member's age. If this option is considered, we propose that certain members be excluded from the extra 15% tax, such as those who have made structured settlement contributions, amounts paid under permanent incapacity or terminal illness benefits.

- **Compulsory cashing** – when Division 296 was first announced, the original stated objective of this policy was to target a small number of individuals who have TSBs exceeding $50 million and $100 million with the Assistant Treasurer indicating that somewhere "south of $10 million" is probably what the government is looking at. However the shift to a much lower threshold of $3 million changes the government's policy position from one that targets ultra-high net wealth individuals to one that targets many self-funded retirees who can be considered middle class Australia, including small business owners and farmers.

  Going back to the government's original policy intentions around these "mega funds" that exist (which are extreme exceptions rather than the norm), we propose those individuals who have extremely high balances (such as $10 million) be forced to compulsorily withdraw amounts in excess of this threshold from superannuation. If this option is considered, we propose that certain members be excluded from this compulsory cashing rule, such as those who have made structured settlement contributions, amounts paid under permanent incapacity or terminal illness benefits.

  Additionally, if the government is of the view that retirees are not drawing down on their superannuation and pensions and are instead saving it for a rainy day or for estate/succession planning purposes, we suggest the government revisit the pension drawdown rates. This option may involve increasing the drawdown rates or changing the way annual drawdown amounts are calculated so the balance is forced out of superannuation faster.

- **Revisit superannuation caps and thresholds** – at present we have many superannuation thresholds and caps which complicate the system. For example, there are caps on contributions that can be made to superannuation, including the three tier TSB thresholds that apply in order to use the bring forward rule, limits on amounts that can be held in the tax-free retirement phase, among others. Assuming Division 296 tax is legislated in its current form, we will have yet another limit that individuals will need to monitor. The superannuation system is already very complex and it is our view that we need to simplify and streamline a number of these thresholds and caps into a single threshold. For instance, it may be that we align the TBC with the $3 million threshold and retain our contribution caps but simplify the TSB thresholds which will still limit the maximum amount that individuals can keep in the tax concessional superannuation environment. This streamlined process will simplify the retirement planning process for many Australians.

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Many of these alternative options require further analysis and design issues that would need to be considered. As always, our association would welcome an opportunity to share our feedback on any of these matters.

Closing comments

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

Yours faithfully,

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Chair, Superannuation Technical and Policy Committee

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About the Institute of Financial Professionals Australia

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

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