17 April 2023

Director
Tax and Transfers Branch
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES, ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam,

Re: Consultation paper (Better targeted superannuation concessions) – proposed 15% additional tax for individuals with superannuation balances exceeding $3 million

The National Tax and Accountants' Association Ltd ('NTAA') welcomes the government's consultation and the opportunity to provide comments on the consultation paper: *Better targeted superannuation concessions* ('the consultation paper'). The consultation paper addresses the government's intention to impose a 15% additional tax for individuals with total superannuation balances exceeding $3 million from 1 July 2025 ('the proposed 15% additional tax').

The NTAA is a national member-based organisation that represents the interests of around 10,000 member firms, including taxation accountants and superannuation professionals. For many years, the NTAA has been dedicated to helping and providing support to these professionals by:

- providing a tax and superannuation consulting service through a national tax hotline;
- developing and running nationwide tax and superannuation seminars; and
- liaising with Federal and State Governments, and by participating in ATO tax forums and consultative groups.

The NTAA has numerous concerns regarding the proposed 15% additional tax outlined in the consultation paper. These concerns together with other comments are outlined below.

1. **Non-indexation of the $3 million total superannuation balance ('TSB') threshold**

The consultation paper makes it clear that the $3 million TSB threshold will **not** be indexed.

When the proposed 15% additional tax is introduced, the government expects that this measure will apply to less than 80,000 individuals with superannuation accounts. According to the government, more than 99.5% of individuals with a superannuation account will be unaffected by this measure (i.e., by 2025-26).

However, the non-indexation of the $3 million TSB threshold will result in many more individuals being affected by this measure over time (i.e., depending on the annual rate of inflation after the proposed measure is introduced).

The government's rationale for not indexing the $3 million TSB threshold is that this is similar to other superannuation thresholds that are not indexed, such as the:

- $250,000 income threshold for being liable to pay the 15% additional tax in respect of concessional contributions under Division 293 of the ITAA 1997; and
- $37,000 income threshold for being able to access the low-income superannuation tax offset of up to $500 for an income year.

However, the consultation paper fails to make reference to many superannuation thresholds that are indexed. This particularly includes the general transfer balance cap, which limits the total amount an individual can transfer into the tax-free retirement phase over their lifetime (e.g., by commencing one or more retirement phase pensions). The general transfer balance cap was set at $1.6 million when it was first introduced on 1 July 2017, and has since been indexed to $1.7 million on 1 July 2021. This cap will be further indexed to $1.9 million on 1 July 2023.

The NTAA believes that the proposed $3 million TSB threshold should be indexed consistent with the current $1.7 million general transfer balance cap, as both effectively reduce the tax concessions available for earnings that relate to superannuation balances above a certain threshold.

2. **Proposed 15% additional tax will apply to unrealised capital gains**

The proposed 15% additional tax for an income year will be imposed on the proportion of an individual's **earnings** for the year attributable to their TSB above $3 million.

An individual's **earnings** will be calculated as the difference between their closing TSB for the year (adjusted for any withdrawals and net contributions) and their closing TSB from the previous year. This will include notional (unrealised) gains and losses related to the individual's TSB for the year.

This means that, a proportion of notional (unrealised) gains related to an individual's TSB for an income year will be subject to the proposed 15% additional tax (where a liability arises for that year). The government clearly acknowledges this in the consultation paper.

At the same time, the government also proposes that, where an individual has negative earnings for an income year (including notional or unrealised losses), these can be carried forward and offset against positive earnings (including notional or unrealised gains) in future income years.

The NTAA has the following concerns regarding the above approach and outcome for notional (unrealised) gains under the government's proposal:

(a) Taxing unrealised capital gains is inconsistent with the existing tax law, which only taxes realised capital gains (e.g., on the disposal of a CGT asset).

(b) A proportion of notional (unrealised) capital gains will be subject to the proposed 15% additional tax without any application of the general CGT discount.

(c) Taxing notional (unrealised) capital gains will create a tax liability at the individual level, without a corresponding inflow of cash to assist in paying for such a liability.

(d) The above approach and outcome could also result in the same gain being taxed twice. Firstly, at 15% as part of the earnings calculation for TSBs above $3 million. Secondly, at 15% (or 10% for a discount gain) when the relevant fund asset is eventually disposed of.

(e) There appears to be no mechanism for the adjustment of unrealised capital gains that are partly or wholly reversed in a subsequent income year.

    For example, suppose that an individual has the following:

    - A closing TSB of $3 million in the 2025 income year.
    - A closing TSB of $3.5 million in the 2026 income year.
    - A closing TSB of $4 million in the 2027 income year.

- A closing TSB of $3.5 million in the 2028 income year.

The individual's **earnings** under the proposal will be $500,000 in each of the 2026 and 2027 income years, but they will have negative earnings of $500,000 in the 2028 income year.

A proportion of the individual's $500,000 earnings in each of the 2026 and 2027 income years will be subject to the proposed 15% additional tax. However, the individual's negative earnings of $500,000 in the 2028 income year can only be carried forward to a future year.

In this type of situation, there appears to be no mechanism under the government's proposal to allow an individual to recoup any part of the 15% additional tax paid in the first two years in respect of their notional (unrealised) gains.

3. **The impact of the government's proposal on superannuation splits that occur upon relationship breakdowns (e.g., upon a divorce)**

Under the government's proposal, it appears that a superannuation split between spouses or former spouses as part of a relationship breakdown could result in the receiving spouse's TSB exceeding $3 million and being subject to the proposed 15% additional tax.

For example, suppose that a spouse has a TSB of $2.5 million and they receive a $1 million lump sum roll-over amount into their super account from their spouse's super account as part of a superannuation split on divorce. In this case, the receiving spouse's TSB will, prima facie, increase to $3.5 million after the split. This will result in the receiving spouse becoming subject to the 15% additional tax on a proportion of the $500,000 excess above the $3 million TSB threshold.

As this is an unavoidable outcome for the receiving spouse (and also an unintended consequence), the NTAA submits that the government should consider excluding 'superannuation split' amounts upon relationship breakdowns from the proposed 15% additional tax. This could be achieved by, for example, excluding the value of such splits from a receiving spouse's TSB for the purposes of:

- determining whether a liability arises for the 15% additional tax; and
- calculating the proportionate earnings amount on which any 15% additional tax will be imposed.

This approach would be consistent with CGT roll over relief that applies under the existing law for asset transfers between spouses (or from a company or a trust) as part of a relationship breakdown under Subdivision 126-A of the ITAA 1997.

4. **The impact of the government's proposal on individuals receiving a reversionary pension**

The government's proposal will have a similar impact as noted above for superannuation splits upon a relationship breakdown, where an individual becomes entitled to receive a reversionary death benefit pension (i.e., as a reversionary beneficiary) upon the death of another person.

In this case, the value of the reversionary pension will, prima facie, be included in the recipient beneficiary's TSB. This could result in the beneficiary's TSB exceeding the $3m threshold and the beneficiary becoming liable to pay the 15% additional tax. In effect, imposing a 15% additional tax in this situation will be seen as a form of 'death tax'.

As this is an unavoidable outcome (and an unintended consequence) for a recipient beneficiary, the NTAA submits that the government should consider excluding the value of a reversionary pension from a beneficiary's TSB when applying the proposed 15% additional tax.

5. **Minimum pension withdrawals and an individual's TSB when calculating 'earnings'**

When calculating an individual's **earnings** for an income year for the purposes of the 15% additional tax, any withdrawals made during the year are added back to the individual's closing TSB for the year. According to the consultation paper, this approach is intended to reflect what the individual's TSB for the income year would have been if they had not made any withdrawals.

Adding back withdrawals to an individual's closing TSB for an income year effectively increases the amount of their **earnings** for that year, resulting in a higher 15% additional tax liability.

This approach can be disadvantageous for individuals in pension phase who are compelled to draw down a minimum annual pension amount under the pension standards in the *Superannuation Industry (Supervision) Regulations 1994*. This is because, although minimum annual pension withdrawals are compulsory for individuals in pension phase, they will still be added back to an individual's TSB when calculating the earnings on which the 15% additional tax will be imposed.

The NTAA believes that this is an unintended consequence of the methodology for calculating the proposed 15% additional tax.

For this reason, the NTAA submits that the government should amend the proposed measure to ensure that minimum annual pension withdrawals are **not** added back to an individual's TSB for the purposes of the proposed 15% additional tax.

6. **The impact of the government's proposal on limited recourse borrowing arrangements ('LRBAs') in SMSFs**

Under the existing law, where an SMSF has an LRBA entered into on or after 1 July 2018, a member's share of the fund's outstanding LRBA at the end of each year may need to be added to their TSB at the end of each year. This add back will generally be required where:

- the member's interest(s) in the fund are supported (to some extent) by the asset(s) that secures the fund's borrowing; and
- either, the LRBA is with an associate of the fund **or** the member has satisfied a condition of release with a nil cashing restriction (e.g., 'retirement' or 'reaching age 65').

The government's original intention with adding back an individual member's share of an SMSF's LRBA to their TSB was to ensure that an individual's TSB more accurately reflects the overall values of fund assets supporting their super interests. Under the existing law, an individual's TSB has been relevant and integral for accessing a range of superannuation concessions (especially being eligible for an annual and/or bring-forward non-concessional contributions cap).

However, with the introduction of the proposed 15% additional tax from 1 July 2025, having to add back an individual member's share of an SMSF's outstanding LRBA to their TSB could cause the individual's TSB to exceed $3 million, resulting in a liability for the 15% additional tax.

The NTAA believes that this is an unintended consequence of the government's proposed measure. On this basis, the NTAA submits that the government should exclude LRBA amounts from an individual's TSB for the purposes of applying the proposed 15% additional tax.

7. **Providing individuals with the option of withdrawing excess superannuation balances**.

Many individuals who have accumulated large superannuation balances over the years would have done so on the basis of the existing tax concessions available to complying super funds. In particular, fund earnings on an individual's accumulation entitlements in a complying super fund (including concessional contributions) are generally taxed at the rate of 15%.

However, individuals with TSBs above $3 million from 1 July 2025 will be faced with having to pay an additional 15% tax on a proportion of their earnings above $3 million, resulting in these earnings being taxed at an overall effective rate of 30%.

As a result, some individuals in this situation may be looking to withdraw part of their super entitlements leading up to 1 July 2025 and to invest those withdrawals outside of superannuation.

However, under the existing law, a superannuation withdrawal can only be made once an individual has satisfied a condition of release (e.g., 'retirement' or 'reaching age 65'). Furthermore:

- individuals under the age of 60 will generally be liable to pay tax on their superannuation withdrawals (i.e., to the extent of a taxable component); and
- any asset disposals in a fund to facilitate such a super withdrawal will usually trigger a CGT liability (i.e., to the extent the asset is supporting accumulation entitlements in the fund).

To ensure the proposed 15% additional tax does not disadvantage individuals in the above circumstances, the NTAA believes that the government's proposal should allow such individuals a period within which they can restructure their superannuation balances, as follows:

- Individuals should be allowed to withdraw part or all of their excess super balances (i.e., above $3 million) without having to satisfy an existing condition of release – in this regard, the government could introduce an additional condition of release just for this purpose.

- Any such withdrawals should be tax-free to the individual, irrespective of their age.
- Any asset disposals in a fund to facilitate such withdrawals should be exempt from CGT.

8. **Proposed 15% tax creates more uncertainty for individuals investing in superannuation**

The concessionally taxed superannuation environment has traditionally been one of the key attractions for many Australians investing in superannuation. This broadly incentivises Australians to work towards funding their own retirement, thereby reducing financial pressures on consolidated revenue and future government budgets.

The NTAA is of the view that the government's proposed 15% additional tax could create further uncertainty for Australians when it comes to making decisions about future investments in superannuation. This is because, individuals usually invest in superannuation for the long-term. Therefore, changes that have the effect of reducing superannuation tax concessions create uncertainty about the scope for further changes being made. This has the potential to divert investment behaviour away from the superannuation environment.

Yours faithfully,

Geoff Boxer
Chief Executive Officer