

BCA submission to
Treasury Laws
Amendment (Better
Targeted
Superannuation
Concessions) Bill
exposure draft

October 2023

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1. Overview

The Business Council of Australia welcomes the opportunity to comment on the exposure draft for the Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 and related legislation.

Superannuation is one of the three pillars of the retirement income system and policy decisions about superannuation touch on major areas of government policy, including the tax and welfare systems and home ownership.

Individuals may spend more than 40 years saving for retirement during their working lives and could have over 15 years in retirement. It is undeniable that the economic and policy landscape will change over such an extended time. It is also reasonable for the public to expect a relative degree of certainty over the policy arrangements for retirement incomes given these long horizons and the complexity of the issues involved.

Despite this, retirement income policy arrangements have been changed repeatedly, undermining confidence in the system and the ability to plan for retirement. It is important that further changes in the taxation arrangements for superannuation, even if narrowly targeted, promote certainty and confidence in superannuation as a whole.

To this end, it is important that governments do not come to view the pool of superannuation savings as a politically expedient source of additional revenue for the purposes of balancing the budget, which is not to deny the importance of budget balance. Individual tax measures that are seemingly well-targeted on equity or other grounds may cumulatively pose a threat to the integrity of the system, not least by raising uncertainty about future taxation arrangements.

The tax measures contained in this bill are likely to undermine confidence in the superannuation system in a number of ways:

- The increased tax on superannuation balances over \$3 million is retrospective in effect.
- The lack of indexation of the proposed total balance threshold (TBT) will increase the incidence of the tax over time and has potential interactions with the indexed transfer balance cap (TBC).
- The taxation of unrealised gains also introduces a new concept into the Australian tax system that has the effect of denying the well-established concessional treatment of capital gains, increasing effective tax rates by more than the additional notional 15 per cent tax rate.
- Consideration should be given to discounting accrual-based earnings or the proposed new tax rate to maintain effective concessional treatment of capital gains.

The bill also introduces a progressive structure to the taxation of super fund earnings previously taxed at zero in the pension stage and 15 per cent in the accumulation stage. The government should instead explore options through a comprehensive review of the tax treatment of all saving income. This could include consideration of a uniform rate on all fund earnings set at a lower rate, as suggested by the 2010 Henry tax review.

2. Key recommendations

- The BCA recommends that the proposed \$3 million threshold be indexed to avoid a growing tax burden over time that will require legislated adjustments in future. The threshold could instead be set as a multiple of the indexed transfer balance cap.
- The BCA recommends against the wider application of the taxation of unrealised gains to superannuation balances below the proposed \$3 million threshold or to the taxation of capital gains outside superannuation. Consideration should be given to discounting accrual-based earnings or the proposed new tax rate to maintain effective concessional treatment of capital gains.
- The government should explore options through a comprehensive review of the tax treatment of all saving income, which could include a uniform rate on all fund earnings at a lower rate, as suggested by the 2010 Henry Tax Review, in lieu of the measures proposed in this bill.
- The consultation period for the bill is just 15 days, which is unacceptably short for a complex piece of legislation with a 1 July 2025 start date.

3. Timing considerations and prospectivity

The proposed measure will commence on 1 July 2025 and apply from the 2025-26 financial year onwards. This means individuals with a total superannuation balance (TSB) more than \$3 million on 30 June 2026 will be subject to the new arrangements. Earnings on the part of an individual's TSB over \$3 million will attract an additional 15 per cent tax. The government estimates that the measure will raise an additional \$900 million over the forward estimates and \$2 billion when operating in its first full year.¹

The prospective application of the measure is appropriate given that some funds will likely need to restructure their holdings of illiquid assets in order to meet the additional tax burden.

However, it should be noted that while the measure is prospective in application, it is not without retrospective effect. Superannuation balances in excess of \$3 million were accumulated in the expectation that the existing taxation arrangement would continue. Superannuation is unlike other forms of saving subject to tax in that it is accumulated within an inflexible framework of tax and other rules with a view to achieving long-term outcomes for fund members. In this context, even prospective measures can have retrospective effect, denying the validity of former contribution rules and undermine confidence in superannuation as a saving vehicle.

The prospective application of the measure may nonetheless afford opportunities for some fund members no longer in the accumulation stage to restructure their superannuation and other assets to reduce the incidence of the additional tax, for example, by selling assets to realise existing gains before the measure comes into effect.

Going forward, there will be an incentive to keep balances below the \$3 million threshold for additional tax. Had the measure been grandfathered to apply to balances accumulated after the commencement date so as to be entirely prospective in its incidence, it is unlikely any significant revenue would be raised. Concessional contributions limits are now tighter than they have been historically, making the accumulation of large balances in the future less likely.

4. Indexation

The government has stated that the \$3 million threshold will not be indexed. The original consultation paper notes that this is similar to other thresholds in superannuation tax law, such as the Division 293 threshold or the low-income superannuation tax offset, and argues that the absence of indexation 'provides certainty to people when arranging their tax and financial affairs.'

The 'certainty' argument against indexation is unconvincing. Notwithstanding the current high rate of inflation, there is reasonable certainty that long-run inflation outcomes will be consistent with the RBA's inflation target, so future changes in an indexed threshold are broadly foreseeable by fund members, even over long horizons.

Indexation of tax thresholds is desirable to avoid an unintended increase in the tax burden over time. As the personal income tax thresholds illustrate, the absence of indexation requires continuous adjustment to legislated thresholds to alleviate growing tax burdens. These legislated changes become politically contested and uncertain. It is preferable for indexation to be built into legislation from the outset to avoid having to address what is likely to be a growing and unintended tax burden over time, even if this only becomes a problem at long horizons. On the government's own estimates, the number of superannuation account holders affected by the tax will increase from 0.8% to 10% over 30 years.

The indexation of the transfer balance cap means that it will eventually overtake the TBT. This raises the question of whether earnings on the amount of the TBC above the TBT would be subject to the additional 15 per cent tax or whether the TBC would then takeover from the TBT so that the latter becomes indexed by default.

¹ Treasurer Jim Chalmers, 'Superannuation tax breaks,' Joint media release with The Hon Stephen Jones MP Assistant Treasurer, Minister for Financial Services, 28 February 2023, <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/superannuation-tax-breaks>. See also Treasurer Jim Chalmers, Joint press conference with Anthony Albanese MP, Prime Minister, <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/transcripts/joint-press-conference-parliament-house-canberra-1>

5. Negative earnings and revenue volatility

The proposed measure provides that when investment losses or fund expenses cause an individual's total fund balance to be less at the end of a financial year than it was at the end of the previous financial year, the amount of the negative earnings will be able to be used to offset positive earnings in future years. Capital losses that are reflected in negative earnings can be used to offset any future positive earnings that relate to income, including rent and interest.

While these provisions are appropriate, they imply that the proposed tax will be a volatile revenue source. In the event of broad-based downturn in financial asset prices, the measure could be expected to raise little revenue for an extended period. By the same token, years in which there are strong gains in financial and other asset prices could be expected to yield upside revenue surprises. The volatility in revenue from this measure could be expected to broadly mirror that seen in capital gains tax revenue.

6. Taxation of unrealised gains

The proposed measure is novel in taxing unrealised gains above the \$3 million threshold, based on the change in total superannuation balances net of withdrawals and contributions, with earnings proportioned based on the threshold. This measure effectively negates the existing one-third capital gains tax discount provisions for assets held for more than 12 months, undermining the well-established principle that capital gains should be concessional tax. It also means that the effective tax rate on fund earnings is higher than the notional additional 15 per cent, not least due to the loss of the deferral benefit from taxing gains only on realisation. The government should give consideration to applying the new tax only on earnings as currently defined or discounting accrual-based earnings or the notional 15 per cent tax rate to maintain concessional treatment.

The proposed legislation defines earnings on the basis of member balances rather than the more conventional definition of earnings because the ATO does not collect information on realised taxable earnings on individual fund balances. The bill's concept of fund earnings is thus based on administrative convenience rather than the existing concept of earnings applied to balances below the threshold.

Given existing arrangements for valuing and reporting superannuation balances, the taxation of unrealised gains should not pose an undue additional compliance or reporting burden on funds. The additional tax liability from the proposed measure can be met by releasing funds from existing superannuation interests or from funds held outside of super.

If a taxpayer has an unrealised gain that reverses and they then exit the superannuation system, they will not have the opportunity to recover the tax they have already paid on the unrealised gain that never eventuated. Concerns have also been raised about the taxation of unrealised gains in funds holding unlisted, illiquid and hard to value assets that may not be generating sufficient cash flow to pay the tax. This may limit options to pay the liability out of superannuation balances or force a restructuring of fund holdings where the realised gains are different to the notional gains on which the additional tax is assessed. It would be appropriate for the government to extend the time available for consultation to ensure that the taxation of unrealised gains does not give rise to unintended consequences of this nature.

The BCA cautions that the taxation of unrealised gains in superannuation balances over \$3 million is not appropriate for other tax bases, including superannuation balances more generally. It would be particularly problematic to extend accruals taxation outside of superannuation to the taxation of capital gains, for example, which would entail significant compliance costs.

7. Defined benefit schemes

It is the government's intention that the proposed measure will apply commensurately to unfunded, partially funded and fully funded defined benefit schemes based on the value of the defined benefit interest. In the case of pre-pension interests, this would be based on the withdrawal benefit calculation. For defined benefits in the pension phase, the transfer balance cap value at the time the pension commenced is used. For lifetime defined benefit pensions, it is 16 times the annual payments available under the pension, the formula currently used for the TBC.

Achieving commensurate treatment is made difficult by the fact that defined benefit schemes do not have contributions or earnings and are taxed in the hands of the beneficiaries at full marginal rates subject to a capped tax offset,

recognising the fact that no tax is paid on contributions or earnings. The proposed approach to defined benefit schemes seems designed mainly to ensure that the defined benefit interests are counted towards the total balance threshold along with any accumulation-based interests.

8. Inadequate consultation and impact analysis

The consultation period of 15 days for the proposed measure is unreasonably short and unnecessarily so as the proposal is due to commence in more than two years. The original consultation paper was released on 31 March with a closing date of 17 April. BCA notes that the Best Practice Consultation Guidance Note issued by the Department of Prime Minister and Cabinet recommends a minimum consultation period of 30 days.² The Note also maintains that longer consultation periods may be necessary when they fall around holiday periods. The original consultation period straddled the 2023 Easter holidays, which effectively shortened the initial consultation period even further.

The Office of Impact Analysis in the Department of Prime Minister and Cabinet also notes that as this measure will likely have major impacts on affected individuals and superannuation funds, an Impact Analysis (IA) was required to be prepared but was not completed. Therefore, as per the Australian Government Guide to Policy Impact Analysis, the Office of Impact Analysis considers the measure is insufficient to meet the Government's Impact Analysis requirements.³

Inadequate consultation periods and impact analyses have been seen across a number of recent consultations, particularly those dealing with sensitive and complex proposals with high political salience. This is likely to produce sub-optimal policymaking, with increased risk of unintended consequences. The BCA continues to monitor Treasury's overall adherence to principles of best practice consultation.

The BCA recommends that additional time is taken to consult on the exposure draft and to conduct an impact analysis consistent with best practice.

9. Recommendations

Notwithstanding the narrow application of the proposed additional tax on superannuation balances in excess of \$3 million, the BCA remains concerned that the proposed measure increases complexity and distortions to the already markedly varied way different types of savings are taxed.

The proposed measure was announced in the context of a very prominent public debate about a much broader suite of potential additional revenue measures. Those making saving decisions today might reasonably apprehend that further additional taxes will be imposed on superannuation in the future, undermining confidence in superannuation as a saving vehicle. This trend is in effective opposition to the government's stated desired to underpin confidence in superannuation through its proposed legislated objective.

The BCA makes the following recommendations in relation to this measure:

- The BCA recommends that the proposed \$3 million threshold be indexed to avoid a growing tax burden over time that will require legislated adjustments in future. The threshold could be set as a multiple of the indexed transfer balance cap.
- The BCA recommends against the wider application of the taxation of unrealised gains to superannuation balances below the threshold or to the taxation of capital gains outside superannuation. Consideration should be given to discounting accrual-based earnings or the proposed new tax rate to maintain effective concessional treatment of capital gains.
- The government should explore options through a comprehensive review of the tax treatment of all saving income, which could include a uniform rate on all fund earnings at a lower rate, as suggested by the 2010 Henry Tax Review, in lieu of the measures proposed in this bill.

² Best Practice Consultation Guidance Note, Department of Prime Minister and Cabinet, March 2020.

<https://oiapmc.gov.au/sites/default/files/2021-09/best-practice-consult.pdf>

³ Office of Impact Analysis, 'Insufficient Impact Analysis – Reducing tax concessions on superannuation balances exceeding \$3 million,' Department of Prime Minister and Cabinet, 2 March 2023.

- The consultation period for the bill is just 15 days, which is unacceptably short for a complex piece of legislation with a 1 July 2025 start date. This is inconsistent with government's own best practice consultation guidelines. The BCA accordingly recommends an extension of time for this consultation to address some of the issues raised in this submission and to minimise unintended consequences that might require future legislative fixes.



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