SUBMISSION

1. Introduction

I am a 66-year-old retiree drawing a pension from my SMSF. I am the sole member of my SMSF and am the sole director of the SMSF's Trustee company.

2. Potential Breach of Constitution Clause 51 (xxxi)

Australian tax law has always regarded "tax" as an impost on an income whereby the ATO and the taxpayer share the income cash earnings (from employment, realised Capital Gains (CGs), dividends, distributions, interest etc): the ATO's share is determined in accordance with the applicable legislation and the taxpayer is entitled to the remainder.

The draft legislation, however, proposes a 15% tax that will also apply to unrealised CGs, from which, by definition, there are no cash earnings. In effect, the draft legislation proposes the appropriation of superannuation property by the ATO in the guise of a "tax".

Constitution Clause 51 (xxxi) confers parliament with the power to make laws with respect to "the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws". This includes parliament's power to make laws for the purpose of taxation. (According to Australian Government, Australian Law Reform Commission, "Property" includes "rights in superannuation")[1].

The proposed 15% tax on unrealised CGs represents the acquisition of superannuation property by appropriation that imposes an immediate financial loss to the superannuation member; this is patently "unjust" and thereby, in my view, breaches Constitution Clause 51 (xxxi). Furthermore, the draft legislation allows more of the same superannuation property (capital) to be appropriated by the ATO repeatedly over subsequent financial years without any CGs ever being realised. This further demonstrates the "unjust" nature of the proposed 15% tax on unrealised CGs.

3. Risks to The Commonwealth of Australia

Parliament cannot afford to take the risk of legislating a tax on unrealised CGs that may be subject to a successful High Court challenge with respect to Constitution Clause 51 (xxxi) - the upheaval to the superannuation system would be immense - as would be the financial costs to the Australian Government in compensation liabilities. The Government should be cognizant of the repercussions of the failed "Robodebt Scheme" whereby expedient means of calculating welfare recipient's earnings were found to be illegal.

4. Australian Super's Consultation Paper Submission, 17 April 2023

Australian Super's (AS) responses to Treasury's questions and additional comments Item 4 (refer Attachment 1) states that "large super funds already typically incorporate tax on an accruals basis. This includes capital gains tax liabilities". These liabilities, however, only become payable by AS to the ATO when CGs are realised. In contrast, the draft legislation requires the cash payment of Division 296 tax on unrealised CGs, either from the personal account of the superannuation member or by the superannuation member making a cash withdrawal from the superannuation account.

AS also states (response to Item 4) that “If there was a departure from the proposed approach to calculating earnings on balances above $3 million, then there would be a significant administrative and system change burden on superannuation funds. This would ultimately be borne by members”. In my view, superannuation members are entitled to know the actual earnings from their superannuation account for the payment of the proposed Division 296 tax imposed directly on the superannuation member as an individual, and it is the fiduciary duty of the trustee of the Superannuation Fund to provide this information. AS acknowledges that Superannuation Funds typically incorporate tax on an “accruals basis” – a forward looking measure. It follows that providing actual earnings information that is “backward looking” is well within their capability.

Instead, AS (response to Item 8) encourages the “Government to consider a mechanism that enables equitable outcomes for these scenarios” where a member is taxed on unrealised gains that are “not realised or derived by the member at the point the member exits the superannuation system in a future year”; and AS makes suggestions regarding “carry back of losses”. Clearly, AS recognises there are inherent problems with the draft legislation’s proposed methodology for calculating Division 296 superannuation earnings but is reluctant to voluntarily depart from the draft legislation’s “proposed approach to calculating earnings on balances above $3 million…”. Treasury must also consider its own fiduciary duty to taxpayers: the draft legislation proposes obligations on superannuation members to pay Division 296 tax on a personal basis but does not propose any obligations on Superannuation Funds to provide the required earnings information to superannuation members for the purpose of paying Division 296 tax. In my view, this is patently unjust.

5. Recommendations

(i) The application of a tax on unrealised CGs should be rejected for the following reasons:

a) **Legal Risks**
The proposed 15% tax on unrealised CGs represents the ATO acquisition of superannuation property by appropriation that imposes an immediate financial loss to the superannuation member; this is patently “unjust” and thereby, in my view, breaches Constitution Clause 51 (xxxi). The repercussions of a successful High Court challenge to this legislation would be immense;

b) **Diminished Taxation Revenue Long Term**
Appropriation of the same capital repeatedly over subsequent financial years without any CGs ever being realised will not only diminish the capital of the superannuation interest but, over the long term, will also lead to diminished tax revenue receipts as superannuation capital dwindles;

c) **Volatility of Tax Liabilities & Liquidity Unpredictability**
Calculated Division 296 tax, as proposed in the draft legislation, produces volatile year-to-year fluctuations in tax payable/ “negative superannuation earnings” (refer Attachment 2 for evidence of this) creating an unpredictable

environment for managing cash requirements. It also creates volatile year-to-year tax revenue receipts.

(ii) All superannuation funds, including APRA regulated Superannuation Funds be required to implement systems for determining the actual realised earnings of all superannuation members for the purpose of paying Division 296 taxes, recognising that more and more superannuation members are likely to be captured by the Division 296 tax net over time. The government should consider this a fiduciary duty of a Superannuation Fund's trustee to superannuation members.

(iii) The LSBT concept should be scrapped; the focus instead should be on applying an additional Division 296 tax to large, realised superannuation earnings. This will be readily understood and accepted by the community.

The government has stated its intention to also apply its proposed "better targeting" reforms to Defined Benefit Scheme pensions. The application of an additional tax to large superannuation earnings rather than large superannuation balances should make this task easier;

(iv) Account based Pension Accounts should not be taxed under any circumstances. The legislated Transfer Balance Cap (TBC) amount and minimum Pension Account withdrawal requirements provide adequate means for restraining the magnitude of a tax-free Pension Account balances. Furthermore, adoption of Recommendation (iii) would provide additional restraint to Accumulation Accounts balances prior to commencement of a tax-free Pension Account.

6. Proposal for Division 296 Tax Applied to Earnings above AAET

The proposal requires the determination of an Accumulation Account Earnings Threshold (AAET) for the application of an additional 15% Division 296 tax on realised Accumulation Account earnings.

Using the draft legislation's proposed LSBT of $3m as a guide and using AS's average return for the Balanced Option since inception of 9.28%[2] as a guide, AAET is 9.28% of $3m i.e., $278,400.00 for Accumulation Accounts where the superannuation member has not commenced a Pension Account.

Using the current TBC amount of $1.9m, and by extension, when the superannuation member has commenced a Pension Account utilising the full TBC amount, AAET is 9.28% of ($3m - $1.9m) i.e., $102,080.

The general formula for determining the AAET is therefore:

AAET = $102,080 + ($176,320 x (TBC - TBU)/TBC)

where:

TBU is the utilised amount when the full TBC has not been utilised. TBU = TBC when the full amount of the TBC has been utilised.

The above methodology provides governments with the flexibility to vary the AAET and the tax rate.

7. References

1. https://www.alrc.gov.au/publication/traditional-rights-and-freedoms-encroachments-by-commonwealth-laws-alrc-report-129/18-property-rights/definitions-of-property-3/

2. https://www.australiansuper.com/compare-us/our-performance