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18 October 2023

Director
Superannuation Tax Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam,

Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023

CPA Australia represents the diverse interests of more than 170,000 members, working in over 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

Our submission provides our views on the exposure drafts *Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023* (the "draft Bill", the "Exposure Draft") and the *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023* (the "draft Imposition Bill").

CPA Australia supports the principle that fairness and equity in government support of superannuation must be a main feature of an ideal retirement savings system. We agree that the amount of total government support should have limits that are reasonable, but that do not affect adequacy.

The government's plan to set a 15 per cent tax on notional earnings on balances over a $3 million threshold will have a significant impact on individuals with larger superannuation balances. The proposed measure, which will see unrealised capital gains subject to tax, has been proposed against the backdrop of another measure, which will see an objective legislated for superannuation. CPA Australia's submission on the Exposure Draft *Superannuation (Objective) Bill 2023* provides our views on the objective.

Some of the issues raised in our response to the February 2023 Consultation Paper have been addressed (e.g., stopping of the calculation in a year where a death benefit is paid). However, we note that a number of the issues remain – and new ones have been created.

We continue to press our recommendations made in that submission – a summary of these are included in the attachment. However, our major concern was that the objective of superannuation should be legislated prior to major policy change such as this one to ensure that the change is in accordance with community expectations regarding superannuation.

Moreover, as the Assistant Treasurer and Minister for Financial Services, the Hon. Stephen Jones MP stated in Parliament, the proposed threshold is set to recoup a target amount of taxation for budgetary purposes. To achieve its goal, the calculation method chosen is designed to be a simplistic proxy for a genuine earnings measure. We believe this trade-off of simplicity versus equity to be incompatible with the principle of retirement income adequacy and inconsistent with the proposed objective of superannuation. The threshold should be set to ensure that individuals have adequate retirement savings. We consider that the objectives of equity and adequacy should not be compromised by short-term revenue pressures.

We do not agree that the role of the word "sustainable", used in the proposed objective, has been intended to be used to justify improper use of superannuation funds for this purpose.

Our submission makes the following recommendations:

- Where funds are largely illiquid – such as those which hold illiquid assets and have little current need for liquidity, the option for the fund to pay release authorities in the form of a deferred tax liability should be available.

- The claim that members with more than $3 million in superannuation would be subject to "up to 30 per cent" earnings tax made in the draft Explanatory Materials (the "draft EM") is demonstrably misleading, and should be withdrawn and replaced to note that the 15 percent rate of tax applies to a proxy measure which is different to the ordinary 15 per cent tax on fund earnings.

- We recommend that where a member takes a lump sum benefit due to disability or terminal illness, that they are also not liable to pay the tax in the same way that death benefits are exempt. For members taking benefits in the form of an income stream, such as in the case of income protection insurance benefits, we recommend that the tax be not assessed for the duration of the benefit's payment term.

We have also suggested a simplified way to tax benefits on superannuation balances of more than the threshold, where benefit payments are proportionately subject to tax of an additional 15%.

Our specific comments on each of the components of this consultation follows in the attachment.

We acknowledge the valuable contribution to this submission by members of CPA Australia's Retirement Savings Centre of Excellence.

If you have any queries with respect to this submission, please do not hesitate to contact Richard Webb, Senior Manager, Financial Planning and Superannuation Policy on 03 9606 9607 or richard.webb@cpaaustralia.com.au.

Yours sincerely

Elinor Kasapidis
Head of Policy and Advocacy
Learning and Innovation
CPA Australia

Detailed responses

The draft Bill and the draft Imposition Bill propose to reduce the tax benefits for individuals who have more than $3 million in their superannuation accounts. Starting from the 2025-26 financial year, the tax rates on superannuation earnings will vary depending on the balance of the account. Earnings on balances below $3 million will be taxed at a maximum of 15 per cent, while earnings on balances above $3 million will be taxed at, what the draft EM explains as, "up to an overall 30 per cent on a percentage of earnings equal to the percentage of superannuation balances above $3 million".

Our detailed response reiterates our position on unaddressed issues identified in our submission to the Consultation Paper and number of additional issues arising from this Exposure Draft.

We note in this submission that the claim of a tax rate of up to 30 per cent made in paragraphs 1.1 and 1.9 of the draft EM is demonstrably misleading. We recommend it should be withdrawn and replaced to note that the proposed 15 percent rate of tax applies to a proxy measure which is different to the 15 per cent tax on fund earnings.

Unrealised capital gains and the claim of "30 per cent"

Paragraphs 1.1 and 1.9 of the draft EM claims that members of superannuation funds with a Total Superannuation Balance (TSB) of $3 million or more are being taxed at "up to 30 per cent" on a percentage of earnings. It is important to be aware that the method being used to calculate the tax liability uses a movement in account balances. For most members, this would include unrealised capital gains, which introduces incongruity into the tax system. Tax is generally assessed on realised capital gains with the capital gains tax discount available for individuals for assets held for more than 12 months. The proposed treatment of capital losses also stands to detrimentally and permanently impact investors who fail to recover investment losses, or who simply draw their superannuation down below $3 million.

In our submission on the Consultation Paper, we provided an example of how a superannuation investment can pay much more tax than a similar investment in an insurance or friendly society bond, even though both would be notionally taxed at 30 per cent:

> *[We] point to modelling of one scenario undertaken by CPA Australia which suggests that where an additional amount of $1 million (separate to that member's first $3 million held elsewhere) is invested in a superannuation fund for 10 years, the investment will, on average, pay 43 per cent less tax if invested in an insurance or friendly society bond, which also pays a notional 30 per cent in tax. The higher taxation amount paid by the superannuation investment is almost entirely due to the taxation of unrealised capital gains.*

We question why superannuation members are not rewarded for locking away their money until retirement (compared to at-call investments such as insurance or friendly society bonds), but instead are taxed more heavily than other investors.

We recommend that the claim of 30 per cent should be withdrawn and replaced to note that the 15 percent rate of tax applies to a proxy measure which is different to the 15 per cent tax on fund earnings.

Tax on benefits in the instances of death, disability and terminal illness

The draft Bill, under section 296-30, proposes that the tax will not be applicable in the event of a member passing away before the end of the year. We also note the exemptions for child recipients and structured settlement contributions outlined in sections 296-20 and 296-25. These exemptions reflect a pragmatic approach, which we welcome.

However, it is important to highlight that the tax will still apply to members who receive incapacity benefits due to illness or injury. We firmly believe that these instances should also be exempted. Furthermore, the absence of an exemption for terminal medical conditions raises concerns about the policy's historic alignment with

death benefits: The then Minister for Superannuation and Financial Services, the Hon. Nick Sherry MP, gave assurances in 2008 that such benefits would remain tax-free. This oversight breaks this promise.

We recommend that where a member takes a lump sum benefit due to disability or terminal illness, that they are also not liable to pay the tax. For members taking benefits in the form of an income stream, such as in the case of income protection insurance benefits, we recommend that the tax be not assessed for the duration of the benefit's payment period.

Treatment of defined benefits and income streams

The draft Bill brings in a pivotal provision (at section 307-230A) which allows for the determination of value for defined benefit or income stream interests, specifically for TSB calculations. We view this as a positive step forward and welcome its inclusion.

It is crucial to recognise that any alterations made to calculation of the TSB will have a ripple effect across various facets of superannuation policy, encompassing not only the new tax but also other areas, including contributions restrictions. While we appreciate this holistic approach, we want to emphasise our longstanding position on the necessity for a comprehensive review of the existing limits and thresholds within the superannuation system. This would ensure a more effective and balanced framework for all stakeholders involved.

Related to this, we note that under subdivision 296-E, interests in constitutionally protected funds, as well as funds for federal judges, have been excluded from taxation, even though they will contribute to the TSB. Although we recognise the many administrative hurdles to applying this consistently, we are not certain that the method used is consistent with the proposed objective of superannuation, specifically with the need for preservation of savings to be carried out in an *equitable* way.

Alternative taxation methods

The intention behind this measure is to apply a 15 per cent tax rate on earnings attributed to assets exceeding the initial $3 million threshold. It is worth noting that the chosen method includes the taxation of unrealised capital gains which we do not support, given its misalignment with current tax policy settings.

This prompts us to question whether there could have been more effective alternatives considered. One proposal we suggest is a simplified approach: rather than taxing pro rata gains within one's TSB, a more straightforward method might involve levying a 15 per cent tax on a pro rata portion of benefit payments when one's TSB surpasses $3 million. This tax could be applied to a proportionate amount of the taxed element of any taxable benefits received, whether in the form of lump sums or income streams.

Such a calculation method sidesteps the issue of taxing unrealised capital gains and would benefit from administrative simplicity.