



18 October 2023

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

By email to: [superannuation@treasury.gov.au](mailto:superannuation@treasury.gov.au)

Dear Sir/Madam,

**Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023**

On behalf of the Institute of Public Accountants (the **IPA**), I submit our comments on the proposed reforms to the superannuation system which are outlined in the *Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023* (the Bill) and the *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023*, announced in the 2023-24 Budget.

The IPA is one of the three professional accounting bodies in Australia, representing over 50,000 members and students in Australia and in over 100 countries. Approximately three-quarters of the IPA's members work in or are advisers to small business and small to medium enterprises.

As a representative voice for our members and the accounting and superannuation profession, we welcome the opportunity to provide feedback and make the following comments on the Proposed Reforms for Treasury's consideration.

**Overview**

The IPA welcomes sensible and measured reforms to put the superannuation system on a more sustainable and equitable footing for the benefit of Australian taxpayers. The superannuation system provides a concessional tax environment for the accumulation of retirement savings by Australian taxpayers. As such, it is appropriate that the concessions afforded by the superannuation system be appropriately targeted, to preserve the integrity of the superannuation system and equity in the treatment of taxpayers.

With that said, in IPA's view, the Proposed Reforms, if implemented as currently proposed, will lead to inequitable taxation outcomes and increase technical uncertainty and compliance costs for taxpayers affected by the Proposed Reforms.

Fundamentally the Government has not moved from its original intention and the deeply contentious elements remain intact namely:

- Inclusion of unrealized capital gains in the methodology of calculating "earnings" which will create many unintended consequences particularly for funds with illiquid assets that cannot be easily liquidated to meet new Division 296 tax. This can be disruptive to a small business operator (including farmers) who have their real property used in the business held by their SMSF. Selling illiquid assets is typically associated with substantial transaction costs, market timing considerations and other macroeconomic factors;
- Lack of symmetry as there are no refunds when "earnings" turn negative. Asset values can fluctuate widely. It is common to see a string of bull market years followed by a sharp bear market decline. This means there is a strong possibility a member can effectively be cumulatively taxed on investments that make an overall loss without any real recourse to recover any previous Division 296 tax paid;
- No indexation of the \$3M threshold;
- No optionality for achieving the policy intent for funds capable of calculating "earnings" on a member basis using established tax principles applied to actual earnings. This alternative option would avoid the complexities associated with having to exclude certain withdrawals and contributions transactions from the calculation of earnings and also avoid the carried forward of negative earnings.

A two-week consultation period clearly indicates that the Government has little appetite to alter its proposed course and consider alternate methodologies to achieve its policy objectives, so we are under no illusion that major changes are being considered, particularly around the measurement of earnings. The earlier original consultation period for the proposal back in April 2023 was also just two weeks. This is an inadequate time frame for proper consultation and could lead to poor policy outcomes and unnecessary complexity.

We acknowledge some adjustments in the draft legislation reflecting some of the consultation concerns raised in response to the original discussion paper earlier in the year. The exclusion of structured settlements, not taxing deceased members for Division 296 taxes in the year of death, not including LRBA in the total superannuation balance and lastly adjustments for net contributions and withdrawals to take account of specific events (inheriting super pensions, transfers under a contribution split or family law split, insurance payouts etc.) are welcomed improvements.



Most significantly, if the Proposed Reforms are implemented as currently proposed, taxpayers affected by the Proposed Reforms will be subject to tax on a basis that no other Australian taxpayer is presently: tax on unrealized income. We respectfully submit that this is an unfair and inequitable distortion of Australian tax law and jurisprudence. Moreover, it disproportionately affects a segment of the Australian tax paying population, who have not engaged in egregious or aggressive tax planning behavior, but rather have acted in compliance with historical superannuation contribution rules.

The IPA urges Treasury to reconsider this key element of the Proposed Reforms and settle on an alternative that reduces the inequitable outcomes and practical compliance challenges that will arise for taxpayers affected by the Proposed Reforms. This could be achieved by applying tax to realized earnings and capital gains which are attributable to superannuation balances above \$3 million, at appropriate timing points. Further, the IPA urges Treasury to consider implementing transitional rules that will allow taxpayers who may be affected by the Proposed Reforms to reorganize their affairs in an orderly fashion, by allowing for the transition of assets out of a superannuation environment without penalty. There is also inequity of those who have not yet satisfied a condition of release to have the ability to transition assets out of a superannuation environment on the same basis, and with the same tax treatment, as a person who has satisfied a condition of release, where the purpose of doing so is to transition assets from a superannuation environment to a non-superannuation environment, and bring their superannuation balance to a level at or below \$3 million.

The majority of impacted superannuates of the proposed reform use a SMSF structure. SMSF's are capable of applying a higher rate of tax on realized gains on a member basis. Most would appreciate that not all APRA regulated funds have this flexibility. Optionality could in part be used to deal with some of the unfairness of the proposed measure. Whilst optionality creates its own complexity, the inequitable nature of the proposed methodology warrants a dual mechanism for the majority of impacted superannuants. The Government has already this year put in place legislation that treats SMSF differently to APRA funds when it comes to Non-Arm's Length Income provisions, so there is already precedence for adopting different course of action to achieve a policy intent outcome.

Our comments made to the consultation 'Better targeted superannuation concessions' is reproduced in Appendix 1 and form part of this submission as they are still relevant.

If you would like to discuss our comments, please do not hesitate to contact me.

Yours sincerely



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## **APPENDIX 1: Comments made to the consultation 'Better targeted superannuation concessions'**

### *Taxation of unrealized capital gains and amounts*

It is a central precept of taxation that income must 'come home' to the taxpayer and, to that end, realization is essential to income derivation<sup>1</sup>. There are very few instances where an unrealized amount can be assessed to a taxpayer per se (e.g. trading stock) and limited circumstances where a taxpayer can be assessed on an amount where there is no

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<sup>1</sup> See: Parsons, R.W: *Income Taxation in Australia*, The Law Book Company Ltd, 1985 at 2.14

correlated realized financial benefit; where this does occur, it is in an anti-avoidance context e.g. the controlled foreign company (**CFC**) or personal services income (**PSI**) attribution provisions.

The IPA submits that the Proposed Reforms requiring taxpayers to account for tax on unrealized gains and amounts, calculated by the application of the proposed methodology, represents a very significant departure from accepted tax orthodoxy and principle. Moreover, it does so discriminately in respect of a select and limited segment of the taxpaying population, being those who have accumulated a superannuation balance exceeding \$3 million.

In the main, taxpayers who are in the position of having a superannuation balance in excess of \$3 million have not engaged in any egregious or aggressive tax planning, but rather by having acted in compliance with historical superannuation contribution provisions, enacted into law, following the reforms to the superannuation contribution rules introduced by the Howard/Costello government in 2006/2007. Moreover, superannuation balances have grown as a function of the strong performance of various asset classes (in particular, equities and real estate) in Australia over the last 20 years.

Taxing unrealized gains and amounts to taxpayers, correlated to the increase in the value of the assets held in their superannuation as proposed under the calculation approach set out by the Proposed Reforms, will cause practical difficulties for taxpayers.

To fund tax liabilities, Taxpayers may be required to call on their personal financial resources or to liquidate the assets of the superannuation fund in a disorderly fashion. Forced asset liquidations may distort economic decision-making, as affected taxpayers may be realizing assets without regard to market conditions or prevailing asset pricing.

In the case of superannuation funds that hold illiquid assets that cannot be fractionally realized (such as real estate), to fund tax liabilities, Taxpayers may need to arrange alternative funding or place reliance on third-party lenders, which may prove practically difficult where a taxpayers' assets are consolidated in a superannuation fund, given the inability to pledge superannuation fund assets as security for debt. These funding and cash-flow challenges will be amplified considerably for small-to-medium sized business owners, who very often hold real property that is used in the course of carrying out their business in a self-managed superannuation fund; in such a case, realizing real property assets used in carrying on a business will not be a feasible option and taking on expensive third-party debt will add a significant cash-flow burden and place pressure on operating margins in their business.

The IPA urges Treasury to reconsider the underlying premise of the Proposed Reforms in applying tax to unrealized gains and, as an alternative:

- To achieve equity of treatment as between taxpayers and remove the structural bias that will result for affected taxpayers if the Proposed Reforms are implemented as currently proposed, to revert to accepted and orthodox tax principles and tax taxpayers on realized gains and amounts.
- To achieve the desired policy aims of the Proposed Reforms, whereby the concessional tax environment offered by the superannuation system is not used to accumulate 'excessive' personal wealth in superannuation, Treasury may consider mandatory timing point for the realization of superannuation fund assets. This mandatory timing point may be based on a taxpayer's age (for example, by requiring an asset realization to bring the superannuation fund balance within a prescribed asset value threshold, or alternatively a stepped-up tax rate assessed on an unrealized basis, when the taxpayer has reached preservation age plus 10 years) or by tightening the requirements around the extraction of superannuation assets and imposing additional tax obligations when a taxpayer dies (similar to what occurs with CGT event K3 where assets pass to a tax-preferred beneficiary or to a non-resident beneficiary of a deceased estate)<sup>2</sup>. Having a mandatory timing point would have the benefit of allowing taxpayers affected by the Proposed Reforms to realize superannuation assets in an orderly fashion over a known time frame and pay tax on a realization basis rather than on unrealized gains and amounts.
- If the current approach to the taxation of unrealized gains and amounts is implemented as part of the Proposed Reforms, then there should be a deferral of the time at which any tax assessed on unrealized amounts is required to be paid. This deferral should be for a period that is reasonable and sufficient to allow an affected taxpayer to make arrangements to fund the tax liability and eligibility for the deferral should be capable of self-assessment (i.e. it should not be reliant on the Commissioner of Taxation exercising a discretion).

Moreover, the IPA respectfully submits that the proposed treatment of 'negative earnings' under the Proposed Reforms are problematic and will produce inequitable outcomes for taxpayers affected by the Proposed Reforms. Under the current proposal, 'negative earnings' (i.e. a depletion of the TSB brought about by investment losses or expenses) may only be applied to offset positive earnings, determined by the TSB methodology, on a carried-forward basis. This approach may produce inequitable outcomes in circumstances where an asset, in respect of which an unrealized gain has been recognized and taxed, goes into 'negative' value and either does not recover in value to the same level at which tax was assessed on an unrealized basis or if the member dies. In such a case, a taxpayer will have been assessed and paid tax on a capital gain that will never crystalize and, as the Proposed

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<sup>2</sup> Section 104-215 of the *Income Tax Assessment Act 1997*.



Reforms are presently drafted, it is not suggested that the taxpayer would be eligible for a refund of tax previously paid on an unrealized gain. The IPA urges Treasury to reconsider this particular element of the Proposed Reforms and ameliorate the potential inequity for affected taxpayers.

#### *Transition to the new regime*

The IPA respectfully submits that taxpayers who would be affected by the Proposed Reforms should be afforded the choice and opportunity to restructure their affairs in a way that would minimize the compliance burden and complexity that would arise if the Proposed Reforms are implemented as currently reformed. The IPA considers that this would be fair and reasonable, given that superannuation balances have been accumulated in compliance with historical contribution rules and taxpayers have acted in good faith and placed reliance on the stability and consistency of government policy in the reform of the superannuation rules.

The IPA respectfully submits that taxpayers who exercise a choice to restructure their affairs so as to not be subject to the added compliance and funding challenges that would arise if the Proposed Reforms were implemented should be able to do so without penalty. This is particularly the case for taxpayers who may choose to bring forward the timing of realization of superannuation assets, as part of transitioning assets out of superannuation and into alternative structures but have not yet satisfied a condition of release under the superannuation rules.

As such, the IPA urges Treasury to consider implementing temporary, transitional measures under which taxpayers who have not yet satisfied a condition or release to have the ability to transition assets out of a superannuation environment on the same basis, and with the same tax treatment, as a person who has satisfied a condition of release, where the purpose of doing so is to transition assets from a superannuation environment to a non-superannuation environment, and bring their superannuation balance to a level at or below \$3 million.

The IPA submits that Treasury should make its position on temporary, transitional relief publicly known and that it should be the subject of further consultation.

#### *Indexing the \$3 million threshold*

The IPA submits that to ensure fairness and equity in the superannuation system, the \$3 million threshold which has been demarcated as the 'bright line' for what comprises an 'excessive' superannuation balance should be subject to annual indexation and adjustment for inflation. This would be a sensible proposal and provide administrative efficiency, as



absent an automatic inflation adjustment, it would be necessary for the Parliament to legislate to change the \$3 million threshold.