FOI 3316
Document 1

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From: Hawkins, Adam
Sent: Friday, 3 March 2023 6:03 PM
To: s22
Cc: Brown, Diane; Philp, Brenton; Kelly, Lynn; s22 Di Marco, Katrina; Cai, Yi Yong; s22
Subject: Large balances: Q&A for QT and additional info [SEC=OFFICIAL]
Attachments: QTB - Large balances key questions.docx; AFR - Big super hoards face 22pc tax rate, not 30pc.pdf

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Hi s22

As discussed, attached is a QTB covering the key questions and answers for question time next week that was requested via Diane.

To support the point on liquidity requirements, there is information on the ATO's website for SMSFs that can be found here: [Your investment stra...~https://www.ato.gov.au/super/self-managed-super-funds/investing/your-investment-strategy/](https://www.ato.gov.au/super/self-managed-super-funds/investing/your-investment-strategy/)

TAD have also produced a range of cameos. We have included in the QTB the key cameos but below is the full set if you would prefer to draw from these.

As a heads up, for Monday next week, we are aiming to have with you: a worked example on franking credits, a primer on how defined benefit fund taxation works and a draft consultation paper (or maybe on Tuesday).

Finally, two other things we've discussed. I mentioned the John Kehoe article that explains the effective taxation point and franking credits – this is attached just for info. We also talked about progressive taxation in superannuation and there are a few points on that below (although, I note that this is a contested area – particularly on earnings – where economists argue for a lower rate of tax on long-term savings – can discuss).

Cameos

Cameo 1
A 20-year-old today who earns an average wage throughout their career (around $90,000 in 2023), is projected to have a superannuation balance that exceeds $3 million in their early 60s. That same individual is projected have wages that exceeds the top marginal tax bracket ($200,000) in their early 40s.
Cameo 2
A 35-year-old today with a superannuation balance of $75,000, who earns an average wage throughout their career (around $90,000 in 2023) is not projected to have a superannuation balance that exceeds $3 million before they retire.
Cameo 3
A 50-year-old today with a superannuation balance of $200,000, who earns an average wage throughout their career ($90,000 in 2023) is not projected to have a superannuation balance that exceeds $3 million before they retire.
Cameo 4
A 20-year-old today who earns half of the average wage throughout their career (around $45,000 in 2023), is not projected to have a superannuation balance that exceeded $3 million before they retire.
Cameo 5 / Grattan analysis
In 30 years, it projected that roughly only the top 10 per cent of earners will retire with superannuation balances of around $3m or more.

Caveats
The average wage is around 15 per cent higher than the median wage. This means someone earning an average wage is earning more than 50 per cent of the population.

Progressive taxation in superannuation

- Superannuation is deferred income to an individual. Therefore, it is appropriate that taxation settings reflects that it is working life income spread over their entire life. Higher-income people should be subject to a higher effective tax rate on superannuation than low-income people.

- However, high-income individuals have a greater capacity save, which means that they tend to contribute larger amounts to superannuation and have higher balances than do low-income individuals. Due to this, and being subject to higher marginal tax rates, the flat rate of tax on superannuation earnings is more concessional for them. Overall, superannuation helps high-income individuals to reduce their effective tax rate by significantly more than low-income individuals.

- There are existing elements on the superannuation system that are already progressive. The low income super tax offset (LISTO) provides an offset equal to the tax paid on concessional contributions for low income earners. A higher effective tax on superannuation is imposed through both Division 293 tax that increases the tax rate on contributions and the transfer balance cap that limits the amount that can be held in the earnings tax-free phase of superannuation.

Thanks,

Adam

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Large superannuation balances

KEY MESSAGE

- The Australian Government is committed to improving the equity and sustainability of the superannuation system, to ensure Australians can enjoy a dignified retirement.
- Superannuation savings currently enjoy generous tax concessions to help people save for their retirement. However, these concessions cost Australians $50 billion a year, with the cost projected to exceed that of the Age Pension by 2040.
- Under the Government's approach, there will still be tax concessions for all superannuation members, they just won't be as generous as before for people with balances over $3 million.

QUESTIONS

Will people be forced to sell their assets?

- Super funds – APRA regulated and self-managed alike – are required under existing superannuation laws to have an investment management strategy that considers liquidity of the fund's assets.
- This is so they can meet the costs of running a super fund. For example, accountancy and administration as well as taxation.
- Individuals will also have the choice to pay the tax themselves or use their superannuation.
- In 2019-20, the average taxable income for individuals with balances over $3 million was around $300,000. Of this, around one sixth is attributable to salaries or wages, with the remaining income derived from business income or returns on investments.

Will young people be caught if the threshold is not indexed?

- The $3 million threshold is very generous. It can provide far more than what is needed for a comfortable retirement.
- This aims to provide structural savings to the Budget over time.

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Date of Update	03 March 2023		

- It is open for future governments to reassess the settings, as is this case for many other thresholds in the tax system.
- A 35-year-old today with a superannuation balance of $75,000, who earns an average wage throughout their career (around $90,000 in 2023) is not projected to have a superannuation balance that exceeds $3 million before they retire.In 30 years, it projected that roughly only the top 10 per cent of earners will retire with superannuation balances of around $3 million or more.

Why are you taxing unrealised capital gains?

- The Government's approach strikes the right balance between improving the equity and sustainability of the superannuation system and minimising compliance cost.
- Alternative models would introduce significant complexity to the system.
- The cost of which shouldn't have to be borne by the average superannuation fund member.
- There will still be tax concessions for all superannuation members, they just won't be as generous as before for people with superannuation balances over $3 million.

Can people under preservation age exit?

- Saving through superannuation is concessional. The expectation of accessing these concessions is that these savings are preserved for retirement, consistent with the objective of superannuation.
- Individuals of all ages will continue to enjoy generous concessional tax treatment of their superannuation savings.
- In 2025-26, over 86 per cent of large balances above $3 million are expected to be held by individuals over the age of 60.
- Once reaching retirement, individuals will have the choice to remove assets from the superannuation system.

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Big super hoards face 22pc tax rate, not 30pc
By John Kehoe

Australian Financial Review (AFR)
Thursday 2nd March 2023
747 words
Page 7 | Section: Revenue shake-up News
390cm on the page

Big super hoards face 22pc tax rate, not 30pc

John Kehoe

Policy upshot

The effective tax rate paid by superannuants with more than $3 million in their accounts will be about 22 per cent due to franking credits and capital gains tax discounts – below the 30 per cent headline rate.

Unrealised gains, such as an increase in the market value of shares that have not been sold, will also be captured by the new tax. But high balance account holders are unlikely to benefit as much from refundable franking credits in the future as they do now.

Large superannuation balances will face a tiered tax system from July 2025, incorporating existing rules.

Under the current law, superannuation fund earnings in the accumulation phase face a headline tax rate of 15 per cent.

Earnings derived from balances over $1.7 million in the retirement pension phase also face a 15 per cent headline rate. (The $1.7 million balance transfer cap for pension accounts is scheduled to be indexed to about $2 million by 2025 when the super tax changes announced on Tuesday take effect.)

However, the current effective tax rate paid is typically lower than the 15 per cent headline rate, due to dividend imputation credits for company tax paid and capital gains tax discounts.

Therefore, large account balances will typically continue to pay an effective rate of about 8 per cent on earnings from a fund's first $2 million to $3 million of asset value (assuming the government continues to index the $1.7 million balance transfer cap for retirees). Above the $3 million threshold, the fund will face an additional new headline tax rate of 15 per cent on top of the existing tax.

Overall, the total rate paid will be about 22 per cent, according to Grattan Institute economic policy program director Brendan Coates.

"The additional tax rate is going to be about 13.5 per cent, allowing for a slight capital gains tax discount," he said. "Therefore, the effective tax rate on the fund is going to be something like 22 per cent."

A spokesman for federal Treasurer Jim Chalmers said 30 per cent was a headline rate and franking credits and CGT would operate just as now.

The government is expected to apportion the income from large super balances. For a $6 million self-managed super fund, 50 per cent of the annual earnings would face the new higher tax rate, and 50 per cent would face the lower existing rates.

Currently, super funds in pension phase for retirees pay zero tax on earnings for balances below $1.7 million, which is expected to continue under the new regime.

Brad Twentyman, director of superannuation at accounting firm Pitcher Partners, said he was advising SMSF clients to wait until the details became clearer before considering restructuring assets.

"I expect $1.7 million [in retirement] will be exempt, the next $1.3 million will be 15 per cent, and then over that will be 30 per cent," he said.

Miranda Stewart, a tax law specialist at the University of Melbourne, said earnings for balances over $3 million would be subject to a headline tax rate of 30 per cent and would remain eligible for the one-third CGT discount for super funds and franking credits.

"The effective tax rate will depend on the portfolio and to what extent it comprises capital gains or franked dividends," Professor Stewart said.

KPMG superannuation specialist Ross Stephens said the effective tax rates paid would depend on the asset allocation within a fund.

A fund with a heavy exposure to domestic equities would benefit from higher franking credits for tax paid by Australian companies.

A fund with more foreign assets would receive less franking credits and pay a higher tax rate.

Wilson Asset Management chairman Geoff Wilson said increasing the super tax rate to 30 per cent would effectively stop the refund of franking credits to people with balances over $3 million.

The new, higher rate aligns with the 30 per cent company rate paid by companies, meaning franking credits would offset corporate tax paid but would be unlikely to deliver a refund to high-balance super accounts.

Refunds for franking credits would mainly go to lower balance accounts.

"The people who will continue to get the benefit of franking are the mums and dads with smaller amounts in super," Mr Wilson said.

Treasurer Jim Chalmers talks national accounts yesterday. PHOTO: ALEX ELLINGHAUSEN

(SMSFs should) wait until the details became clearer before considering restructuring assets.

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Thanks, Adam – much appreciated. See you Monday, have a great weekend

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