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18 October 2023

Director
Superannuation Tax Unit
Retirement, Advice and Investment Division
Treasury
Langton Cres
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Dear Sir/Madam,

Submission: Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023

We attach our submission on the recent Exposure Draft released on 3 October 2023 by the Government.

We welcome the release of the draft legislation, which is a comprehensive set of amendments that seeks to reduce the tax concessions for individuals with a total superannuation balance (TSB) above $3 million by imposing an additional 15 per cent tax on certain earnings under a new Division 296 of the *Income Tax Assessment Act 1997*.

We acknowledge and support a sustainable superannuation system, that meets community needs and expectations, and reflects appropriately the Australian economy's capacity to support the system, whilst also fiscally sustainable for the Commonwealth Government from a budgetary cost perspective.

We are supportive of the Government's review process regarding reforms to the superannuation system, and welcome the opportunity to participate openly and transparently in the examination of the amendments.

The comments in our submission are made in good faith with the intention of considering whether the Bill as drafted is giving effect to our understanding of the policy objectives, does not give rise to unintended or undesirable consequences, and is drafted in the best manner to facilitate the administration of the law and compliance with the law.

We would be pleased to discuss any aspect of this submission further. Thank you for the opportunity to contribute to the consultation process.

Yours faithfully

DWatkins

Tax, Regulation & Reputation Leader
Deloitte Tax Services Pty Ltd

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Submission: Better Targeted Superannuation Concessions

A. Submission summary

We submit the following amendments would improve the design of the new tax, facilitate broader acceptance and align the design to good tax principles:

- Creating a condition of release to allow for withdrawal of amounts above a determined threshold
- Alternative methods for taxing individuals with over $3 million should be allowable as a replacement for the current tax on movements in Total Superannuation Balance (TSB) or on an opt-in basis.
    - Individuals in SMSFs be assessed on their actual taxable earnings
    - Individuals in APRA regulated funds be assessed on an estimate of earnings (or proxy earnings) provided by their fund Some APRA funds could provide (proxy) calculations on an 'as needed' basis, rather than implementing systems to calculate earnings for all members if this was determined, after further consultation with the APRA funds, to be more efficient for some funds
- Allow for indexation on the $3 million cap, in recognition that what a reasonable amount held in superannuation for the purposes of retirement will change over time.

B. Comments

1. Broad support for reforms to high superannuation balances on sustainability grounds

The proposed objective for superannuation, as currently drafted, is *'to preserve savings to deliver income for a dignified retirement, alongside Government support, in an equitable and sustainable way'*. While the current superannuation and retirement income system is sound and broadly sustainable, we recognise that it is appropriate from time to time to introduce reforms to improve sustainability, equity and retiree outcomes.

We recognise the issues as outlined in the 2021 Intergenerational Report, whereby overall superannuation tax concessions as a proportion of GDP were projected to increase from 2.0% in 2020-21 to 2.9% in 2060-61. The increase was primarily driven by an increase in investment earnings tax concessions from <u>1.0% to 1.9%,</u> while contribution tax concessions remaining largely unchanged at 1.0% of GDP[1].

We also note that the 2023 Intergenerational Report, which takes into account the Government's proposed Better Targeted Superannuation Concessions, projected that overall superannuation tax concessions as a proportion of GDP would increase from 1.9% in 2022-23 to 2.4% in 2062-63. A more modest increase in investment earnings tax concessions from <u>1.0% to 1.5%</u> contributed to the increase in overall superannuation tax concessions.

As the superannuation system continues to mature and superannuation balances grow (thereby reducing the reliance on the Age Pension), the cost of the Age Pension is now projected to decrease from 2.3% of GDP in 2022-23 to 2.0% of GDP in 2062-63. As a result, the total projected cost to the Federal budget of Australia's retirement income system is projected to remain relatively steady over the next 40 years at around 4.0-4.5% of GDP.

The Better Targeted Superannuation Concessions measure, <u>if modified in a balanced manner</u>, will play a role in maintaining a sustainable superannuation and retirement system. The measure will also complement previous reforms which limit the amount that can be contributed to superannuation and will discourage use of the superannuation system as a vehicle for minimising tax on wealth accumulation.

[1] Earnings concessions are a function of many factors including the growth of the superannuation system, forecast rates of return and tax settings.

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2. The measure does not appropriately balance the principles of simplicity against equity

Australia's Future Tax System (Henry Review) Final Report stated that "*Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community.*[2]" The objective reflects the long established tax and transfer system design principles; Equity; Efficiency; Simplicity, Sustainability and Policy Consistency. These principles are present in all tax systems that have high levels of voluntary participation.

We submit that too much emphasis has been placed on simplicity to the detriment of equity considerations in the Better Targeted Superannuation Concessions measure – one of these simplification measures was to use the change in Total Superannuation Balances as a proxy for taxable earnings.

This emphasis on Simplicity was a dominant design feature at the consultation paper stage:

- "As the majority of superannuation members are unaffected by this measure, the proposed approach seeks to avoid imposing significant and costly systems and reporting changes that would impact other members."
- "The systems and reporting changes that would support calculating taxable income for APRA-regulated funds at a member level present significant challenges. Utilising existing fund reporting requirements and applying the reforms at the individual level largely avoids these issues….."

However, we submit this simplification emphasis was not balanced with equity and fairness considerations. By using changes to the TSB, taxpayers are subject to a less accurate and usually higher reflection of the taxable income earned in the fund.

By focussing on the whole population of members, the significant and potentially highly detrimental impact on many that will be affected by the measure has been ignored. The pursuit of reducing tax concessions for a smaller cohort of those with exceptionally high superannuation balances should not colour or influence good tax design, particularly when there are other options available.

Arguably after consultation on the discussion paper, simplification has not been achieved in any case. To calculate liability for Division 296, the ATO will need to consider 6 types of withdrawals, 9 types of contributions and several categories of exemptions. Calculation of actual taxable earnings (or a reasonable proxy or estimate) may be a much simpler alternative.

3. It is reasonable to depart from sector neutrality, provided equitable outcomes are achieved

The emphasis on sector neutrality was also a dominant design feature at consultation paper stage:

- "Applying the new arrangements equally to accounts held in SMSFs and APRA-regulated funds ensures that it does not influence the choice of members to invest through an SMSF or APRA-regulated fund".

This was despite observations that most individuals impacted by this measure will be members of SMSFs.

The Government itself has already set a precedent in departure of sector neutrality, in respect of the legislation of the Non-Arm's Length Expenditure (NALE) changes. The legislation, currently before Parliament, exempts in full APRA regulated funds from the NALE provisions.

This departure from sector neutrality was done for simplicity and equity considerations. We submit the same argument would apply with respect to the Better Targeted Superannuation Concessions measures.

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[2] Australia's future tax system, Report to the Treasurer, December 2009 page vii at 2. https://treasury.gov.au/sites/default/files/2019-10/afts_final_report_part_1_consolidated.pdf

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4. Unrealised gains and losses: The measure as drafted does not fulfil the Government's own objective of taxing an additional 15 per cent of earnings and is inconsistent with good tax policy design

The principle of the measure was to "bring the headline tax rate to 30 per cent, up from 15 per cent, for earnings corresponding to the proportion of an individual's superannuation balance that is greater than $3 million".

We submit that the calculation of earnings in the draft legislation will result in a much different headline rate than 30% when it is considered that:

- Changes to the adjusted TSB effectively measures accounting profits, not taxable income
- Unrealised gains and losses are included in the calculation
- Negative earnings are carried forward and in some cases, will not be recouped.

The taxing of unrealised gains in the manner proposed is a concerning path for the Government to take. These measures will place a significant financial burden on many people, including many small business owners and primary producers with significant real property in their superannuation funds.

For good reason, there are limited examples in the Australian tax system where unrealised gains and losses are taxed. In many cases, the taxpayer will be given the option to elect in or out to being taxed on unrealised gains (or assets at market value). Some relevant examples of the provisions include:

- Division 230 ITAA 1997 Taxation of Financial Arrangements
- Section 70-45 ITAA 1997 Valuation options for trading stock at year end
- Section 104-160 ITAA 1997 Individual or company stops being an Australian resident (option for individuals to remain in the Australian tax net)
- Division 83A ITAA 1997 Employee Schemes (special rules may apply to reduce the amount included in taxable income or to defer the taxing point.)

5. Possible policy options to tax earnings

We submit the following amendments would improve the design of the new tax, facilitate broader acceptance and align the design to good tax principles:

To address equity concerns:

- Creating a condition of release to allow for withdrawal of amounts above a determined threshold. We submit there should be provision for taxpayers to self-correct, in order to bring themselves under the $3million threshold, particularly if they have not yet satisfied a condition of release (such as retirement).
- Alternative methods for taxing individuals with over $3 million should be allowable as a replacement for the current tax on movements in TSB or on an opt-in basis.

Different equitable outcomes could be proposed for different fund types:

- Individuals in SMSFs be assessed on their actual taxable earnings. This could be facilitated by providing an option to vary the assessment based on an application to the fund for taxable earnings
- Individuals in APRA regulated funds be assessed on an estimate of earnings (or proxy earnings) provided by their fund. This could be facilitated by providing an option to vary the assessment based on an application to the fund for the estimate of taxable earnings
- Some APRA funds could provide (proxy) calculations on an 'as need' basis, rather than implementing systems to calculate earnings for all members. One possibility is that the ATO notifies funds each year of individuals identified with TSB above the threshold who will be subject to Division 296 tax and it is only for these members that a (proxy) calculation of actual earnings be undertaken and provided back to the ATO if this was determined, after further consultation with the APRA funds, to be more efficient for some funds..

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6. Lack of automatic indexation and recognition of changing adequacy levels over time

The inclusion of "dignified" in the objective of superannuation indicates there is a certain standard of living in retirement to which the superannuation system should strive to deliver for Australians, alongside Government support. The draft legislation acknowledges that community expectations of a dignified retirement may change over time which should be reflected in policy-makers' assessment of this concept.

There are many examples where thresholds and caps within the superannuation system are indexed to reflect that measures of a dignified retirement must change, and that Government support will necessarily change with it. Some relevant examples of this are the concessional contributions cap and non-concessional contributions cap, both which allow individuals to steadily increase the amount they contribute into super. In addition, the Transfer Balance Cap (TBC), which limits the total amount an individual can transfer into the tax-free retirement phase over their lifetime, was set at $1.6 million when it was first introduced on 1 July 2017 and has since been indexed to $1.7 million on 1 July 2021 and $1.9 million on 1 July 2023.

When introduced, the Government expects that this new measure will apply to less than 80,000 individuals with superannuation accounts. However, the new tax will gradually apply to more and more individuals over time as superannuation balances grow.

Rather than relying on future Governments to increase the threshold from time to time, in order to improve the fairness and equity of the new tax, we would recommend that the TSB threshold be indexed. For example, it could be linked to the TBC as both caps effectively reduce the tax concessions available for investment earnings that relate to superannuation balances above a certain threshold.