17 April 2023

Director
Tax and Transfers Branch
Retirement, Advice, and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuation@treasury.gov.au

Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION – BETTER TARGETED SUPERANNUATION CONCESSIONS: CONSULTATION PAPER

The SMSF Association welcomes the opportunity to provide this submission in response to the Better Targeted Superannuation Concessions Consultation Paper. The Association's submission is set out in three parts.

PART 1 – Introductory letter and overview

PART 2 – Consultation Questions and Recommendations

PART 3 – Case Studies

This letter represents Part 1 of our submission.

Responses to the consultation questions are set out in the paper titled Part 2 – *Consultation Questions*.

In support of our submission, we have also included a range of case studies. These will illustrate the issues raised throughout this submission and have come from real client scenarios provided to us by our members. Please refer to the paper titled Part 3 – *Case Studies.*

It is intended that all three parts of this submission are read in conjunction with one other. This will be essential in understanding the issues identified and matters discussed.

Overview

The SMSF Association agrees the objective of superannuation should not be to provide tax concessions for individuals with excessively large superannuation balances. However, the superannuation system already contains a myriad of contribution caps and balance thresholds, some of which over time will address the issues that the proposed model also seeks to address. The SMSF Association has been a long-term advocate of the need to simplify the rules by reducing the number of superannuation caps and thresholds. The proposed model achieves the exact opposite and risks making a complex system even more complex.

Significantly large superannuation balances are a legacy issue and are a product of historical policy settings over successive Governments. The existing policy framework strictly limits amounts that can be contributed into superannuation. As a result, an individual's ability to accumulate significant wealth within superannuation is unlikely and could not be replicated in the future.

The transfer balance cap operates to strictly limit the amount of capital that can be used to commence a retirement income stream or pension. The associated tax concessions on retirement pensions are therefore tightly constrained.

With the introduction of *Fair and Sustainable* superannuation reforms, member benefits relating to a deceased member must be compulsorily paid out of the superannuation system. Over time, these large balances will be expelled from the superannuation system.

The proposed model actively promotes simplicity over equity. The Association cautions against setting what is a dangerous and concerning precedent. Positioning in this manner is counter to both vertical and horizontal equity taxation principles. When we consider the various distortions that arise and exceptions that will need to be addressed, the outcome is far from simple or equitable.

For example, to ensure the proposed calculation of earnings does not overstate the amount of earnings which will be subject to this new tax, numerous adjustments will need to be made to the definition of 'contributions' and 'withdrawals', and various amounts excluded from an individual's Total Super Balance (TSB) for the purposes of the proposed model.

The adjustments that have so far been identified include:

- Limited Recourse Borrowing Arrangements (LRBAs) – certain amounts included in a member's TSB will need to be excluded for the purposes of the proposed model
- Disability benefits – insurance proceeds will need to be excluded from the calculation of a member's TSB
- Death benefits – a deceased member's interest will need to be excluded
- Excess contribution withdrawals, Division 293 assessments, contribution splitting amounts, family law settlements, will need to be excluded from the definition of a 'withdrawal'
- Small business CGT concessions and applicable fund earnings associated with an overseas transfer, will need to be included in the definition of a 'contribution' for the purposes of the proposed model.

The above-mentioned calculation adjustments and exclusions are discussed in more detail in Part 2 of our submission.

The model proposed has been designed to benefit APRA funds. Some 60,000 of the approximate 80,000 members that will be impacted (or 75% of that population) are members of SMSFs. The lack of equity and unintended consequences arising from the proposal are driven by a desire to placate the large APRA funds. SMSF members who have balances in excess of $3m should not be penalised and required to pay tax on unrealised gains simply because some APRA regulated funds may find it difficult to report the taxable income attributed to fund members.

This is a clear case of the 'tail wagging the dog.' Given the significance of the impact on members of SMSFs, and the distortions already arising, any model must first be considered in an SMSF context.

Given the difficulties that some APRA regulated funds may face in reporting a member's actual taxable earnings, we note the consultation paper dismisses the option of calculating this new tax on actual earnings. However, it is important to note, with minor system and reporting changes, the SMSF sector, and we understand some APRA regulated funds, would be able to report a member's actual taxable earnings to the Commissioner of Taxation on an annual basis.

Part 2 of our submission puts forward an alternative way of calculating earnings which is based on the member's actual taxable earnings. If this information is not available, or the fund chooses not to report this information, a default notional earning rate would apply. In our view this is the simplest and most equitable way of introducing the proposed $3m threshold.

Importantly, our alternative approach would avoid tax being imposed on unrealised gains. The impact of taxing unrealised gains should not be underestimated. Under the proposed model, SMSFs with farming or business premises within the fund may encounter significant liquidity pressures. Changes in property values do not automatically correlate to increase in leasing income or rental yields. Market forces driving property prices differ to those driving yield. Broadly, yield is driven by the use, size, quality, and location of the property asset.

Where members of the fund are also the business operators, or operating other rural businesses, incomes are uneven and not consistent each year. Indeed, there are difficult years where no income is derived. This impacts their ability to pay wages and superannuation contributions for themselves. Reduced contributions, or the cessation of contributions, will therefore impact the fund's liquidity.

The rural sector has been challenged by a series of significant events over recent years including flooding, bushfires, mice plagues, and drought. It is not uncommon for lease payments to be deferred during extended periods of drought. This will negatively impact the cash flow to the fund.

Similar issues arise for small business owners. Typically, the family home and personal assets are at risk due to debt securities, director guarantees and trade or supply agreements. The level of wealth inside the fund at a point in time is not indicative of the individual's personal wealth or liquidity outside of the superannuation system.

We note the $3m threshold will not be indexed. However, rather than providing certainty to people when arranging their tax and financial affairs, we maintain not indexing the $3m threshold will achieve the opposite. Over time a greater proportion of the population will exceed the $3 million threshold leading to confusion and uncertainty about future retirement planning strategies and resulting in more people turning to other tax favoured structures which may be subject to lower levels of regulatory oversight.

The public consultation phase in response to the Objective of Superannuation consultation paper has only just recently closed. The proposal has not yet progressed to exposure draft.

The *Better Targeted Superannuation Concessions* consultation paper proposes a significant policy shift and proposes a fundamental change in taxation policy and concepts.

The proposed policy does not consider the broader retirement income system or the impacts on it. The Retirement Income Review examined the essential pillars and components of the retirement income system of which superannuation is only one part. Other essential components include home ownership and aged care.

Significant policy changes must be considered under a legislated Objective of Superannuation and consideration of the impacts within the broader retirement income system are paramount.

Limited Consultation

The extremely short and limited consultation period has not allowed sufficient time to properly consider the impacts and identify the unintended consequences arising from this model. Indeed, we have seen new concerns arise daily through engagement with our members, stakeholders, and other industry groups. The process has the appearance of a tick-a-box exercise that risks detrimental outcomes for many individuals affected by the proposal.

We urge Government to take a careful and considered approach to any policy reform. A rush to legislate could have lasting, negative impacts. The superannuation system is one that is already ladened with complexity and red tape. What is proposed will add to the mire.

If you have any questions about our submission, please do not hesitate to contact us. We welcome the opportunity to further consult on these proposed measures.

We thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.13 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.