

09 March 2023

SMSF INDUSTRY UPDATE

Q&A Response

We received an unprecedented number of questions from members during the SMSF Industry Update webinar held on 9 March 2023. Unfortunately, due to time constraints, it was not possible to answer these during the live session. We have taken all your questions and responded to them in this Q&A.

Unsurprisingly, the proposed introduction of the \$3 million cap, and in particular, the proposed methodology, has generated a lot of discussion and questions.

At present, the only information available for the proposed cap comes from the joint media release from the Treasurer and the Assistant Treasurer, and the Treasury factsheet attached to that release. Both are available [here](#).

Government has stated they will widely consult on the proposed measures. We look forward to working with Government and Treasury and participating in the formal consultation process when that commences.

Questions have been grouped under the following sections:

1. Objective of Superannuation
2. Proposed additional 15% tax on balances exceeding \$3 million
3. Indexation
4. ATO Statistics

This Q&A is current as at 15 March 2023.

Objective of Superannuation

Q1

Q SMSF Association needs to do more to resist the piecemeal approach to change by all Governments.

A The SMSF Association actively engages with Government, Treasury as well as regulators (ATO, ASIC, TPB) on an ongoing basis and through formal consultation processes.

We have long advocated for a legislative objective to superannuation. The intent of an objective of superannuation is to remove superannuation from the political cycle, to provide clear policy guide rails to ensure any changes to superannuation are not detrimental and align with the underlying policy intent of the superannuation system.

Q2

Q SIS already indicates the purpose of superannuation is to provide for the members retirement or dependants upon death. Presumably the apparent need for a purpose to be codified is more correctly that the existing purpose is to be changed?

A The sole purpose test in *Superannuation Industry (Supervision) Act 1993* section 62, sets out the purpose for which a fund is maintained. This plays an important compliance role and is historically connected to the provision of tax concessions. The concept of a sole purpose test pre-dates both the *Superannuation Industry (Supervision) Act 1993* and *Regulations 1994*, and the *Income Tax Assessment Act 1997*. The sole purpose test has an operative function in the law.

The objective is quite distinct from the sole purpose test. Its purpose and focus is on policy development, and while that may lead to new or amended laws, it will not directly impact the operation of the law.

The objective will need to be considered in future legislative and regulatory development in response to Government policies. The objective is intended to provide a reference point for Government in policy development. It will also assist stakeholders, such as the SMSF Association, when participating in Government consultations and providing feedback on whether what has been proposed is consistent with the objective. Similarly, there will be the opportunity for MPs and Senators to scrutinise Bills with the objective in mind as they pass through the Houses of Parliament.

Proposed additional 15% tax on balances exceeding \$3 million.

Q1

Q Do you think that the tax on super caps could drive investment patterns into different investment opportunities than they otherwise would? The reason is that a prudent investor may not accept a higher level of inherent risk where they are not penalised for exceeding the caps, but in the super cap tax universe they may take more risk to not only capture a higher upside, but a larger downside to carry forward. Has there been any discussion around this as 0.5% of the SMSF population affected holds about 40-50% of fund assets.

A Research has shown that consumer confidence is impacted any time there is regulatory change. Similar concerns were raised in 2016/2017 when the *Fair and Sustainable Superannuation* reforms were announced and implemented. Any impact the current proposals may have on investor behaviour would be speculative at this early stage.

This is an important consideration. Changes in investment behaviours may result in undesirable outcomes. Behavioural finance expert opinions and existing research on investor behaviours would need examination.

Q2

Q So Sums Insured may need further gross-up to account for the tax that could be payable, which means increased insurance premiums and potential affordability issues?

A At this stage, insurance benefits would be captured when we look at the operation of the total superannuation balance under the current law. This appears to be an unintended outcome. Were the model proposed to progress, consideration would be needed to exclude both the insurance benefits and withdrawals that relate to the payment of benefits from insurance proceeds.

An increase in insurance benefits would result in an increased assessment where the persons TSB exceeds \$3 million.

Q3 and Q4

Q How will defined benefit funds be impacted?

Q It will be interesting to see if this proposal becomes law, will apply also to Politicians and public servant defined benefit super schemes.

A Defined benefit funds present a challenge for Treasury and Government in coming up with a workable, equitable solution. Complexity already exists with the transfer balance cap rules and how defined benefit interests are valued and taxed.

It will be challenging for those individuals who have a defined benefit fund interest and an interest in a defined contribution fund such as an SMSF, retail or industry fund. Particularly given the arbitrary valuation method that applies to defined benefit funds.

Q5

Q Can you please explain how those with defined benefit funds will impact SMSFs?

A small number of old SMSFs provide defined benefit pensions. These are legacy arrangements and will be small in number. However, the impact to those individuals should not be overlooked by Government when considering options to address defined benefit funds under this proposal.

There will be clients who are members of an SMSF who also have a defined benefit fund interest in another fund. The defined benefit interest will likely be a legacy employer fund, including Government employees.

A defined benefits fund interest will impact a person's TSB calculation. Defined benefit funds are included in the TSB calculation under existing legislation. The value is determined by a prescribed formula. This is arbitrary in nature and may result in a higher TSB calculation for the individual.

Given the nature of defined benefit funds, any tax assessed will be payable by the individual or they can nominate the assessment is paid from their SMSF.

Q6

Q Liquidity for funds with large single assets can also be a huge issue. Is this something SMSFA will discuss in consultation? Any way that this can be managed, as it will push a bill out to members who may not be able to afford a bill (assuming major assets are in super and illiquid). Large commercial properties, or portfolio of residential properties

A The taxation of unrealised gains, and the likelihood of the double taxation of capital gains, is something that the SMSF Association will be raising during the consultation phase. What we know so far is that the assessment would be levied in a similar manner to the existing Division 293 assessments for high income earners. The assessment results in a personal tax liability, however the individual can elect for the assessment to be paid by their nominated superannuation fund or funds. The fact sheet has indicated that an assessment could be split and paid from more than one superannuation interest.

Q7 and Q8

Q How can what has been proposed be practically administered?

Q How can the ATO track the components of the calculation, such as pension or lump sum benefit payments?

A The SMSF Association understands why the Government wants to use a member's total superannuation balance to assess whether they exceed the \$3m threshold and to calculate 'earnings' for the purposes of this new tax. We agree it's the simplest approach. But simple is not always the best or fairest approach. The SMSF Association is concerned that the proposed approach could potentially replicate the administrative issues and costs that arose under the former *superannuation surcharge*. This was abolished in 2007 and cost more to administer than the revenue collected.

The model proposed utilises a person's total superannuation balance and would rely on the Australian Taxation Office to calculate, prepare, and issue the assessments. The information required is already collected and reported by SMSFs to the Australian Taxation Office. SMSF annual returns report for each member not only their balance, but also separately report contributions, as well as pension and lump sum payments made. Changes to reporting requirements would likely be needed by the large APRA funds.

We would expect that existing processes would be utilised, such as SuperStream where a superannuation fund is nominated to make payment.

Q9

Q Will they refund the "overpaid" tax when the value of a fund (and therefore the member's interest) significantly decline?

A The proposed method allows for losses calculated on amounts over \$3 million to be carried forward and applied to reduce future year earnings on amounts over \$3 million.

What is unclear is what happens when a person's total superannuation balance falls below \$3 million. The formula seemingly does not apply, and it is unclear whether any losses generated in prior years continue to carry forward in the event the person's TSB again exceeds \$3 million.

The proposal does not allow for a reconciliation or refund of tax paid.

Q10

Q Should unrealised gains/losses be excluded from the balance calculations?

A We don't support the inclusion of unrealised gains in the calculation of taxable earnings. The proposed formula and methodology can lead to unintended and disproportionate outcomes.

Q11

Q There is an argument that the new tax proposal is retrospective. This is because the proportion of earnings that is taxable at 15% varies depending upon the member's TSB. The TSB is mostly a function of monies that have accumulated over many years and decades! This may even be unconstitutional which would render the proposed tax invalid. Hopefully the SMSF Association will examine this more fully.

A We have been actively working through the proposal and a range of different scenarios to examine the potential impacts and outcomes. Members have also been sending through live case studies illustrating the impacts to their clients.

The SMSF Association has already had robust discussions with the Board and Public Policy Committee. A specialist working group will also examine the practical issues more deeply to ensure as many issues as possible are properly examined and documented.

This process will continue throughout the consultation process. Although formal consultation processes have not yet commenced, we are already speaking with Government and Treasury on many of the issues and concerns arising from this proposal.

Q12

Q Is the TSB net of tax provision?

A In short, yes. How a person's TSB is calculated is set out in ITAA97 s 307-230.

The value of a superannuation interest at a particular time will be the realisable value of an interest at that time unless the regulations specify a method to be used (ITAA97 s 307-205(1) and (2)).

The fact that the legislation refers to a realised value allows for adjustments for the provision of deferred income tax liabilities. Also, rather than a direct market value of assets, TSB contemplates the amount of superannuation benefits that would become payable if an individual voluntarily caused their interests to cease at a certain time, comparable to winding up the fund. For example, the liquidated value of an asset may be different to the market value of a property by a substantial amount.

Q13

Q If "taxes are taxable" is this constitutionally permissible?

A The Policy and Technical Team at the SMSF Association are not Constitutional Law experts, so we are unable to provide a specific answer to your question. However, issues such as this appear to be unintended consequences that will need to be identified, flagged, considered, and addressed.

Q14

Q Not clear why the SMSF Association supported the abandonment of a hard cap? Needs to be explained why this was deemed an appropriate trade-off to justify the endorsement of a tax on unrealised gains. How is this any more complicated than the existing arrangements to deal with 0%/15% tax on superannuation earnings? Why not 0%/15%/30%. I note that in June 2017 members in multiple funds needed to notify their trustees which seemed to work fine. Or the Div 293 arrangements?

A The SMSF Association does not support the introduction of a cap. Large balances are a legacy issue, and the system is already a complex one with multiple caps. Further, the appropriate levers are already present in the superannuation system.

Contribution caps and the operation of the total superannuation balance for non-concessional contributions limit (or prohibit) the amounts a person can contribute into superannuation. The transfer balance cap already restricts the tax concessions available in retirement and compels death benefits to be paid out of the superannuation system as soon as practicable.

Q14 continued

Our broader policy position is for the removal of red tape and complexity from the system.

The SMSF Association did not support a model where the only option was a hard cap. A hard cap would have required members to withdraw excess balances from the superannuation system within a prescribed time frame. This approach could have adverse outcomes for those directly impacted as well as remaining fund members (ongoing costs and returns). It could also negatively impact financial markets and asset valuations, trigger capital gains tax and funds could incur significant transaction costs and have other detrimental outcomes for impacted members.

For these reasons, the concept of a soft cap was preferred over a hard cap. However, we did not advocate for the current model proposed and do not support the taxation of unrealised gains or other amounts that do not relate to taxable income as they are included in the calculation of a person's total superannuation balance.

Our policy position across a range of issues has consistently focused on ensuring member choice is retained.

Q15

Q If Dave has a partner in the fund less than \$3mil and Dave passed away during the FY2026, will the carried forward loss be able to be passed to the partner if the partner is the sole beneficiary of Dave's super benefits?

A We don't have sufficient detail just yet to understand how death benefits in general would be treated. A range of issues, questions and complexities are emerging around deceased member interests, insurances, and death benefit payments. Some scenarios could result in distorted outcomes unless adjustments or concessions are included.

If we look at existing taxation measures, losses are attributed to a specific taxpayer and not attributable to another. Here the tax liability is the individual's personal tax liability. We would not expect losses would be transferrable as this would be inconsistent with other taxation measures. However, as noted above, the broader treatment of deceased member interests and death benefits warrants closer examination.

Indexation

Q1

Q Has there been any news on 2024 concessional contribution cap?

A No indexation of the concessional contribution cap has been triggered for the 2023/24 financial year. The method of indexation for concessional contributions differs to the transfer balance cap and uses 'average weekly ordinary times earnings' rather than the CPI index (ITAA97 s 960-285(7)).

The indexation of the transfer balance cap from 1 July 2023 to \$1.9 million will however change the bring forward thresholds for non-concessional contributions.

ATO Statistics

Q2

Q Do we know what proportion of women are in SMSFs with their life partner vs women that are sole Member/Directors?

A Unfortunately the ATO published data does not provide that level of granular data.

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