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.

SMSF Association

Submission – Part 2

Better Targeted Superannuation Concessions

Consultation Questions & Recommendations

17 April 2023

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.

Our Beliefs

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

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Important Note

The SMSF Association's submission in response to the *Better Targeted Superannuation Concessions* consultation paper[1] is set out in three parts:

PART 1 – Introductory letter and overview

PART 2 – Consultation Questions and Recommendations

PART 3 – Case Studies

This paper is Part 2 of this submission.

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.

Abbreviations

Abbreviation	Meaning
CC	Concessional Contributions
CGT	Capital gains tax
ITAA97	Income Tax Assessment Act 1997
LRBA	Limited Recourse Borrowing
NCC	Non-concessional contribution
TAA	Taxation Administration Act 1953
TBA	Transfer Balance Account
TBC	Transfer Balance Cap
TPD	Total and Permanent Disability
TSB	Total Superannuation Balance
SISA	Superannuation Industry (Supervision) Act 1993
SISR	Superannuation Industry (Supervision) Regulations 1994
SBCGT	Small business capital gains tax

[1] 'Better targeted superannuation concessions' (Consultation Paper, The Treasury, 31 March 2023) <https://treasury.gov.au/consultation/c2023-373973>.

Consultation Questions

Calculated Earnings

CQ-1: Modifications to TSB Calculation

1. Do you consider any further modifications are required to the TSB calculation for the purposes of estimating earnings? If so, what modifications should be applied?

The SMSF Association does not support the proposed model or the use of the movements in a member's TSB as a basis for calculating taxable income.

To ensure the proposed calculation of earnings does not overstate the amount of earnings which will be subject to this new tax, various amounts will need to be excluded from an individual's TSB for the purposes of the proposed model. These exclusions are set out below.

A. TSB is not an appropriate measure to use to calculate 'earnings'

We don't support the methodology proposed. The use of an individual's TSB for the calculation of tax liabilities captures items that are not otherwise taxable. It also will capture taxpayers whose actual member account balances sit below the proposed threshold but are captured through the operation of current TSB rules.

A summary of the issues so far identified is provided below:

1. ***Arbitrary measure****:* A person's TSB is merely a point in time measure and is arbitrary. Any changes in valuation of fund assets that occur at the end of a financial year may significantly impact a person's tax liability under the proposed measures.

   For example, where the share market experiences a short-term bump, such as that which might be experienced at the end of a financial year.

2. ***Captures unrealised gains****:* Capital gains tax are levied on realised gains on the sale or disposal of capital assets. Unrealised gains are not taxable income of the fund. They are paper gains and based on a point in time valuation. For some assets their value will be arbitrary as their true values cannot be accurately determined until such a time as a willing buyer and a willing seller enter a binding contract.

3. ***Taxation of tax refunds****:* Refunds of income tax or goods and services taxes (GST) are not subject to taxation. Tax refunds represent a return of overpaid tax, rather than income earned by the taxpayer. As such, they are excluded from the calculation of assessable income. They are however included in the calculation of a member's interest in a superannuation fund. Taxes will therefore be inherently included in the model proposed and calculation of earnings.

4. ***Non-taxable accounting adjustments and book entries****:* Non-taxable accounting adjustments or provisions made in the superannuation fund accounts will directly impact the value of a member's interest in the fund. This can include a range of transactions. To illustrate, some examples are included below:

   a) ***Provisions - future fund liabilities***. Where a future cost to the fund is material, it is appropriate for the fund trustees to account for the liability in the accounts of the

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fund. This ensures that the fund has appropriately accounted for its liabilities and more accurately representing the value of the underlying member account balances.

Once actual costs incurred have been reconciled, any amounts remaining are added back. The addback of a provision for a liability will have the effect of increasing the value of member's interests in the fund. An example would be a provision for realisation costs on the sale of an asset. For certain assets, the cost of realisation can be high.

b) ***Provisions - deferred tax liabilities***. APRA funds and many SMSFs make provisions in the fund accounts for future capital gains tax liabilities that would arise if the assets were sold today. This ensures that the member's interests represent as close as is reasonably practicable, the actual realisable value of the members interest in the fund.

Addbacks of deferred tax liabilities will occur at different times. Examples include adjustment on sale of the asset or when a member commences a retirement phase pension under the transfer balance cap.

When commencing a pension, the deferred tax liabilities that relate to the assets supporting the pension interest are added back. This adjustment is necessary as the earnings on those assets are now tax free. The addback of deferred tax liabilities can be material, particularly for funds who have experienced long term capital growth on fund assets.

As this adjustment is made at retirement, large unrealised gains accrued over time are not uncommon.

The inclusion of the addbacks of deferred tax liabilities would have the effect of taxing an accounting book entry that was a provision for potential future taxation on realisation of the asset. The result is a tax being applied on prudent trustee accounting policies.

c) *Refer to Part 3 - Case Study 2*

Recommendation 1: Policies on the taxation of superannuation should align with the well-established taxation principles and assessable income concepts. Movement in a person's TSB' does not align with these principles as it is not a true, fair, or equitable measure of taxable income.

An alternative model based on actual taxable income, attributable to the member's interest in the fund, should be considered.

Recommendation 2: The proposed model is not simple, lacks equity and will trigger a range of unjust outcomes. Given the very limited consultation period, it is concerning to see the number of issues that have already been identified. It is likely many more will surface with the benefit of adequate time to consider and assess. Unintended outcomes are damaging and should be avoided as a priority.

Another formal consultation process should be undertaken prior to the development of exposure draft legislation.

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Recommendation 3: The proposed model will add significant complexity and red tape to the superannuation system. Superannuation is already heavily ladened with complexities, including multiple caps and thresholds.

Any changes to superannuation should not add further complexity or red tape. Reforms should instead seek to alleviate regulatory burden, and the associated costs added across the sector for all stakeholders.

B. Access to Client Superannuation Reports

Financial advisers, SMSF accountants and administrators are already experiencing significant issues servicing and advising their clients as they are unable to access essential client information and reports from the Commissioner of Taxation. This includes a client's TSB, transfer balance account, transfer balance cap, contribution history, and cap records.

Currently access is limited to the registered tax agent for the individual. Yet they may not have responsibility for the management or administration of a client's SMSF, nor be licensed to advise the client on superannuation matters.

Clients may be able to access this information via their MyGov account. However, not all clients have access to this service, want to sign up to this service or have the capability to do.

The need for access to timely and accurate data is fundamental to the advice and services provided to clients by financial advisers and SMSF accountants and administrators. This is an issue that was identified with the 2017 Fair and Sustainable superannuation reforms. This issue has not yet been resolved and costs for getting it wrong can be very high.

Issues for these professionals and their clients will be compounded under the proposed model.

Access to this crucial data is vital in ensuring that members comply with their transfer balance cap, monitor, and update the transfer balance account, track contributions and confirm a client's TSB which is an essential element of a number of superannuation measures as well as this proposal.

This highlights the need for Government to ensure that access to this data is not restricted and can be accessed by all authorised advisers in a secure and efficient way.

Recommendation 4: Authorised financial advisers, SMSF accountants and administrators must be granted access essential client superannuation reports and information.

Access to essential Australian Taxation Office superannuation reports must be prioritised and completed before this proposal progresses.

C. Limited Recourse Borrowings

Under the current TSB rules, Limited Recourse Borrowing Arrangements (LRBAs) can create distorted outcomes for some individuals. *Income Tax Assessment Act 1997* (Cth) sections 307-230(1)(d) and 307-231 require the value of a LRBA amount to be added back to an individual's TSB in certain

situations. These are intended as integrity measures which are addressed by the non-arm's length income[2] and expenditure provisions.

A borrowing of itself does not increase the value of the SMSF. If the SMSF has $100 in cash and borrows $200 to purchase an asset worth $300, the fund is still only worth $100. This is illustrated below:

Balance Sheet	*Pre-acquisition*	*Post acquisition*
Cash	$100	$ -
Investment	$ -	$300
Total Assets	$100	$300
Liabilities - Loan	$ -	$200
Equity	**$100**	**$100**

The foundational premise of a balance sheet is that equity represents the value of net assets after liabilities. In a superannuation context, equity represents members accounts.

Using the above illustration, the outcome under ITAA97 s 307-230(1)(d) for some members, will be a TSB of $300. This could include members aged less than their preservation age who suffer a total and permanent disability event.

Recommendation 5: Amounts included in a member's TSB under *Income Tax Assessment Act 1997* (Cth) subsection 307-230(1)(d) and section 307-231 should be wholly excluded from this proposal.

Refer to Part 3 - Case Study 4

D. Disability benefits

The existing TSB rules are modified to exclude 'structured settlement contributions' defined as amounts received as compensation or damages for personal injury.[3] Often individuals in receipt of these benefits are well below their preservation age. They are reliant upon their superannuation benefits to fund their ongoing living expenses, medical costs, and ongoing care. Consideration must be given to the original policy intent surrounding these measures.

To meet the individual's long-term needs, funds are invested to ensure their needs can continue to be met over their lifetime. This will include growth and income driven investments.

Insurance proceeds may be received, either alone or in addition to structured settlement payments. It is acknowledged the proposal will seek to exclude the receipt of insurance proceeds from being captured as income in the year of receipt by classing as contributions.

However, the outcome for the member may be a TSB in excess of $3 million, once insurance proceeds are taken into account.

Where a person's TSB exceeds $3 million, any benefits paid to the disabled member will be included as withdrawals and added back to the earnings calculation, regardless of source. This is outside the original policy intent. It is essential that the benefits are wholly and expressly excluded from this tax

[2] *Income Tax Assessment Act 1997* (Cth), s 295-550.
[3] Ibid, ss 307-230(2).

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regime. This must equally apply to structured settlement benefits and TPD proceeds. Noting the alignment on the definition of permanent incapacity under the condition of release definitions.

It should also be noted that a person who is below preservation age will be required to pay tax on the taxable component of any pension benefits paid. Noting, a 15% tax offset will apply.[4] An adjustment to the tax-free portion of a benefit payment only applies to lump sums.[5]

Disparities already arise with the treatment of these types of benefits paid by the superannuation fund:

- Structured settlement contributions are added as a tax-free benefit in the member's account.[6]
- Insurance benefits paid for a member in accumulation phase are added as a taxable benefit in the member's account.

The result of the above are very different taxing outcomes for an individual aged less than 60 years. The structured settlement benefits most and will have a substantially higher tax-free element.

When we examine the transfer balance cap, disparities arise once more:

- Structured settlement contributions create a debit in the member's transfer balance account.[7] This has the effect of creating a greater amount available to commence a pension under the transfer balance cap.
- No such adjustment is made for TPD insurance proceeds.

Recommendation 6: Unrealised gains, earnings, and withdrawals from structured settlement contribution interests, and total and permanent disability insurance proceeds should be wholly excluded from this proposal.

Recommendation 7: The treatment of total and permanent disability insurance proceeds must be equalised and brought inline with the treatment of structured settlement contributions for taxation purposes, total superannuation balance treatment.

Refer to Part 3 - Case Studies: 4, 5a and 5b.

E. Exclusion of Deceased Persons Benefits

Income Tax Assessment Act 1997 (Cth) s 307-230 does not exclude a deceased person from having a TSB. Prior to this policy proposal, a person's TSB in death has had limited application and, in most instances, ceases to be relevant (e.g., assessing amounts that can be contributed under the contribution caps).

The timing and nature of death benefit payments will have profoundly different outcomes. In some circumstances, the benefits could be paid out directly to beneficiaries by the superannuation fund

[4] Ibid, ss 301-40(2).
[5] Ibid, s 307-145.
[6] Ibid, ss 292-90(2)(b).
[7] Ibid, ss 294-80(1) item 2.

trustee before an assessment is raised. As the tax is a personal liability, it will be payable by the estate, even though it is not in receipt of the superannuation benefits.

The superannuation beneficiaries may not be the same parties as the beneficiaries of the deceased persons estate, resulting in a reduction in their legal entitlements.

Separate provisions may be made for a variety of reasons, including blended families.

On the death of a member a superannuation fund trustee is required to cash the members benefits as soon as practicable.[8] Benefits can be paid as lump sums or, in limited circumstances, as a pension. A pension is payable to a restricted class of beneficiary, and generally limited to a spouse, a minor child or a disabled child of any age.[9] Further, the amount that can be paid as a pension is limited by the operation of the transfer balance cap rules and the individual transfer balance cap of the beneficiary.

Tax will arise through the operation of the CGT provisions on the sale or deemed disposal of fund assets to fund lump sum death benefit payments to beneficiaries.

Taxable benefits paid to non-tax dependants, including adult children will also be subject to taxation. Any future earnings on the benefits received will be at the individual's marginal tax rates.

Recommendation 8: A deceased member's interest should be excluded from this proposal.

F. Impacts on beneficiaries of a deceased member are magnified.

A beneficiary of a reversionary pension is automatically entitled to the pension upon the death of the original pension member. The transfer balance cap rules recognise this, and allow the beneficiary 12 months from the date of the death of the pension member to restructure their superannuation interests to comply with the transfer balance cap.

Similar consideration should be given to the application of these measure.

- The reversionary pension value should be treated as a contribution for the purposes of this proposal.
- The reversionary pension should be excluded from the member's TSB for first 12 months.
- Lump sum withdrawals made to comply with the transfer balance cap should be excluded.

Recommendation 9: Exclude the value of a reversionary pension interest from the beneficiaries TSB for the same period as the TBC modified rules.

Any lump sums withdrawn required to comply with the transfer balance cap within the 12-month period, should not be treated as a withdrawal for the purposes of this proposal.

G. Mutual exclusivity of property values and leasing income

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.

[8] *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 6.21(1).

[9] Ibid, reg 6.21(2A).

An example of this is farming properties. Under the proposed model, SMSFs with farming or business premises within the fund may result in liquidity pressures for a fund. This is due to the inclusion of unrealised gains in the calculation of earnings.

SMSF trustees consider and address the fund's liquidity needs when formulating the fund's investment strategy. This will be based on the fund's future liabilities including pension payments, ongoing expenses, and taxes.

Leasing income may be fixed for a period under the terms of the lease. However, it is market forces that are the main driver for leasing income. The increase in land value does not change its use or the value of that right to use.

It should be noted that not all farm leasing arrangement involve related parties. With many farm children choosing to leave the land, many farmers will seek to lease their property to an unrelated operator. The farm has been a long-term part of their retirement strategy and will ultimately be sold as part of their long-term retirement strategy or on death of one or both members.

A farming property's land value may substantially increase in value in a year for a wide variety of reasons. Some examples are listed below:

A. Increased buying activity in a region by large corporate operators.
B. Consolidation in some markets, where operators seek scale. This activity can also result in an increase in property value when in drought.
C. Treatments to the land by the farm operator, such as soil enrichment for crop or pasture.
D. Improvements to or addition of essential water assets, such as upgrades to irrigation, dams, and tanks.
E. New fencing.
F. Land remediation and planting and growth of protection zones to address salinity, wind, soil, and water erosion.

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.

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 trustees plan to meet the fund's cash flow and liquidity needs is intrinsically linked to the inflow of income and contributions. While provisions can be made for longer term requirements periods of sustained challenges will quickly erode fund provisions. This will be further exacerbated by additional future tax liabilities levied upon the fund's increase in the paper value of the underlying property.

If the trustees are forced to sell the property, the taxation impacts are multiplied as capital gains tax will also be triggered at that time. The family may not be able to acquire the property personally which could result in the loss of the property and/or their family farming business.

Furthermore, it may not be an opportune time to sell, which could have a further detrimental impact on the fund and its members. Also noting the timing difference between the point of valuation, the

time the assessment is raised, and the date of disposal. Members should not be forced into fire sale scenario to fund the payment of this arbitrary tax.

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.

Specific data on the number of farming properties held in superannuation is not readily ascertainable. These types of properties will be a subset of business real property which is reported as a single class of investment in the SMSF Annual Return lodged with the Commissioner of Taxation. Sample data from members and stakeholders is indicative of around 30% of farming properties being held by SMSFs and around 34% of business real property investments by SMSFs being farming properties.

We expect that these proposed measures will significantly and negatively impact farmers and small businesses.

For these reasons we do not support the use of the TSB model.

Refer to Part 3 - Case Studies: 3 and 4

CQ-2: Adjustments for outflows ('withdrawals')

2. What types of outflows (withdrawals) should be adjusted for and how?

A. Excess contributions and Division 293 Assessment – exclusion of amounts withdrawn

Contributions made using the small business capital gains tax concessions are excluded from being classed as a non-concessional contribution.[10] However, if the contribution fails to meet the small business capital gains tax requirements, it will by default be classified as a non-concessional contribution. A contribution may fail as a small business capital gains tax contribution for a variety reasons. It can also be as simple as a failure to complete or provide the required cap election form to the member's superannuation fund on or before the contribution is made.[11]

If an individual fails the required TSB test for non-concessional contributions,[12] the whole of the contribution will be classified as an excess non-concessional contribution.

The contribution cannot simply be returned, reversed, or unwound. Instead, the proceeds remain locked in the superannuation system due to the operation of the preservation rules. Only after a release authority is issued by the Commissioner of Taxation can the trustee release the excess contributions amount to the member.[13]

For excess non-concessional contributions, the default notice is issued by the Commissioner for the withdrawal of excess proceeds from superannuation.[14] As a 47% tax rate[15] applies to the entire excess contribution if the member instead elects to retain the excess contribution amount in the superannuation fund, such elections are not common.

[10] *Income Tax Assessment Act 1997* (Cth), s 292-90(2)(c)(iii), s 292-100.
[11] Ibid, s 292-100(9).
[12] Ibid, s 292-85(2)(b).
[13] *Taxation Administration Act 1953* (Cth), s 131-35(1).
[14] Ibid, s 131-15(2).
[15] *Superannuation (Excess Non-Concessional Contributions Tax) Act 2007* (Cth), s 5.

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Excess concessional contributions are taxed at an individual's marginal tax rate. Where the member does not elect to withdraw the excess contributions (net of fund taxes - 15%), they are then applied to the individual's non-concessional contribution cap. If not withdrawn, the excess contribution will be taxed twice as excess concessional and then excess non-concessional contributions. The result is a tax rate of up to 94%. Noting that the concessional contributions, including excess amounts are also taxed in the superannuation fund at the fund rate of 15%.

Whilst we agree that any actual earnings received by the fund during the period would be assessable in the fund, it would particularly punitive if excess contributions amounts which are withdrawn are then also included in the proposed formula and added back as withdrawals in the calculation of earnings.

The addback of excess contributions released in the earnings formula as 'withdrawals' is a distortion and creates a punitive outcome. As this is a transaction that directly relates to contributions and the operation of the contribution rules, they should be afforded the same treatment as the original contribution and excluded from the formula.

Division 293 Assessments

Any amounts withdrawn under the Division 293 measures relate directly to concessional contributions which may comprise compulsory superannuation guarantee amounts. The member may have no ability to modify the contributions made into superannuation on their behalf.

The inclusion of amounts withdrawn under a release authority as earnings under this provision is punitive, given the lack of control the individual may have on contributions paid and the additional tax already levied. The sum being withdrawn is for the payment of tax to the Commissioner of Taxation and is not a personal benefit for the use of the member. As such it should be excluded as a 'withdrawal'.

Recommendation 10: Exclude from 'withdrawals' all excess contributions and Division 293 assessments withdrawn from superannuation in accordance with a release authority issued by the Commissioner of Taxation.

B. Contribution Splitting

Eligible members can apply to split up to 85% of the concessional contributions made in a financial year with their spouse.[16]

Amounts split with a spouse are treated in a similar manner to a rollover of benefits between funds.

These transactions must continue to be classed as a rollover and not a withdrawal of benefits, and therefore excluded as an addback to the proposed formula.

Recommendation 11: Ensure that contribution splitting amounts continue to be classed as rollovers and excluded as a 'withdrawal'.

[16] *Superannuation Industry (Supervision) Regulations 1994* (Cth), div 6.7.

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C. *Family Law Settlements*

All withdrawals from superannuation required under a Family Law settlement must be expressly excluded as withdrawals under the proposed formula.

Family law settlements involving superannuation can be approached in several different ways depending on the client's circumstances. Where an individual has met a condition of release, an individual may be required to withdraw a specified amount from superannuation, to then be disbursed in accordance with the consent orders or settlement agreement for the benefit of the ex-spouse.

Amounts can also be split with the spouse, resulting in a rollover of benefits from the superannuation interest of person A to the superannuation interest of person B.

We note the consultation paper specifically addresses Family Law splits received and includes them in the definition of a contribution. For consistency and equity, similar treatment is required for the party who is forced to forego a portion of their superannuation interest.

Family law settlements are complex matters. The addition of a tax liability to an amount that must be compulsorily paid out of the member's superannuation interest for the benefit of a spouse is punitive, particularly where the receiving spouse will receive different treatment under the 'contribution' classification under the proposed formula. CGT liabilities will also arise where assets must be sold to facilitate the transfer of a cash benefit.

It will be difficult to ascertain the future tax liability that will arise for the member given the look back nature of the formula. Tax liabilities are provisioned for in the calculation of benefits and splits to a spouse. This will be disadvantageous for the spouse forced to release a portion of their superannuation benefits. It is also adding significant complexity to an already complex process.

> **Recommendation 12:** Funds withdrawn, split or transferred in accordance with an agreement or consent orders in the Family Court should be excluded as a 'withdrawal'.

CQ-3: Adjustments for inflows ('net contributions')

3. What types of inflows (net contributions) should be adjusted for and how?

A. *Small business CGT contributions*

A clear definition of voluntary contributions is essential. This should extend to all personal contributions, including those made under the small business CGT concessions.

> **Recommendation 13:** Include contributions made under the small business CGT concession in the definition of 'contributions'.

B. *Limited Recourse Borrowings*

In certain circumstances, a limited recourse borrowing is added back to an individual's TSB. Refer to the discussion and recommendations at CQ-1, Item C: *Limited Recourse Borrowings.*

LRBA values should be excluded from an individual's TSB and excluded from the earnings calculation as an addback of this nature does not represent income to the fund or member.

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C. *Applicable Fund Earnings*

Applicable fund earnings[17] calculated on foreign pension transfers should be classed as contributions under the proposed formula. These relate to the transfer of a person's interest in a foreign pension fund to their Australian superannuation fund. Commonly this will be via an SMSF due to various jurisdictional rules, tax, and compliance obligations.

The Australian economy and tax system benefits from the funds being relocated to Australia. Further, they are in effect a rollover from another superannuation interest, albeit the transaction occurs under other different part of the tax act.

Any future earnings on sums transferred will be captured and the individual's TSB going forward will include the applicable fund earnings amount.

> **Recommendation 14:** Include applicable fund earnings (AFE) amounts as 'contributions' under the proposed formula.

CQ-4, 5: Alternative methods

4. Do you have an alternative to the proposed method of calculating earnings on balances above $3 million? What are the benefits and disadvantages of any alternatives proposed including a consideration of compliance costs, complexity and sector neutrality?

5. What changes to reporting requirements by superannuation funds would be required to support the proposed calculation or any alternative calculation methods?

A. *Sector Neutrality*

We welcome Treasury's intention to adopt a methodology that is sector neutral and seeks to minimise compliance costs and complexity across the superannuation sector. These are all very important considerations.

Treasury modelling has shown that a greater proportion of members in SMSFs compared to APRA funds will be impacted by the proposed measure. We understand that around 60,000 SMSF members will be impacted in a population of 80,000 individuals. SMSF members therefore represent around 75% of the target population. While the goal of sector neutrality should always be the starting position, it is not always possible. It will not be possible to have a single consistent approach here.

Given that the greatest impact will be on the SMSF sector, it is puzzling why a greater focus is being placed on impacts to the APRA fund sector. SMSF members who have balances in excess of $3m should not be penalised and required to pay tax on unrealised gains simply because the APRA fund sector may find it difficult to report the taxable income attributed to fund members. We therefore encourage Treasury and Government to continue to work closely with the Association and the broader SMSF sector to work towards a fair, equitable and workable solution.

B. *Alternative Model – Taxation of Actual, Attributable, Taxable Income*

Superannuation funds should be permitted to choose to either report actual taxable income attributable to a member's interest or have a notional deemed earning rate applied by default. An election to use the actual, attributable taxable income would be made by the fund in its reporting of

[17] *Income Tax Assessment Act 1997* (Cth), s 305-75.

member data to the Commissioner of Taxation. Where this is not reported, a notional deemed earning rate would be applied as the default mechanism.

This will allow funds the choice on which method they wish to apply based on their existing accounting and reporting processes and obligations. For those APRA funds and superannuation products that are unable to report the required member data, a default assessment under a notional deemed earning rate would be applied.

A positive election can be made by the fund trustee by reporting the actual taxable income attributable to the member on balances over the prescribed threshold. The prescribed formula can be built into modern administration software systems which could easily undertake the required calculations. As an alternative, the trustee could elect to engage an actuary to calculate the reportable income amount.

Where the attributable earnings are not reported, or are unable to be reported by the trustee, a default earnings rate is to be applied by the Commissioner of Taxation.

The SMSF sector and software providers would be able to update their systems, processes, and software to readily adopt the model proposed.

The deemed earnings rate should represent the financial markets performance for the financial year in question, thus ensuring that excessive earnings are not calculated in years where a downturn in market conditions occurs. Existing measures for Division 293 and excess contribution assessment apply a notional earning rate. A similar methodology could be applied here.

For individuals who may be members of a fund that chooses to report actual attributable taxable income and a fund that does not report this income, the Commissioner would aggregate the earnings calculated under both methods and apply the proposed tax to the proportion of the earnings in excess of the $3m threshold (as per the proportioning method outlined in the consultation paper).

In summary, the model proposed:

- Is based on actual taxable income attributable to the member
- Provides a suitable alternative for funds unable to report member income
- Result is sector agnostic and sector neutral
- Provides superannuation fund trustees a choice
- Is more equitable than the model proposed
- Removes many of the complexities, issues and concerns that arise from imposing a tax on TSB movements and in particular unrealised gains.

Recommendation 15: Adopt an alternative model based on actual, attributable taxable income. Where a fund cannot, or chooses not to, separately report taxable income attributable to a member, the Commissioner will apply a notional deemed earning rate.

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Earnings that are subject to the additional tax rate

CQ-6, 7: Proportioning Method

6. Do you consider any modifications are required to the proposed proportioning method? If so, what modifications should be applied?

7. Do you have an alternative to the proposed proportioning method? What are the benefits and disadvantages to any alternatives, including a consideration of compliance costs, complexity, and sector neutrality?

Refer to discussions at:

- CQ-1, Item A: *Modifications to TSB Calculation*
- CQ – 4, 5: Items A and B: *Alternative Methods*.

Tax liability

CQ-8: Creation of unintended consequences

8. Does the proposed methodology for determining the tax liability create any unintended consequences?

A number of unintended consequences have been identified in the short time available to us. Of concern, is the number that may have not been identified or fully explored due to the extremely short consultation period. Some of those issues and concerns have been raised throughout this submission. Others we have identified are set out below.

A. $3 million threshold (unindexed)

The SMF Association does not support the introduction of another new superannuation threshold. The superannuation legislation already contains a myriad of contribution caps and balance thresholds, some of which over time will address the issues that the proposal also seeks to address. We have been a long-term advocate of the need to simplify the rules by reducing the number of superannuation caps and thresholds. The proposal achieves the exact opposite and risks making a complex system even more complex.

The paper states that the proposed $3 million threshold will not be indexed. We do not support the rationale provided in the consultation paper to justify the lack of indexation.

Key measures such as the transfer balance cap, TSB, and contribution thresholds (concessional and non-concessional) are all subject to some form of indexation. Indexation is an essential feature of these caps and thresholds. Each plays an important role in keeping pace with inflation including costs of living and wage growth.

It is vital that indexation of these items all continue as legislated to meet their underlying policy objectives.

Whilst we do not support the proposed $3 million threshold, the lack of indexation must be addressed. Rather than a fixed threshold, we would recommend that it is indexed to a multiple of

the transfer balance cap. Linking it in this manner ensures that the tax threshold is also indexed accordingly and fit for purpose, taking into account the effects of inflation.

Retirees in the current environment are concerned about their retirement savings and whether their savings will be enough to sustain them in retirement and meet their ongoing, and future needs. Setting a low threshold, that is not indexed, in isolation of the retirement income pillars is concerning. Lump sums required for aged care, mortgage debt and a secure home in retirement are not actively considered.

To minimise the impact to Government funding in the future, individuals should be encouraged to save and provide for their aged care needs in the future. Superannuation is the appropriate vehicle to do so, given the long-term savings time horizon.

Recommendation 16: Indexation of cap is paramount, as highlighted by the current inflationary environment. The superannuation system is already complex with different caps and thresholds. Simplification and removal red tape is needed.

Indexation of the cap should be linked to indexation of the general transfer balance cap.

B. One off market fluctuation events

Circumstances can arise where a single asset in the fund is subject to a large swing in value. This may be a one-off event that later reverses as the market adjusts or rebalances. There are many examples where this can occur, with one recent example being former ASX listed share Afterpay.

Capital was raised via an initial public offering (IPO) at $1 per share. The share price rose to $160.05, then settling around $66 per share, before the company was acquired and a corporation action resulted in replacement shares in the new entity. Prior to its acquisition, Afterpay was an ASX 200 company.

An investor who placed $10,000 in the IPO would have seen their shares valued at $1,600,500 at their peak and around $660,000 at the time of takeover. The shift in value is not taxable income and does not become liquidated funds or trigger a taxable gain until the shares are actually sold.

Individuals should be enabled to apply for loss look back provisions to compensate for these kinds of market movements.

Refer to Part 3 - Case Study 1

CQ-9: Unintended Consequences – Payments

9. Do the proposed options for paying liabilities create any unintended consequences?

A number of issues are raised throughout this submission. What is proposed is presumptive, and assumes an individual has high levels of wealth outside of superannuation. This will not always be the case.

Not all funds hold liquid assets. Whilst property and unlisted shares are some well-known examples, other previously liquid assets can become illiquid. A company in which the fund holds shares may be suspended due to the company going into administration or liquidation. During the GFC we saw various managed investments frozen with investors unable to sell or deal in their investment. With the current geo-political environment, there are investment funds that are frozen due to the exposure within that fund to Russian or Ukrainian investments.

Loss lookback provisions are needed to enable those who fall below the prescribed threshold to apply for a refund of the tax paid.

Regardless of the type of superannuation account held by the member, an ability to defer the payment of the tax liability must remain an option. This could be similar to the treatment of liabilities against interests in constitutionally protected funds and the former superannuation surcharge, where a separate surcharge account was maintained.

Defined benefit interests

CQ-10, 11, 12: Valuation considerations

10. Do the existing valuation methods for defined benefit interests in the pre-pension phase (under the existing TSB definition) work appropriately for the purpose of calculating superannuation balances over $3 million?

11. Do the existing valuation methods for defined benefit interests in the pension phase provide the appropriate value for calculating earnings under the proposed reforms?

12. Are there any alternative valuation methods that should be considered for either pre-pension or pension phase defined benefit interests?

See discussion in section following.

CQ-13, 14: Providing commensurate tax treatment for defined benefit interests

13. Are there any preferred options in providing commensurate treatment for defined benefit interests?

14. What are the benefits and disadvantages to any alternatives?

A. SMSFs and Defined Benefit Pension

Issues affecting defined benefits are not limited solely to certain Government or legacy employer funds. There will be individuals who have an interest in both a defined benefits and defined contribution funds such as an SMSF or APRA fund. Further, some older SMSFs will hold defined benefit pensions.

The size and number of defined benefits and legacy pensions within the SMSF sector by Regulators are not well understood.

1. Data reported to the ATO in the SMSF annual return does not identify the type of retirement income stream paid.
2. The number of SMSFs with defined benefit pensions is not readily ascertainable from ATO data but it is understood to be in the thousands.
3. Members have contacted us seeking guidance on the potential impacts these provisions will have on their SMSF defined benefit pension clients.
4. Many of these defined benefit pensions have material balances.

Any decisions made regarding the treatment of defined benefits funds, must also consider SMSFs which hold defined benefit pensions, and the niche issues that will apply in an SMSF context.

Recommendation 17: Methodologies considered for the treatment of defined benefit pensions must also consider the impacts on SMSFs with defined benefit pension interests.

B. Legacy Pension Amnesty

In the 2021-22 Federal Budget delivered on 11 May 2021, the Government announced that, for a two-year period, members in SMSF will be able to exit certain legacy pension products and enter more modern, flexible arrangements.

What was proposed would enable holders of market-linked, life-expectancy and lifetime products to exit their pension and move the proceeds to a more conventional style account-based income stream.

This would enable the member to start a new pension under current superannuation law and to withdraw some or all the proceeds from superannuation as lump sums.

This was an important announcement for those members who are trapped in outdated products and unable to exit their SMSF. There are cases where the annual cost of administration is more than the annual pension benefits received.

Despite the announcement and a proposed commencement date of 1 July 2022, the measures have not yet been legislated or even reached exposure draft stage.

With what is proposed under the *Better Targeted Superannuation Concessions,* an amnesty will become even more important, as more people will need to be able to restructure their SMSF pensions.

Recommendation 18: Legislate a legacy pension amnesty prior to the commencement of the proposed model.

Reporting process for funds

CQ-15: Effective methods for collecting information required

15. What would be the most effective method for collecting the required information? What are the benefits and disadvantages for the method identified, including a consideration of compliance costs, complexity, and sector neutrality?

Updates to the Australian Taxation Office *SMSF Annual Return* to include any additional labels.

SMSF Association

Submission – Part 3

Better Targeted Superannuation Concessions

Case Studies

17 April 2023

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.

Our Beliefs

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

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Important Note

The SMSF Association's submission in response to the *Better Targeted Superannuation Concessions* consultation paper[1] is set out in three parts:

PART 1 – Introductory letter and overview

PART 2 – Consultation Questions and Recommendations

PART 3 – Case Studies

This paper is Part 3 of this submission.

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.

Introduction

The following case studies represent real life, client-based scenarios. They illustrate the unintended consequences and complexities emerging from the proposed model.

These represent just some of the issues and scenarios identified. The short consultation period has not provided sufficient time to examine and compile all scenarios.

We would encourage Government and Treasury to undertake further consultations before proceeding to the exposure draft stage.

We would be pleased to further discuss the case studies included in this submission and would welcome the opportunity further consult and work with Government and Treasury.

[1] 'Better targeted superannuation concessions' (Consultation Paper, The Treasury, 31 March 2023) <https://treasury.gov.au/consultation/c2023-373973>.

Case Studies

Case Study 1 – Investment performance triggers balance exceeding $3m

Kelvin is the sole member an SMSF.

Over the years he has contributed when he can into superannuation and made prudent investments.

Kelvin's SMSF is invested in a diversified investment portfolio using a mix of listed Australian and international shares, and exchange traded funds.

Some investments are self-directed as he likes to research and follow the share market. He also uses a broker for advice, and the placement of trades.

He has seen sustained growth in his portfolio over the years.

Kelvin currently has $1.2 million in his SMSF.

It is important to Kevin that he has sufficient income to fund his retirement and can met his extra medical expenses as he has an underlying medical condition. He hopes to retire soon but has a personal bank debt, a legacy of a failed business venture and personal guarantee.

He worries about his future financial security and whether he will have enough funds to pay for his future aged care and medical needs, taking into account the final loan repayments.

An opportunity arises to invest in an initial public offering (IPO) for a new ASX listing through his broker.

Shares are issued at $0.50. Kelvin invests $20,000 via his SMSF (1.6% of the fund value).

Shares are issued in early March and the share price rises. This continues to 30 June. On the back of positive announcements and sound performance, the shares are now with $5. The holding is valued at $200,000.

A significant company announcement sees a rapid spike in the value of the shares. After a period of strong, sustained growth, the shares reach $75 by 30 June in year 2. The holding is now worth $3 million. As a result, Kelvin's member account is valued at $4,500,000.

A proposed takeover of the company fails, and the share price suffers a sharp decline in value, stabilises, and falls again. By 30 June of year 3, Kelvin's member account is valued at $1,900,000.

Kelvin's TSB does not exceed $3 million again.

Kelvin's TSB for the years in question is as follows:

Starting TSB	$1,200,000
Year – 1	$1,400,000
Year – 2	$4,500,000
Year – 3	$1,900,000

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Calculation:

Year 2 Earnings = ($4,500,000 + 0 – 0) - $3,000,000 = $1,500,000

Proportion of earnings = ($4,500,000 - $3,000,000) / $4,500,000 = 33%

Tax Liability = 15% x $1,500,000 x 33% = **$74,250**

Issues:

- Tax is being levied on unrealised gains.
- The value on which the tax is calculated is never realised.
- Carrying forward the losses on the decline in value can never by applied, as his TSB stays below $3 million.
- Kelvin's TSB valuation is a point in time value based on market performance. It does not reflect Kelvin's level of personal wealth outside of superannuation.

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Case Study 2 – Treatment of tax provisions and addbacks

Any adjustments to tax provisions will directly impact a member's balance in a super fund. This will therefore be included in an individual's TSB.

Joan has a TSB of more than $3 million at the end of the prior financial year. The growth in Joan's superannuation balance has been through good advice and a long-term investment strategy, investment in strong performing investments through a diversified investment portfolio.

At the end of the current financial year, Joan decides to retire. She elects to commence an account-based pension using her full $1.9m transfer balance cap.

A large portion of her remaining accumulation balance will be needed to payout the mortgage on her home once the fixed interest period ends. This will be paid out as a lump sum in a future year when the proceeds are required.

Joan's SMSF has been accounting for deferred tax liabilities for future capital gains on her SMSF investments. This is a provisional book entry that accounts for the capital gains tax that would arise if the investments were sold at 30 June. It provides Joan with the realisable value of her member account at that date.

In June, when Joan commences her pension, an adjustment is required to the deferred tax liabilities. The assets supporting her pension are now no longer subject to income tax on earners or capital gains tax on disposal.

The accountant who administers her SMSF performs the necessary calculations for the tax adjustment required. Joan has had a long-term investment strategy for her fund which includes property and shares. Large amounts of unrealised gains are present in her SMSFs investment portfolio. This includes a property originally purchased for $300,000 which is now valued at $970,000. The portfolio of shares includes bank shares acquired at IPO for $5.40 which are now trading at $110, and mining shares acquired at IPO for $0.01 which are now trading at $26. Both are ASX 200 companies.

An amount of $80,000 is added back to Joan's member account because of the adjustment to the provision for deferred tax liability.

Joan has made no contributions or withdrawals during the year of income. No pension payment is required for the year where a pension commenced in June.

The addback of the deferred tax liability on the commencement of Joan's pension will be included in the earnings calculation along with the growth in asset values and fund income.

Case Study 3 – Farming Property Valuation

Marco and Rosa, both aged in their 50's, are husband and wife and engaged members in their SMSF.

The SMSF holds a 50% share in farmland, a residential property, listed shares and cash.

The farm was originally acquired in 2017 for $1.2 million.

In 2021, the property was valued at $1.77 million, and the members balances were $2 million each.

In 2022, the farmland suddenly increased in value to $3.94 million. This is triggered by significant corporate acquisitions and amalgamation of similar properties in the region. The member's balances increase to $3.4 million each for the year.

The market leasing rate remains relatively unchanged for properties in this location, of similar size and same agricultural activity. Over the years, market rates have either remained unchanged or not seen any material increase in value.

In the 2025/26 year, cropping quality is high as is demand for properties in the area. Based on sales activity in the region, the property is now worth $4.8 million. The property is leased to a neighbour who is looking to expand their operations and compete with the larger properties in the region.

In the 2026/27 year, the region suffers a devastating drought and locust plague. The immediate outlook is dire. It is some of the worst conditions experienced in the region for many years. Market conditions determine that is appropriate to defer lease payments. The fund receives reduced then no lease payments under a deferred lease arrangement with lessee. No contributions are received for Marco or Rosa. Business conditions are too difficult, so the couple are not paid wages or superannuation from their rural based business.

Ultimately when the property is sold, a significant capital gains tax liability will arise in the fund.

As the property has been held for a period of more than 12 months, the fund is entitled to a 1/3 CGT discount. The effective tax rate on the taxable gain is 10%. The taxable gain will also be net of disposal costs including sale and settlement costs.

CGT payable will be in addition to the additional tax levied under the proposed model. The proposed tax is levied on the individual members personally during the holding period to which this measure applies.

The additional tax calculated on the growth in value of fund assets and is levied at a flat rate of 15%. The CGT discount and disposal costs are not considered.

Where a decline in value occurs, although losses are calculated, these are only of benefit if an increase occurs again in the future. The result is the excess payment of tax on a value that has not been realised.

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Case Study 4 – Small business Comprehensive Example

Mick (45) and Daniella (39) run a plumbing business. The business had contracts in the building sector but also provided maintenance and general plumbing services. Over the years they saw the opportunity to tap into the home renovation market and expanded to provide bathroom renovations. They have had to move business premises twice in the last 6 years. Moving is not only inconvenient, it is expensive, and time lost also has a cost.

Like many small business owners, they want stability and certainty. After getting advice, they decide to invest in their future by using their SMSF to purchase business premises.

- A common strategy for a wide variety of business owners is to hold the business premises in their superannuation fund.
- Doing so provides long term stability and certainty for the business.
- The added bonus, the lease payments made by the business to the SMSF are providing for Mick and Daniella's retirement. (As well as capital growth)
- The business is everything to Mick and Daniella. It not only provides income today, but also factors into their future retirement plans when they plan to sell the business.
- The business and the property can be sold separately at different times.

Like many small business owners, the family home is at risk. Not only is there the private mortgage, but the property will also be used as security for borrowings for the business, and director guarantees.

They will often pay themselves last. In difficult years, employees and contractors are always paid. So Mick and Daniella's income will be the ones to be cut when times are tough or cash flow is tight.

During COVID, Government restrictions made it difficult to operate. Worst still, the supply chain interruptions meant that Mick and Daniella did not have access to essential supplies. To make matters worse, post Covid, fixed priced contracts impacted profit margins as the cost of supplies and other costs increased.

One of the major builders they have contracts with has collapsed. This represents a significant portion of their business income and cash flow. Large amounts remain unpaid. It looks like they will receive nothing through the liquidation process.

The business premised they purchased is in a quality, well located and in demand area. Year on year the property value has continued to increase. It has been a smart investment.

Summary of Issues

- Measures don't consider wealth external of superannuation. Presumption is significant personal wealth as well as a high super balance.
- Many more people are retiring with mortgage debt. For small business owners, their homes are often used as security for business debt – business loans, overdrafts, vehicle and equipment finance, director guarantees for trade agreements, leases.
- Many small business owners contribute to super when they can. Some years may see low or no contributions made, in good years, larger contributions (subject to the contribution caps and rules) tend to be made.

- Mick and Daniella know the importance of superannuation and contribute when they can. There have been some years where they have not been able to contribute due to difficult business conditions.
- Good investment strategies and strong performing investments can provide people with an opportunity to grow their superannuation next egg.
- The SMSF is required to report all fund assets at their market value on 30 June each year. As the property increases in value, the SMSF's value will increase. Therefore, the member's balances will adjust accordingly. This will include:
    - Taxation of paper gains
    - Currently growth in the value of an asset is taxable as a capital gain when the asset is sold.
    - If a loss occurs under the calculation, the loss can be carried forward to reduce any future earnings calculated.
    - Tax is not refunded.
    - If the member's TSB value falls below $3m, it appears that no adjustment or tax refund will be made.
- Limited recourse borrowings, often used to purchase property, will in certain circumstances be added back when calculating a person's TSB. Effect is a calculation of earnings based on gross assets rather than net assets.
    - Applies to LRBA's commenced from 1 July 2018 where:
        - Loan is from a related party; OR
        - Member has met a condition of release.

LRBA and TPD Event

- Mick is well below his preservation age (60). What happens if Mick has an accident and is seriously injured? As a result of his injuries, he will no longer be able to work. His super fund holds an insurance policy for Mick and successfully claims on the policy.
    - Although the insurance proceeds received will be excluded from the earnings calculation, Mick will still be liable for tax on earnings if he has a TSB of more than $3m.
        - This is despite his change of status and young age.
        - Mick is 15 years away from attaining his preservation age of 60.
        - Earnings comprising of direct income, capital gains and unrealised gains from fund investments (including insurance proceeds invested) will be assessable.
        - Advice and an appropriate investment strategy are essential in ensuring that the superannuation benefits can fund Mick's ongoing care and needs, as well provide an essential source of income into the future.
    - Any benefits paid to Mick are added back and included as earnings. This includes benefits paid as lump sums and/or pension benefits.

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- Mick has now met a condition of release (permanent incapacity):
    - If the LRBA was with a bank and started from 1 July 2018, his share of the loan will now be added back to his TSB

Illustration:

The following is a high level, simplified example to illustrate the impact of the addition of the LRBA to a member's TSB.

Super balances:

	Balances
Mick	$1,020,000
Daniella	$180,000
Total	$1,200,000

Purchase business premises $4m, borrowing $2.8m

Effect on TSB:

	Actual Member Balances	**TSB Adjustment for LRBA**	**Total Super Balance**
Mick	$1,020,000	$2,380,000	$3,400,000
Daniella	$180,000	$420,000	$600,000
Total	$1,200,000	$2,800,000	$4,000,000

Case Study 5a – Structured Settlements v TPD Proceeds

	Structured Settlement	TPD Proceeds
Member component	Tax-free	Taxable
Adjust tax-free element for lump sum benefit paid	Yes	Yes
Exclude from TSB	Yes	No
TBA Adjustment (increase effective TBC)	Yes	No
Classed as a 'contribution' and excluded from earnings	Yes	Yes
Benefit payments excluded as withdrawals	No	No
Growth excluded	No	No

Case Study 5b - Structured Settlements v TPD Proceeds

Adam (42) is seriously injured as a result of an accident. He has sustained life changing injuries and will never be able to work or care for himself unaided again.

Adam is treated differently, depending on whether he receives a structured settlement payment compared to TPD proceeds.

Year 1:

	Structured Settlement	**TPD Proceeds**
Opening TSB	$900,000	$900,000
Sum Received	$3,500,000	$3,500,000
Contribution adjustment	Yes	Yes
Member A/C Component	Tax-free	Taxable
TSB Adjustment	Yes – excluded from TSB	No
TBA Adjustment	Yes	No
Closing TSB	$900,000^	$4,400,000*

^ TSB is not representative of an individual's actual member account balance

**While the insurance proceeds themselves are excluded as income in year one, Adam's TSB exceeds $3 million. The proportion of any growth in Adam's fund will relating to balances over $3 million will still be assessable for the additional 15% tax.*

Adam needs to modify his home to accommodate his needs. The modifications required would be significant and he would be unable to reside in the home during construction. Alternatively, he would need to build a special purpose home.

The rental market is extremely challenging and there is no suitable rental accommodation to accommodate his disability. He doesn't want to be placed in an aged care facility during construction.

Build or renovate, there are significant building delays. He has been told to allow up to two years for the project to be completed.

He decides to stay in his home and look for a suitable site on which to build his home.

Adam has had a small amount of insurance and investments outside of superannuation that has paid out his mortgage and provided a temporary source of income. He doesn't want to start drawing on his superannuation too soon as he knows his money needs to last. He withdraws $150,000 as a lump

sum to purchase a special purpose bed, other items and make some simple modifications to make life that bit easier.

Year 2:

	Structured Settlement	TPD Proceeds
Opening TSB	$900,000	$4,400,000
Lump Sum Payment	$150,000	$150,000 ~
'Withdrawal' Earnings Addback	N/A	Yes
Closing TSB	$1,300,000^	$4,800,000*

^ TSB is not representative of an individual's actual member account balance

** Adam's TSB exceeds $3 million. The proportion of any growth in Adam's fund will relating to balances over $3 million will still be assessable for the additional 15% tax.*

~Lump sum is added back to the earnings calculation as a 'withdrawal'

In the following year, Adam withdraws $950,000 to pay for home construction and commences a pension.

Year 3:

	Structured Settlement	TPD Proceeds
Opening TSB	$1,300,000	$4,800,000
Lump Sum Payments	$950,000	$950,000 ~
'Withdrawal' Earnings Addback	N/A	Yes
Available TBC	$5,400,000	$1,900,000
Pension Commencement Amt	$3,850,000	$1,900,000
% Fund earnings tax free	~100%	~40%
Tax Component	High tax-free %	High taxable %
Minimum Pension Pmt @ 4%	$154,000	$76,000~
'Withdrawal' Earnings Addback	N/A	Yes
Closing TSB	$350,000^	$4,274,000*

^ TSB is not representative of an individual's actual member account balance.

** Adam's TSB exceeds $3 million. The proportion of any growth in Adam's fund will relating to balances over $3 million will still be assessable for the additional 15% tax.*

~Lump sums and pension payments are added back to the earnings calculation as a 'withdrawal'.

Note:

The treatment of disability benefits for Adam differs greatly, depending on whether he receives either a structured settlement (personal injury compensation payment), TPD insurance benefits, or a combination of both. Yet the definition of permanent incapacity that applies in both circumstances are the same and they are intended to serve the same purpose.

Under the TPD example above, Adam would be paying tax on fund earnings, the taxable component of pension payments as well as be subject to the proposed additional 15% tax. Substantial tax concessions and treatment apply under the rules for structured settlements. These differences significantly impact the longevity of an individual's disability benefits.

Parity is needed, with TPD benefits treated in the same manner as structured settlements.

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Case Study 6 – Blue Collar Workers

Salary data in the table below is taken from Hayes *Salary Guide* [2] for the state of Western Australia.

('000)	Electrician	All-Rounder	Leading Hand Maintenance	Excavator Operator	Dump Truck Operator
Salary Range*	$140 - 180	$140 - $175	$150 - $170	$130 -$175	$122 - $160
SG @ 10.5%^	$14.7 - $18.9	$14.7 - $18.37	$15.75 - $17.85	$13.65 - $18.37	$12.81 - $16.8
SG @ 12%	$16.8 - $21.6	$16.8 - $21	$18 - $20.4	$15.6 - $21	$14.64 - $19.2
SG @ 15%	$21 - $27	$21 - $26.25	$22.5 - $25.5	$19.5 - $26.25	$18.3 - $24

* Excluding superannuation, bonuses, and other benefits
~ Based up 8&6 and 2&1 rosters.
^ Current compulsory rate of superannuation guarantee.

Higher rates of superannuation are common in sector as employee retention strategies and for companies to be an employer of choice in a highly competitive market.

Based on an individual's circumstances, long term sector employees may be captured under the proposed measure, and subject to additional tax. Factors include:

- Wages and salaries
- Superannuation guarantee rates paid
- Growth of superannuation assets over time
- Chosen investment strategies or investment options

Superannuation calculators determine an individual's balance at retirement in present value terms. This is important, as it allows consumers to engage with and understand their superannuation balance in today's economic environment.

Many may be unaware that they will be impacted by this proposal in the future.

This highlights the need to ensure indexation is applied to the threshold.

That threshold should be linked to the general transfer balance cap.

Lack of indexation does not account for or consider the effects of inflation.

[2] 'Hays Salary Guide 22/23' (Report, Hays, 7 June 2022) 174-186