1. *What are some of the unintended consequences you are concerned with?*

- For many taxpayers it is retrospective, especially those in defined benefit pensions.

- It treats two of the important aspects of retirement (homeownership and savings) differently from a tax perspective.

- Taxpayers who are either very good investors and/or accessed very generous contribution rules before June 2007 may be unfairly penalised.

- Taxpayers who experience investment market bubbles may also be unfairly penalised.

- It taxes unrealised capital gains which is substantially inconsistent with our tax regime.

- Investment losses (for Division 296 tax purposes) are carried forward, rather than providing an immediately refundable tax benefit to members – this creates a contingent liability for government finances.

- When account balance falls below $3 million, and does not go above it again, then tax has been paid on unrealised gains which would not be returned to the taxpayer. That is, not only will the regime tax unrealised gains, in this scenario, it will tax gains that are never made!

- Our modelling indicates that it would be difficult to predict when tax will be payable from one year to the next. Cash flow management will be practically impossible and it will force some funds to sell assets, where they are unable to defer payment of tax. In the case of large illiquid assets, taxpayers will also be further penalised for long sale periods.

- The application of the tax for defined benefit members is particularly complex and cannot be planned around. The draft regulations appear to discriminate against women.

- Those without a condition of release are not allowed to take money out of the system to bring their balance below the $3m threshold.

- Early-stage investor incentives permitted in the tax law are effectively removed.

- Applies the tax to those who die on precisely 30 June, but not other days of a financial year.

- Applies tax to those who are disabled or diagnosed with a terminal illness and received an insurance benefit from their superannuation fund that has been retained in the superannuation system.

- Imposes increased investment risks on funds with large illiquid assets, including liquidity risk, reinvestment risk and pricing/valuation risk.

- Funds with large illiquid assets which may normally have long sales horizons may already need to get assets on the market due to normal sales lead times and potentially lengthy settlement periods.

- Funds with large illiquid assets such as business real property may be difficult to sell part-ownership stakes.

Overall changes in the taxation of superannuation often necessitate individuals having to get structuring and planning advice which can be costly. Further constant change to the superannuation legislative landscape erodes confidence in the retirement system.

2. *How could this adversely affect those with SMSFs? Is there a liquidity risk for those with farms in their SMSF?*

SMSF members with high balances will be impacted by the Better Targeted Superannuation Concession tax measure in the same way as taxpayers with interests in large APRA-regulated super funds.

Any superannuation fund member risks a spike in asset values that, under this policy proposal, will face renewed tax. Likewise, assets subject to investment bubbles may be assessed for tax on higher asset values which fail to maintain such high values, leaving members out of pocket through no fault of their own. Similarly, “fire sales” of assets with high valuations might, after assessment, crystallise substantial pricing/valuation risk during asset sales and subject members to unrecoverable tax on lost value.

Reinvestment risk can also be crystallised where funds hold assets which have been invested in for certain favourable characteristics. Those characteristics may not be available elsewhere after disposal of the asset. Large illiquid assets can be unique and thus inherently subject to high degrees of reinvestment risk.

Liquidity risk is also magnified where it is difficult to sell a fractional interest in business real property to fund a tax based on a unrealised gain.

This is particularly an issue for farmers who have their farms in their SMSF. Such SMSFs can often be illiquid as part of a compliant investment strategy identifying little need for liquidity. As a result, increases in the market value of such farms could trigger Div 296 liabilities. If such farmers do not have enough cash inside the SMSF or outside of the SMSF then they may have to sell assets (including the farm) to pay such liabilities. The same issue applies for other business owners who have their business premises in a SMSF.

This issue does not arise under normal tax principles as gains are only taxed on realisation (i.e. when there are proceeds to pay the capital gains tax).

3. *Does this tax constitute double taxation?*

When an asset is sold for a profit, it would normally be subject to capital gains tax in the hands of the fund if the asset was held on capital account. The same asset may have already borne some tax based on its value between two points in time before it was disposed under the proposed framework. The actual tax liability may bear little correlation with the tax paid on movements in its valuation whilst the asset was held.

There are legitimate arguments about whether this constitutes double taxation or not. Regardless, CPA Australia modelled the difference between two notionally equivalent tax vehicles: superannuation fully taxed under the Division 296 regime; and insurance or friendly society bonds; and found that the superannuation investment would pay 43% more tax than in the bond. The assumptions underlying the modelling may be found in CPA Australia's submission to Treasury of February 2023.*What tax principles does this Bill breach, by taxing unrealised gains?*

The established principle of taxation in Australian is only to tax gains when realised. As such, this new tax is a fundamental shift from the way the existing Australian tax system works as it goes against the general tax principle of paying tax on income that has actually been derived or on actual realised gains. In addition, there is no symmetry as tax paid on unrealised gains are not refundable when the gain reverses in a following year.

a. *How does the TSB calculation work? Is there anything else like this in the tax system?*

We refer the committee to the proposed Section 296-35. The formula uses a person's Total Superannuation Balance with many adjustments for withdrawals and contributions during a financial year. To our knowledge there is nothing like this in the taxation system, presently.

b. *Is this a wealth tax?*

A definition of 'wealth tax' used by the OECD would exclude taxes on capital movements[1]. However, the unprecedented nature of this new tax heralds a significant change. As mentioned earlier, the current tax regime in Australia only taxes capital gains when they are realised and sold for more than the cost base. However, as this new tax is unrelated to the actual taxable income generated by a fund and instead captures any growth in balances from the start to the end of each year after adjusting for contributions in and payments out, many view this as a wealth tax.

c. *Is this an example of essentially overpaying tax on income you never earned?*

[1] Home | OECD iLibrary (oecd-ilibrary.org

This is an example of paying tax on unrealised gains, which are not presently included within the definition of taxable income, which is the definition of income upon which tax is paid in Australia.

In many cases the asset will never be realised at a value that it was previously valued at resulting in overpayment of tax. Also, if a taxpayer super balance falls below $3 million, any previously paid tax under Division 296 will not be recoverable.

4. *Can you explain the difference between the approach taken in this bill compared to standard taxation of super earnings and contributions?*

Under normal taxation of fund earnings, only realised gains are included in a superannuation fund's assessable income for taxation purposes. The BTSC formula changes the point of taxation to the current market value of an asset and provides for market value losses to be carried forward to offset future gains in the value of the Total Superannuation Balance.

5. *Do you think the Treasury is just hoping to rake in more revenue than it is owed?*

The approach taken is announced government policy. Those who have met a condition of release and can take some of their wealth out of superannuation might decide to do so particularly in light of the inequitable basis (i.e. movement in unrealised values) for imposing this impost. Also individuals with high balances will reduce in the coming years as people die as this new impost is predominantly dealing with a legacy issue.