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Presented and prepared by
Meg Heffron BEc, FIAA, SMSF Specialist Fellow
Managing Director

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Glossary of Abbreviations

AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
ABP	Account Based Pension
ABR	Australian Business Register
ABS	Australian Bureau of Statistics
ACR	Auditor Contravention Report
AFCA	Australian Financial Complaints Authority
AFS	Australian Financial Services
AFSL	Australian Financial Services Licence
AP	Allocated Pension
APES	Accounting Professional & Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ASA	Australian Auditing Standards
ASAE	Auditing & Assurance Standards
ASIC	Australian Securities & Investment Commission
ATO	Australian Taxation Office
ATO ID	ATO Interpretative Decision
AUASB	Auditing & Assurance Standards Board
AWOTE	Average Weekly Ordinary Time Earnings
BA	Bankruptcy Act 1966
BDBN	Binding Death Benefit Nomination
BRP	Business Real Property
C Reg	Corporations Regulations 2001
CA	Corporations Act 2001
CC	Concessional Contribution
CFD	Contracts for Difference
CM&C	Central Management & Control
CO	ASIC Class Order
CSHC	Commonwealth Seniors Health Card
DB	Defined Benefit
DRS	Derivatives Risk Statement
ECPI	Exempt Current Pension Income
ED	Exposure Draft
EFT	Electronic Funds Transfer
EPOA	Enduring Power of Attorney
ERF	Eligible Rollover Fund
ESA	Electronic Service Address
FBT	Fringe Benefits Tax
FBTA	Fringe Benefits Tax Assessment Act 1986
FHSS Scheme	First Home Super Saver Scheme
FLA	Family Law Act 1975
FL Reg	Family Law (Superannuation) Regulations 2001
GIC	General Interest Charge
IT	Taxation Ruling
ITAA 1936	Income Tax Assessment Act 1936
ITAA 1997	Income Tax Assessment Act 1997
ITAA Reg	Income Tax Assessment Amendment Regulations 2007
ITA Reg	Income Tax Assessment Regulations 1997
ITRA	Income Tax Rates Act 1986
IT(TP)A 1997	Income Tax (Transitional Provisions) Act 1997
JAB	Joint Accounting Bodies (CPA Australia, Chartered Accountants Australian and New Zealand & Institute of Public Accountants)
LCR	Law Companion Ruling (formerly called a Law Companion Guideline) issued by the ATO
LISC	Low Income Superannuation Contribution
LISTO	Low Income Superannuation Tax Offset
LRBA	Limited Recourse Borrowing Arrangement
LPR	Legal Personal Representative
LVR	Loan to Valuation Ratio
MLP	Market Linked Pension
MT	Miscellaneous Tax Ruling
MTR	Marginal Tax Rate
NALE	Non-arm's Length Expenses
NALI	Non-arm's Length Income
NANE	Non-assessable Non-exempt Income
NCC	Non-concessional Contribution

NTLG	National Tax Liaison Group
PAYG	Pay As You Go
PAYGW	Pay As You Go Withholding
PCG	Practical Compliance Guidelines issued by the ATO
PDS	Product Disclosure Statement
PS LA	Practice Statement Law Administration issued by ATO
PSI	Personal Services Income
QC	Quick Code (for referencing publications on ATO website)
RBL	Reasonable Benefit Limit
RESC	Reportable Employer Superannuation Contribution
RFB	Reportable Fringe Benefits
RG	Regulatory Guide issued by ASIC
RSE	Registrable Superannuation Entity
SAF	Small APRA Fund
SAPTO	Seniors & Pensioners Tax Offset
SCC	Superannuation (Government Co-Contribution for Low Income Earners) Act 2003
SCC Reg	Superannuation (Government Co-Contribution for Low Income Earners) Regulations 2004
SCT	Superannuation Complaints Tribunal
SDASPTA	Superannuation (Departing Australia Superannuation Payments Tax) Act 2007
S(ENCCT)A	Superannuation (Excess Non-concessional Contributions Tax) Act 2007
S(ETBT)A	Superannuation (Excess Transfer Balance Tax) Imposition Act 2016
SFL	Super Fund Lookup
SG	Superannuation Guarantee
SG Reg	Superannuation Guarantee (Administration) Regulations 1993
SGA	Superannuation Guarantee (Administration) Act 1992
SGC	Superannuation Guarantee Charge
SGD	Superannuation Guarantee Determination
SGR	Superannuation Guarantee Ruling
SIS	Superannuation Industry (Supervision) Act 1993
SIS Reg	Superannuation Industry (Supervision) Regulations 1994
SoA	Statement of Advice
SPG	Superannuation Prudential Practice Guide issued by APRA
SPR	Legislative instrument issued by the ATO
SMSF	Self Managed Superannuation Fund
SMSFD	Self Managed Superannuation Fund Determination
SMSFR	Self Managed Superannuation Fund Ruling
SMSFRB	SMSF Regulator's Bulletin
S(SSCC)IA	Superannuation (Sustaining the Superannuation Contribution Concession) Imposition Act 2013
TA	Taxpayer Alert
TAA	Taxation Administration Act 1953
TAP	Term Allocated Pension
TBA	Transfer Balance Account
TBAR	Transfer Balance Account Report
TBC	Transfer Balance Cap
TD	Taxation Determination
TPD	Total & Permanent Disablement
TR	Taxation Ruling
TRIS	Transition to Retirement Income Stream
TSB	Total Superannuation Balance

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CONTENTS

1 Introduction & Executive Summary

1.1 INTRODUCTION

In February 2023, the Government announced its intention to introduce a new tax on members with more than $3m in their superannuation balances from 2025/26.

Naturally this has prompted many wealthier clients to reconsider the role of their SMSF in their future retirement savings. In particular, many have questioned whether the introduction of a new tax should prompt them to withdraw sums from their SMSF to bring their balances below $3m.

In this paper we set out some of our modelling on this subject. It is not a comprehensive explanation of the proposed new tax (although brief details assumed for the purposes of the modelling are set out in section 2.2). Nor is it intended to consider whether or not new money should be added to superannuation instead of saved elsewhere. In fact, given the group targeted by this tax (members with more than $3m in superannuation), few will be in a position to add material sums in any case. Rather, this paper considers the question : *for those whose retirement savings are already in the superannuation system, is there merit in taking some of their balance out?*

1.2 EXECUTIVE SUMMARY

On balance, we conclude that the new tax does make superannuation (relative to non-superannuation savings) far less attractive than it has been historically.

That said, for most members who already have large balances *the new tax alone* does not have a sufficiently negative impact to make it critical to withdraw money from superannuation. That is because:

- The treatment of *income* under the proposed new tax vs outside superannuation remains marginally better inside superannuation,
- The treatment of *capital gains* under the proposed new tax is worse inside superannuation while assets are growing because the fact that the new tax will apply to all growth in a member's balance (including unrealised gains) will *bring forward* some of the tax on these capital gains. But this reverses (sometimes entirely) when the asset is sold as the tax treatment on the realised capital gain is more favourable inside superannuation.

This is particularly true where there are up-front costs to move wealth outside superannuation such as capital gains tax or stamp duty. The worst feature of the proposed new tax is that it brings forward capital gains tax. Selling assets to move them does the same. Even worse, it brings forward taxes on historical gains (pre 30 June 2025) that are not touched at all under the proposed new tax.

In fact, the biggest driver for removing money from superannuation remains exactly as it has always been – the risk of beneficiaries paying large amounts of tax on the member's death. The bigger consideration faced by current members with large balances is whether or not they should be more structured in the gradual draw down of their superannuation assets to avoid leaving money in superannuation when they die with no tax dependants.

2 Basis for our modelling

2.1 CLIENT FACT SET

Throughout this paper, we have used the example of a **65 year old** client who initially has **$7m** in superannuation (assumed to be held in an SMSF). There are no other members of the SMSF. The client has a retirement phase pension ($2m) and the remainder is in accumulation phase. Minimum pension payments are drawn each year.

Their primary concern is whether or not to withdraw $4m from their fund to reduce their balance to $3m (largely avoiding the proposed new tax).

2.2 KEY ASSUMPTIONS

In all cases we have assumed that the member is able to withdraw the required funds from superannuation – they have met a full condition of release.

In some cases we have assumed that the $4m withdrawal can be funded from existing cash (ie no capital gains tax will be incurred within the fund to make the withdrawal). This has been chosen deliberately to show the "remove $4m from superannuation" in the best possible light.

Where stated we have altered this assumption to allow for capital gains tax up front in order to make the withdrawal.

We have also assumed that:

- Investment returns will be the same regardless of whether investments are made within super or outside super, the only difference is the tax environment,
- Amounts drawn as pension payments will be the same regardless of the scenario,
- A key factor influencing the calculations is how the investment return is made up between capital growth and income – different assumptions have been made about this (and specified in future sections),
- Inflation is assumed to be 3% pa and all amounts projected into the future are adjusted for inflation. This means that dollar amounts are directly comparable to these amounts today,
- A key difference between leaving the full $7m in superannuation vs withdrawing $4m is that under the "remove from superannuation" option, earnings and eventual capital gains on the non-superannuation assets will be taxed at non superannuation rates. It has been assumed that:
    - The Stage 3 tax cuts will be introduced as currently legislated. Hence a tax rate of 30% (+ 2% Medicare) will apply for individuals with taxable income between $45,000 and $200,000 and the highest marginal tax rate (45% + Medicare) will apply from $200,000,
    - Members with non-superannuation savings will have *some* income already, enough to place them in the 30% tax bracket,

- They will have the flexibility to arrange structures that optimise tax outcomes – including a family trust with the possibility of a corporate beneficiary, and
- The outcome is that *income* will be taxed at a maximum of 30% and *capital gains* (when realised) will be eligible for a 50% discount but taxed at 45% + Medicare. This is imperfect in that it doesn't contemplate additional taxes that would apply if the income was distributed to a company and then later to individuals. Effectively it assumes that there will be enough "individuals" around to receive the income or that by the time money is paid out of a corporate beneficiary the recipients can receive this at no more than a 30% tax rate. Nonetheless, it probably provides an adequate representation of tax outside superannuation.

At the time of writing, the proposed new tax has not been legislated. It has been assumed to operate in line with Treasury announcements to date which include the following key features:

- A tax rate of 15% is applied to a **proportion** of the **earnings** attributed to the member's superannuation balance,
- The **proportion** is based on the member's total superannuation balance at the end of the year. For tax in relation to earning during 2025/26, for example, the proportion for a member with a total superannuation balance of $5m at 30 June 2026 would be:

$$\frac{\$5m - \$3m}{\$5m} = 40\%$$

- The **earnings** amount is any growth in a member's total superannuation balance adjusted to remove contributions and add back withdrawals. For example, a member with a total superannuation balance of $4.8m at the start of the year and account movements as follows would have earnings of $300,000:

Total super balance (30 June 2025)	$4,800,000
Pension payments	($100,000)
Earnings (income and growth)	$300,000
Total super balance (30 June 2026)	$5,000,000

- The amount of the new tax would therefore be:

$$15\% \times 40\% \times \$300,000 = \$18,000$$

- The new tax would be imposed on the member personally after the lodgement of their SMSF annual return. Treasury currently proposes to permit the member to release the amount of tax payable from their superannuation if preferred. For this modelling, it has been assumed that the member will do this and the amount will be withdrawn from their accumulation account approximately 12 months after the end of the year to which it relates (ie 30 June 2027 for earnings during 2025/26).

3 Modelling where investment return is largely "income"

3.1 INITIAL CALCULATIONS

Under this first scenario, we have assumed that all of the investment return is "income" (interest, rent, dividends, non-capital distributions) and there are no capital gains. This is obviously not a likely scenario but we have used this as a starting point to highlight some key elements of the proposed new tax.

Income has been assumed to be 5% pa before tax and it is assumed that amounts such as franking credits would be included in this amount.

The total income in the first year is therefore $7m x 5% (ie $350,000).

3.2 OPTION 1 : $7M REMAINS IN SUPERANNUATION

If the full $7m remains in superannuation, there are two taxes to consider – normal tax on the income within the fund and the personal "new tax" on the resulting growth in the member's account(s).

3.2.1 Tax in the fund

Part of the income would be exempt from tax due to the retirement phase pension (ie it would be exempt current pension income). We have assumed that the actuarial % for the fund would be approximately 28.5%.

Hence income in the superannuation fund would be taxed as follows:

$$\$7m \times 5\% \times (1 - 28.5\%) \times 15\% = \$37,500$$

3.2.2 Proposed new tax

In addition the member would be subject to the proposed new tax.

Their total superannuation balance for the year would be determined broadly as follows:

Total super balance (start of year)	$7,000,000
Pension payments	($100,000)
Earnings (income and growth)	$350,000
Less tax	($37,500)
Total super balance (30 Jun 2026)	$7,212,500

For the purposes of the new tax, the proportion of earnings subject to tax would be 58%:

$$\frac{\$7,212,500 - \$3,000,000}{\$7,212,500} = 58\%$$

And the "earnings" amount would be $312,500.

Hence the tax payable would be $27,200 (58% x $312,500 x 15%).

3.2.3 Combined tax amount

In total then, the taxes paid in relation to this first year would be $64,700 ($37,500 plus $27,200).

3.3 OPTION 2 : REMOVE $4M FROM SUPERANNUATION

In this case the proposed new tax would have virtually no impact. While the superannuation balance will be slightly over $3m at the end of the year under these assumptions, we have ignored the small amount of tax that would be paid under this alternative.

This time, the taxes paid would be as follows:

Within superannuation	Outside superannuation	Total
5% x $3m x (1 – 66.67%) x 15% = $7,500	5% x $4m x 30% = $60,000	$67,500 (vs $64,700 if the whole $7m remains in super)

3.4 COMPARISON

While the difference is very small, it arises because:

- A key downside of the proposed new tax is that it taxes capital gains as they arise rather than when they are realised. If all of the return comes from income, however, it will be taxed in the current year regardless of the vehicle in which the asset is held,
- In fact the proposed new tax is slightly generous under this scenario in that the "earnings" on which is it levied are calculated *after* tax. This means that broadly speaking the taxes applied to **just the earnings on the $4m of the member's balance that is over $3m** is:

Tax in the fund	New personal tax
15% x 5% income	15% x 85% [1] x 5% income 1 After 15% tax in the fund

(in other words, the overall effective tax rate on the earnings in this example is not 15% + 15%, it's 15% + 12.75%)

- In contrast, if the $4m is removed from superannuation, 30% is applied to the full (gross) earnings of 5%.

4 Returns including capital gains

4.1 INTRODUCTION

In practice, of course, returns usually include a combination of income and capital growth.

The main criticism of the proposed new tax is that it imposes a tax on capital gains as they accrue. In contrast, tax is only paid on the growth of assets outside superannuation when they are sold.

That said, it is generally preferrable (from a tax perspective) to *realise* capital gains in a superannuation fund where the effective tax rate is usually 10% (or less for pension funds).

Hence in determining whether or not it is attractive to remove $4m from superannuation, the question to be explored is whether:

- The *penalty* of paying tax as assets accrue in value (the proposed new tax),
- Is outweighed by the *benefit* of receiving more attractive tax treatment when the asset is eventually sold.

The simplistic comparison is:

- Leaving the $4m in superannuation will see tax paid on a proportion of capital growth as it accrues (15%) plus a further 10% on sale (15% + 10% being 25%),
- Removing the same amount from superannuation will see no tax on growth as it accrues but 23.5% paid on sale (45% plus Medicare on a capital gain that has been discounted by 50%).

Not only is the effective tax *rate* higher under the "leave in super" option but it is also paid earlier. This suggests removing the $4m from superannuation should be the better option.

However, we modelled this to determine whether or not there were other factors to consider.

4.2 SPECIFIC ASSUMPTIONS

For this modelling we initially assumed:

- Returns of 5% income, 3% capital growth (before tax),
- $4m could be removed from superannuation without any cost (ie the fund had sufficient cash to make the payment without realising any capital gains),
- The asset purchased with this $4m (regardless of whether it is held in or outside superannuation) would be held for 5 years and then sold in the 6th year (so that there is a specific trigger to pay capital gains tax even outside super), and
- All other client details and assumptions were in line with sections 2.1 and 2.2.

4.3 MODELLING OUTCOME

We projected the same two scenarios into the future:

- Option 1 : The entire $7m remained in superannuation (incurring the new tax), vs
- Option 2 : $4m is invested outside superannuation with minimal amounts of new tax applying.

The graph below shows the **difference between the two** – ie the extent to which Option 2 is *better than* Option 1 at different points in time (note that if the graph is *above* $0 at a particular time, Option 2 (removing $4m from superannuation) is better at that time. In contrast, if the graph is *below* $0, Option 1 (retaining $4m in superannuation) is better at that time). All figures are adjusted for inflation so are directly comparable to amounts today.

This graph shows that:

- Initially – while the $4m asset is growing in value – the member is *better off* if it is held outside superannuation,
- That's because the tax on the income component is broadly the same under both options (in fact, marginally favours keeping the $4m within superannuation as explained in section 3) but the treatment of the growth is different. Under Option 1 (keeping all money within superannuation), the proposed new tax will mean taxes are paid on the growth as it occurs. No equivalent tax applies under Option 2,
- But this reverses when the asset is sold. At that point, growth over the last 5 years is taxed all at once under Option 2. And it is assumed to be taxed at quite high rates – 45% + Medicare, after allowing for the normal 50% discount – an effective tax rate of 23.5%,

- In contrast, realising the asset has no impact at all on the proposed new tax (remember under this tax, a proportion of the gain is taxed progressively as it emerges, not when it's realised) and so the usual superannuation tax rates apply. At worst, this is an effective rate of 10% on the capital gain,
- In fact, in this fund, the effective tax rate will be less than 10% because the member has a pension account. By the time the asset is sold, the pension account is projected to represent around 25% of the fund, meaning 25% of the capital gain is exempt current pension income (ECPI) and so entirely exempt from tax.

  It is easy to miss this last point as conceptually we typically view the "extra $4m" as an amount over and above the fund's pension account. So in theory, the existence of ECPI should be irrelevant as it only relates to the "pension" part of the fund. But remember that the ECPI % is applied to every $1 of income in the fund. In this case we are modelling the impact of simply selling one asset (the $4m asset purchased at the start). Even though this is notionally "the money over and above $3m and so definitely over the pension account", it still shares in ECPI.

The net result is that once the taxes triggered by selling the asset have been taken into account, the member is actually better off if the entire balance has been left in superannuation from the start. And interestingly, even when Option 2 appears more favourable (while the asset is still growing), the difference is modest in relative terms (the graph above peaks at $50,000 in today's dollars, compared to a total wealth at the start of $7m).

4.4 INVESTMENT RETURNS THAT ARE SKEWED TOWARDS CAPITAL GROWTH

The position changes if more of the investment return comes from capital growth.

For example, the graph below shows the same projection assuming that the income component of the return is 2% and capital growth is 6% pa.

This time, the positive impact of avoiding tax on capital gains as they accrue is much larger. So much larger, in fact, that it is enough to outweigh the reversal that occurs when the asset is sold. The benefits of Option 2 while the asset is growing are much more significant in dollar terms as well – notice how this graph peaks at just over $160,000. By the time the asset is sold, however, the result is only a $20,000 improvement (in today's dollars) by having the asset held outside superannuation.

4.5 OTHER VARIATIONS

4.5.1 Costs to transfer the $4m out of superannuation

In our modelling so far, we have assumed that there is no cost to moving the $4m asset outside superannuation. In fact this is unlikely. Commonly capital gains tax, stamp duty etc would be incurred. Even on the most favourable scenario (section 4.4 above), up-front costs of only $15,000 would negate all the benefits of moving the asset outside superannuation.

4.5.2 A variety of different return assumptions

Clearly the case for removing assets from superannuation appeared much more favourable when more of the return came from capital growth rather than income. In each case, however, the broad pattern was the same – the member was better off if the $4m was outside superannuation while the asset was growing but not once the asset was sold. The table below shows the "end position" (ie after the asset is sold in the 6th year) for a range of different return assumptions.

The column headings represent the return expressed as income / growth (ie 5% / 3% shows the results for a total return of 8% which is 5% income and 3% growth). Option 1 is the member's projected wealth if all assets remain in superannuation and Option 2 is the projection if $4m is

moved outside superannuation. The difference is Option 2 less Option 1 and the final row shows this amount adjusted to allow for inflation. If the final result is positive (see highlighted cells), it favours removing the asset from superannuation (ie Option 2). In each of the scenarios where the final result is positive (ie favouring removing the asset from superannuation), the "growth" component of the return is higher than the income component.

	5%/3%	4%/4%	3%/5%	2%/6%	5%/5%	4%/6%
Option 1	$9,586,968	$9,625,882	$9,664,407	$9,702,522	$10,587,981	$10,630,307
Option 2	$9,561,991	$9,619,492	$9,676,362	$9,732,557	$10,581,741	$10,645,577
Difference	-$24,977	-$6,390	$11,955	$30,034	-$6,240	$15,270
Inflation Adj.	-$20,918	-$5,351	$10,012	$25,153	-$5,226	$12,789

4.5.3 A longer timeframe

In the previous examples, the asset was only held for 5 years and sold in the 6th. What if it had been held for 10 years? This gives more time for the positive impact of deferring taxes on capital gains to increase the value of the member's wealth. The graph below assumes 5% income / 3% growth :

Once again, while the $4m asset is growing in value – the member is *better off* if it is held outside superannuation, but this reverses when the asset is sold - at that point, the member will be worse off.

Repeating this modelling with adjusted assumptions (2% income / 6% growth) we have a similar picture to section 4.4:

Once again, it is difficult to present a picture where withdrawing the $4m from superannuation has a *positive* impact on the member's wealth relative to leaving it in the fund in cases where the asset held outside superannuation is ultimately sold.

4.5.4 Uneven growth

In our modelling so far, we have assumed that capital growth is consistent year on year. Of course, another very significant downside of taxing unrealised gains is that the tax liability will arise even if the gain accrued subsequently disappears. Under the proposed new tax, for example, it is possible that:

- An asset increases significantly in value in year 1 (and the new tax is paid), and
- It drops in value in year 2 and the member's balance falls below $3m and never recovers (either because the member withdraws large amounts from superannuation or because subsequent returns are not enough to bring the balance back up above $3m).

The current proposal is that no refund will be provided for the tax paid in the first year, rather there will be a loss to carry forward in year 2 and beyond. If the member's balance never exceeds $3m again, this loss has no value – it will not reduce future taxes. It is also worth noting that the value of the loss could deteriorate over time in any case.

For example, consider the scenario outlined below where a property experiences a significant increase in value initially, an equivalent reduction but the loss carried forward is used in years when

the member's balance is lower than it was at the time the initial growth occurred. For simplicity, we have ignored tax within the fund.

	Year 1	Year 2	Year 3
Comment	Fund owns property, no rent but significant increase in value.	Property drops in value and is sold at the end of the year	Assets generates income, withdrawals during year
Assets at start of year			
Property	$4,500,000	$5,000,000	$0
Cash	$500,000	$500,000	$5,000,000
Member Balance	$5,000,000	$5,500,000	$5,000,000
Withdrawals	$0	$0	($250,000)
Growth	$500,000	($500,000)	$0
Income	$0	$0	$250,000
Assets at end of year			
Property	$5,000,000	$0 (sold)	$0
Cash	$500,000	$5,000,000	$5,000,000
Member Balance	$5,500,000	$5,000,000	$5,000,000

	Year 1	Year 2	Year 3
New tax:	$34,090 (15% x 45.45% x $500,000)	n/a (loss carried forward is $500,000)	n/a – used $250,000 of carried forward loss If there had been no loss carried forward, tax would have been $15,000 (15% x 40% x $250,000). If Year 4 is identical, the full loss carried forward from Year 2 will be used up at the end of Year 4, with an associated tax saving of $30,000 in total.

The key observation from this table is that at the time the carried forward loss is used, the member had a lower balance than he / she did at the time the new tax was paid on unrealised gains.

As a result, a smaller proportion of his / her balance was over $3m and so a smaller proportion of the earnings was subject to the new tax. In this example, the member paid tax of $34,000 on the gains in year 1 but the carried forward loss would only be "worth" $30,000 in tax savings over 2 years (Year 3 and Year 4). Of course the reverse would be true if the member's balance was increasing.

4.6 CONCLUSION

There is no doubt that the proposed new tax materially reduces the tax concessions available within superannuation for wealthier members.

Not only does it impose an additional tax (narrowing the gap between superannuation and non-superannuation rates) but it also imposes that tax on unrealised gains meaning tax liabilities will be *brought forward*.

However:

- removing assets from superannuation is not necessarily the right response for those impacted if we consider the outcome purely from the perspective of their own tax / wealth position during their lifetime,
- this is particularly the case if:
    - most of the future investment return will come from income rather than capital gains, and/or

- there are costs involved in moving assets outside superannuation in the first place.

- In particular, SMSFs with very large accrued capital gains built up before 30 June 2025 (the commencement of the proposed new tax) should be cautious about realising those gains to transfer money out of superannuation. The new tax looks at growth *since that time*, not before. Any action that deliberately triggers the payment of tax on these accrued gains might be counterproductive.

- As an aside, it is worth noting that this is one reason the new tax (with all its flaws) might be more attractive to clients than a tax that is applied to actual taxable income attributable to a member's account balance each year. Remember that in the year an asset is sold, the taxable income attributed to an individual member would include a share of all capital gains both before and after 30 June 2025. If such a method was to be introduced it would be important to have additional mechanisms to specifically exclude pre-existing capital gains (similar to the cost base re-set adopted for the 2017 changes). This would be complex – as it would involve adjusting the cost base for the proposed new tax only, not the actual tax paid within the SMSF. But without such a mechanism, taxing actual capital gains is potentially far worse for some members than the approach currently being suggested.

5 Death taxes

5.1 INTRODUCTION

The proposed new tax is a major reduction in superannuation tax concessions for wealthier members. It reduces the benefits of superannuation rather than making it fundamentally unattractive during a member's lifetime.

But superannuation has always presented a very significant downside for members who **die**. That is the substantial taxes paid by some beneficiaries. While the apparent tax rates in most cases are low (15% on the taxable component where the deceased was over 65 and the money is paid to the relevant beneficiary via the estate), it is applied to some or all of the member's superannuation *capital* rather than income. Hence the amounts can be very large.

This is not immediately relevant for couples who are happy to leave their superannuation to each other but it will be relevant when the second member of a couple dies.

Before 1 July 2007, compulsory cashing rules meant all members were legally obliged to convert their superannuation to a pension or withdraw it entirely from a certain age. Even after 2007, members generally did so without being required to because of the very significant tax benefits associated with converting their entire balance to a pension – a complete tax exemption on all of the fund's investment income (ECPI). From 1 July 2017, however, the introduction of the transfer balance cap meant those with very large balances were constrained in the amount that they could convert to a pension, but they were not required to "do anything" with the rest of their superannuation. Consequently, it generally remained in their SMSF as an accumulation account. In many cases, these accounts have now grown significantly in the last 6 years.

A hidden consequence of the growth in accumulation accounts is the much higher amounts of tax that would be paid on death if the current generation of retirees died without tax dependant beneficiaries.

5.2 MODELLING APPROACH

In this section we have considered our same member with $7m in superannuation. We have assumed (worst case) that the full balance is a "taxable component" and therefore all subject to 15% tax if paid to the member's estate. We have assumed the member has no estate beneficiaries classified as tax dependants.

For this exercise we have ignored the proposed new tax. As outlined earlier, it does narrow the gap between superannuation and non-superannuation savings but if anything, it would simply suggest that leaving money in superannuation is marginally more attractive under most assumptions.

The two options compared in this section are:

- Option 1 – continue with the member's current approach. Minimum pensions are drawn from the pension account but nothing is withdrawn from the accumulation account.

- Option 2 – make regular drawings from the accumulation account as if the member had also converted that amount to a pension. Of course, the tax treatment of the accumulation account within the SMSF would be unchanged (no ECPI) but the approach would see the member gradually drawing down on the account rather than leaving it to grow.

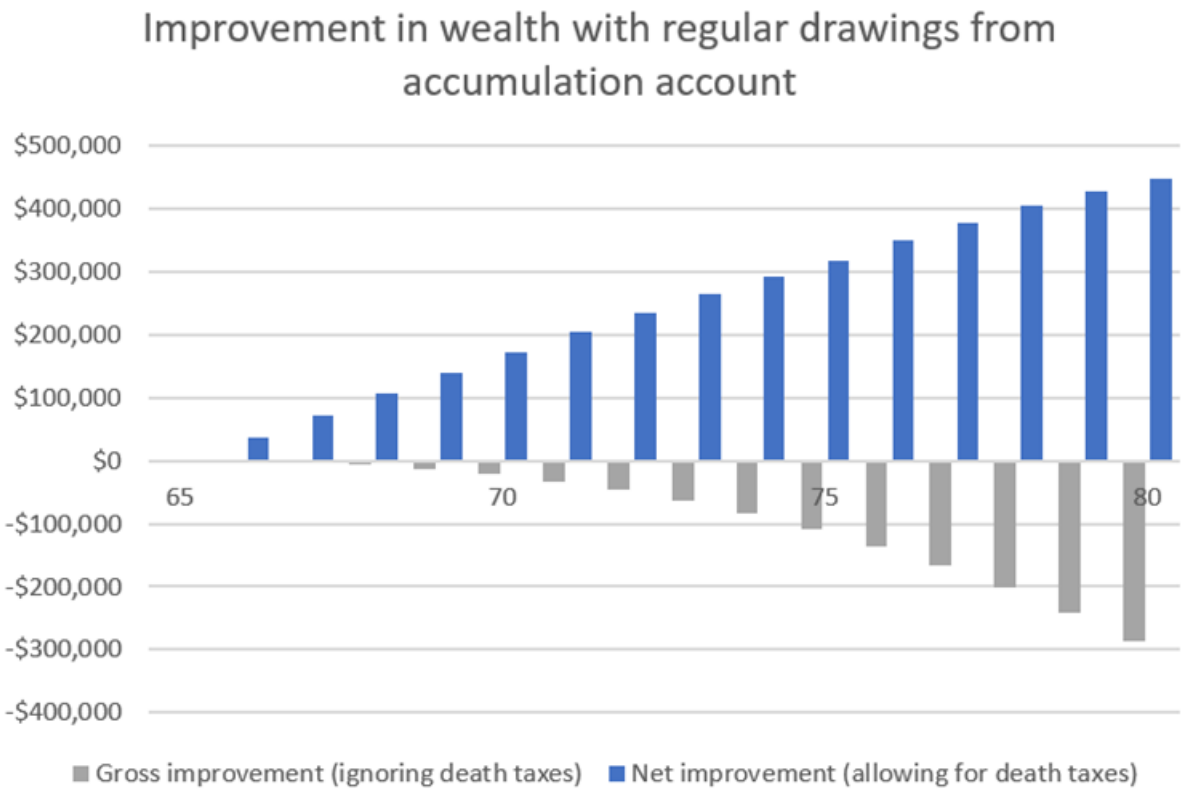
In both cases we have made the following assumptions:

- The member has no need for income/cash flow from the fund (living costs are assumed to be met from other sources),
- The fund's assets produce sufficient cash income to make the payments over time (we comment on how this could impact the results below), and
- Investment returns are 5% pa income, 3% pa capital gains.

5.3 MODELLING RESULTS

We can initially make quite a superficial comparison:

- First, how much wealthier do the additional withdrawals make the member themselves (ie during their lifetime)? This is simply the difference between Option 2 and Option 1 (adjusted for inflation)? This is represented by the grey bars below, and
- Second, if the member died at any point, how much wealthier would the *beneficiaries* be under Option 2 vs Option 1 at that point? This is represented by the blue bars below.



This graph shows that regular withdrawals from superannuation make the *member themselves* poorer over time (the grey bars). For example, by the time the member reaches age 75, they are around $100,000 worse off (adjusted for inflation) than if they had simply left the same amount in superannuation.

This is not surprising – they are withdrawing money from a favourable tax environment (superannuation) and investing it outside superannuation. While the new tax would lessen the impact, remember this model involved moving relatively modest amounts out of superannuation progressively over time rather than a large ($4m) in a single withdrawal.

The blue bars show the position of the *beneficiaries* if the member died at that time. For example, if the member died at age 75, the total amount of the beneficiaries' inheritance would be around $100,000 lower (because moving some money out of super progressively over time has reduced the member's overall total wealth). However, they would also save a lot of tax – because no immediate tax would be paid on their inheritance of the non-superannuation balance. In this case, the immediate tax saving is not only enough to reverse the impact of the $100,000 shortfall in their inheritance but is actually so significant it makes them wealthier in after tax terms by around $300,000 (a $400,000 turnaround). All figures have been adjusted to allow for inflation.

This is definitely a superficial comparison:

- It makes no allowance for the proposed new tax – because doing so would involve predicting the timing of asset sales inside and outside superannuation (it would, however, be likely to reduce the negative impact of removing money from superannuation and so would make the grey bars smaller),
- It makes no allowance for capital gains tax that would need to be paid to move assets out of superannuation to pay a death benefit (note that allowing for this would make the blue bars even higher), and
- It makes no allowance for the fact that under Option 2 the beneficiaries would inherit non-superannuation assets with accrued capital gains that would be taxed when sold. This would lower the blue bars – but approximate calculations to allow for this suggest the impact would not be enough to profoundly change the picture that emerges here.

5.4 CONCLUSION

Our conclusion from this modelling overall is that:

- While the proposed new tax might not present an immediate trigger to withdraw money from superannuation, the same demographic impacted by this tax is likely to have large and growing accumulation balances,
- For members with no tax dependants this presents a much larger problem for family wealth than the proposed new tax,
- There is perhaps some logic to addressing this by tactically withdrawing progressively from superannuation – the mechanism suggested here is simply treating the accumulation account

as if it was a pension account and withdrawing regularly over time. But equally valid would be a strategy of simply withdrawing from superannuation as and when fund assets are sold (so new assets are bought outside superannuation rather than inside superannuation),

- This model considered someone aged 65 with (hopefully) many years left to enjoy all the benefits of superannuation. An entirely different approach might be appropriate for a recently widowed 90-something. At that point, a more significant withdrawal strategy might be called for,
- We have not allowed for the option of leaving wealth in superannuation but withdrawing it entirely immediately before death. In theory this is possible and would be the best of both worlds. However, our experience in practice is that this is incredibly difficult to do and most families are unsuccessful in the careful timing that requires. A simple process that sees superannuation balances being withdrawn over time is a more practical strategy to implement.