FINANCIAL ADVICE
ASSOCIATION AUSTRALIA

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Director
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Dear Sir/Madam

Exposure Draft - Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to provide feedback on exposure draft Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 and associated material.

As stated in our 17 April 2023 submission on Treasury's consultation paper, in principle, our association supports the intent of the government's policy to ensure the superannuation tax concessions available to all Australians are fair, reasonable and equitable. However, we are disappointed that the following issues remain in the draft legislation for this measure:

1. No indexation of the large superannuation balance threshold, which is too low
2. The impact on members with illiquid assets within their superannuation
3. Taxing of unrealised gains
4. No flexibility in the super system to permit members to restructure and withdraw funds above the threshold.

The provisions in the draft legislation will have unfair and unreasonable consequences for particular superannuation members, such as farmers and small businesses, who we assume are not the primary intended target for the tax. We suggest further improvements to enhance the fairness in the calculation methodology and improve the certainty for consumers.

[1] The Financial Advice Association of Australia (FAAA) was formed in April 2023, out of a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest-standing associations of financial planners and advisers. The FPA was a professional association formed in 1992 as a merger between The Australian Society of Investment and Financial Advisers and the International Association of Financial Planning. In 1999 the CFP Professional Education Program was launched. As Australia's largest professional association for financial planners, the FPA represented the interests of the public and (leading into the merger) over 10,000 members. Since its formation, the FPA worked towards changing the face of financial planning, from an industry to a profession that earned consumer confidence and trust, and advocated that better financial advice would positively influence the financial wellbeing of all Australians. The AFA was a professional association for financial advisers that dated back to 1946 (existing in various forms and under various names). The AFA was a national membership entity that operated in each state of Australia and across the full spectrum of advice types. The AFA had a long history of advocating for the best interests of financial advisers and their clients, through working with the government, regulators and other stakeholders. The AFA had a long legacy of operating in the life insurance sector, however substantially broadened its member base over a number of decades. The AFA had a strong focus on promoting the value of advice and recognising award winning advisers over many years. The AFA had strong foundations in believing in advocacy for members and creating events and other opportunities to enable members to grow and share best practice.

1. Large superannuation balance threshold level and indexation

To ensure the equity of the system is maintained over time and given the long-term nature of superannuation, consumers need certainty as to what will happen to this threshold in the future. In particular, we note the implications when the indexed Transfer Balance Cap (TBC) increases to be on par with the $3 million large superannuation balance threshold that is subject to the Division 296 tax rate. Over time, a significantly larger percentage of Australians who responsibly prepare for retirement, in line with cost-of-living increases, will be inadvertently caught by an unindexed large superannuation balance threshold, which may be counter to the government's intent and the objective of the super and retirement systems.

We believe, consistent with previous advocacy from various stakeholders, that the threshold could be set at $5m. This would reduce the number of impacted members (particularly if it is unindexed), whilst having minimal impact on the small number of very large accounts, that are presumably the primary target of this new tax.

The FAAA recommends the large superannuation balance threshold should be higher than $3 million and indexed to keep pace with wage increases and provide greater certainty for consumers over the long-term.

2. Impact on illiquid assets

As stated in the Explanatory Memorandum, the Government's proposed objective of superannuation is '*to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way*.'

When announcing the Better Targeted Superannuation Concessions measure, the Treasurer stated: "*The 0.5 per cent of individuals with superannuation accounts over $3 million will receive less generous tax breaks for balances that are beyond what is necessary to fund a comfortable retirement*"[2]. However, the draft legislation ignores the diversity of users of the super system - it ignores the way farmers and small business owners might use the superannuation system. For example, a farmer may hold their $5M farm in a SMSF as the primary underlying asset to fund their retirement. This is permitted within superannuation law. Given the farm is also a farmer's livelihood, it is not an asset that can be sold in order to minimise or pay a superannuation tax liability. It is an illiquid asset.

Given the potential consequences of a large increase in the value of fund assets in any one year, any fund with a high proportion of illiquid assets would be at risk of needing to find money to pay the tax and would therefore be forced to hold a much higher level of funds in cash. In the long term, this will force more fund assets being held in low-risk liquid assets and detrimentally impact investment returns. Whilst the risk of illiquid funds has been recognised, it has not been solved.

In relation to the impact on SMSFs, the International Centre for Financial Services estimates "*an approximate 4-fold increase in the rate of liquidity problems, from 3.1% to 13.5%, once we*

[2] https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/superannuation-tax-breaks

account for members meeting the added tax expense in a prior period. This implies an additional cumulative liquidity risk factor for affected members."[3]

The FAAA recommends the legislation should be clearer in its application to people with superannuation liquidity problems.

3. Taxing unrealised gains

The application of the proposed Division 296 tax will result in taxing members' unrealised capital gains, which we strongly oppose.

The proposed formula includes unrealised gains in the year's earnings. This results in many circumstances where assets held inside super may incur a higher effective tax rate than assets held outside of super, along with inconsistent treatment of the discounting for capital gains. The timing of the payment of tax is also an important consideration, in that a large tax may be payable in a year of very strong investment returns, whereas the following years could see market declines with no cash refund resulting. The design of this measure is without precedent and raises the question of fairness. We do not support the taxing of unrealised gains.

We appreciate the design of the measure is based upon the application of the tax to the increase in the adjusted total superannuation balance, which automatically includes unrealised gains. Removing unrealised gains would add a significant complication in the application of this model. An alternative might be the utilisaiton of some form of deemed return.

The FAAA suggests addressing the taxing of unrealised gains through a form of deemed return.

4. Preservation rules

Australians have put money into super and invested it accordingly on the basis that super is the best investment vehicle for long-term saving for a self-funded retirement. For some Australians, this may no longer be the case under the Better Target Super Concessions changes. A comparison of some of the key tax applications to alternative investment vehicles, including Super funds (for both ordinary balances and those over $3 million who are subject to the new earnings tax) is set out in the following table.

	Super Fund	Super Fund >$3m	Company	Discretionary Trust	Individual
Income Tax Rate	15% subject to reduction for CGT discount and franking credits	15%	30%	Based on Beneficiary	Based upon Individual
CGT Discount	Yes - 1/3rd	No	No	Yes - 50%	Yes - 50%
Taxing of Unrealised gains	No	Yes	No	No	No

[3] International Centre for Financial Services, The University of Adelaide, *Evaluation of the proposed changes to superannuation tax concessions*, October 2023

Superannuation is also subject to the potential complication of death benefit tax on the payment of death benefits to non-financial dependents, which further impacts the attractiveness of this vehicle.

As indicated in the above table, the complexity of the superannuation and tax system is exemplified when overlaid with the Better Targeted Super Concessions provisions in the draft legislation. Financial planners must provide advice that is in the best interest of their client, including consideration of the best vehicle for saving for retirement to minimise the need for the age pension. This is also in the government's interest. Superannuation may no longer be the best vehicle for some Australians, or at least not to the extent that their balance is over $3 million. As the impact of the proposed new tax may require some Australians to exit the superannuation system, people should have the opportunity to restructure their arrangements.

In order to enable impacted members to reduce the balance of their superannuation accounts, we suggest changes to the preservation rules to allow individuals to withdraw excess funds from the super system. As the withdrawal of funds from super may depend upon selling business assets, the suggested changes to the preservation rules should permit withdrawals to be completed as a one-off or in stages and at any point in time in the future.

The FAAA recommends the preservation rules be amended to permit the withdrawal of funds in excess of the large super balance threshold.

Conclusion

As the $3 million threshold is not proposed to be indexed, far more individuals are likely to be subject to the proposed earnings tax over time, especially in a high-inflationary environment. The proposed tax increase will not just target the 'super wealthy'. As the superannuation system matures, the proposed new tax will hit the retirement savings of more and more hard-working Australians. This will undermine support for superannuation and strategies designed to maximise super balances, such as salary sacrificing. Therefore, it is critical to ensure the settings of the Better Targeted Super Concessions are appropriate and in line with the intent of the measure, and work within the complex tax and superannuation system while minimising unreasonable unintended consequences for superannuation members.

We would welcome the opportunity to discuss with the Treasury any matters raised in our submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

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Financial Advice Association of Australia