generation life

Update to proposed changes to superannuation tax

This information has been prepared for use by financial advisers only.

Following on from Treasury's consultation paper released on 31 March 2023, the Government is consulting on two proposed Bills[1], that would enact changes to superannuation tax concessions for those with superannuation balances[2] above $3 million.

The draft Bills are designed to reduce the tax concessions available to individuals with a superannuation balance exceeding $3 million by imposing an additional 15% tax on 'earnings' under a new Division 296 of the Income Tax Assessment Act 1997. This new tax will be referred to as 'Division 296 tax'.

From the 2025-26 income year onwards, the headline concessional tax rates applying to superannuation earnings would be:

- up to 15% on earnings on superannuation balances at or below $3 million
- up to an overall 30% on a percentage of earnings equal to the percentage of superannuation balances above $3 million.

The tax will be imposed directly on the individual and is separate from the tax arrangements of the superannuation fund or scheme.

Balances in all Australian superannuation accounts, both accumulation and retirement phase, will be included for the purposes of calculating an individual's liability for the new tax. This includes APRA-regulated funds, SMSFs and exempt public sector schemes.[3]

Takeout

This will impact individuals with superannuation balances above $3 million in the 2025-26 financial year and beyond. Earnings on balances above the $3 million threshold will be taxed where the balance remains above the threshold. Careful planning is required to understand when a client may fall into the regime and how they may respond.

There has been no specific provision proposed to allow an individual to remove preserved benefits from superannuation to avoid or reduce the Division 296 tax and whether this may mean years of paying additional tax until a condition of release is met or limiting further contributions to minimise this impact.

How will this work?

The changes are to commence on 1 July 2025 and the additional 15% tax will apply to 'earnings' accrued from this date for individuals with a total superannuation balance (TSB) of more than $3 million at 30 June 2026.

For each income year, a new Division 296 tax liability will be calculated and the individual notified of their tax liability for that year. Division 296 tax will be levied at a rate of 15% on that part of the individual's superannuation earnings corresponding to the proportion of their superannuation balance above $3 million. The $3 million threshold is not indexed.

Planning ahead

With a proposed start date of 1 July 2025 and Division 296 tax to apply to the 2025-26 financial year, the timing of any re-structure of assets and investments that may be considered is important.

Depending on the fund portfolio holdings, superannuation investors might seek appropriate professional advice on areas such as asset liquidity, depth of market, settlement periods and the impact of tax realisation events. For example, where a superannuation fund holds direct property, professional advice might be sought to consider the time required to take the asset to market (including upgrades or repairs required), the value of the asset, the marketing period, the method of sale, buyer demand, the post-sale settlement period, the impact of existing debt facilities, and also the capital gains tax position.

Similarly, for example, understanding the market depth for listed securities and the impact of forced quick sales on price could also be a consideration - appropriate professional advice might be sought on this issue.

Takeout

An individual's balance at the end of the year, will determine the proportion of 'earnings' subject to Division 296 tax. The higher the end balance above $3 million, the higher proportion of 'earnings' that will attract the 15% additional tax.

Earnings includes both realised and unrealised gains and income generated over a financial year. The 15% is a flat rate of tax that cannot be reduced by franking credits or any CGT discounts. The normal CGT discount that effectively taxes capital gains at 10% within a superannuation fund, does not apply to Division 296 tax.

The $3 million threshold level will not be indexed annually to factor in future thresholds in today's dollar terms. The new measure is expected to initially impact around 80,000 members in the 2025–26 income year, however, with increasing investment values and contributions to superannuation over time, the level of impacted members may be much more.

Division 296 tax will be levied directly on individuals and imposed separately to personal income tax and superannuation fund tax. Individuals will have the option of paying their tax liability by either releasing amounts from their superannuation or using amounts outside of the superannuation system. A Division 296 tax on defined benefit interests may be deferred until after the first benefit payment is received.

Division 296 tax will not be payable where the individual is:

- a child recipient of a superannuation income stream at the end of the income year
- the recipient of a structured settlement contribution made in respect to them as a payment for a personal injury at the end of the income year, or any year prior
- an individual who has died before the last day of the income year.

Temporary residents will receive a refund of any Division 296 tax paid once they leave Australia.

Interests in defined benefit schemes and lifetime annuities will count towards the TSB value. How these account types are to be valued has not yet been finalised. Further regulations are expected to be released to clarify this position.

While a new, reduced, general interest charge, of 3% above the base interest rate, has been proposed to apply where a Division 296 tax liability remains unpaid by the due date, there are no other proposals to address issues of limited liquidity, particularly in SMSFs.

How will earnings be calculated?

Earnings, for Division 296 tax, will be calculated as the difference in an individual's superannuation balance at the start and end of the income year. However, the end of year superannuation balance is adjusted for withdrawals and contributions made throughout the income year, which would otherwise understate or overstate the investment earnings. For the purposes of Division 296 tax only, Limited Recourse Borrowing Arrangements (LRBA) are excluded from TSB.

'Earnings' are calculated as follows[4]:

Earnings = (TSB End of Financial Year + Withdrawals - Contributions) - TSB Start of Financial Year

The 'withdrawals total' added back include the following amounts paid from an individual's account during the year:

- a superannuation benefit payment
- superannuation benefits transferred via spousal contribution-splitting
- superannuation benefits transferred to another person via a family payment split
- amounts withheld from an excess untaxed roll-over amount
- amounts released under a valid requested release authority[5].

Withdrawals exclude any rollover superannuation benefits, payment made under a continuous disability policy, an amount that arises due to fraud or dishonesty, and payments of unclaimed superannuation benefits.

The 'contributions total' deducted include the following amounts received in an individual's account during the year:

- non-concessional contributions
- 85% of the concessional contributions
- contributions-splitting superannuation benefits received (or 85% if there is a concessional contribution split)
- family law superannuation payments received due to a payment split
- the TSB value of a superannuation death benefit interest when the individual becomes a retirement phase recipient (this ensures this is not calculated as your 'earnings' and hence subject to tax)
- a death or total and permanent disability insurance payment or contingent beneficiary payment (with the exception of continuous disability payments)
- any amounts allocated to the individual's superannuation plan that are captured within the meaning of concessional contributions under subsection 291-25(3)
- a transfer from a foreign superannuation fund
- the increase in TSB value of a superannuation interest as a result of a remediation payment or compensation for loss as a result of fraud or dishonesty.

Further regulations may be released by Government to make further modifications to what adjustments will be possible to the TSB.

If the above calculation of 'earnings' results in a 'loss', the negative earnings may be able to be carried forward and used to reduce the amount of superannuation earnings subject to Division 296 tax in future income years.

i Takeout

Negative earnings can be carried forward to reduce a future Division 296 tax liability in some circumstances. However, negative earnings will not be permitted to be used to receive a refund on any previous year's Division 296 tax liability, even if that liability was on an unrealised gain that was, in fact, never realised.

Observations

- For superannuation investors , the new tax will be charged on unrealised gains. Investment bonds are only taxed on realised investment gains.
- The changes are proposed to commence from 1 July 2025. Individuals who, prior to the commencement date, might be seeking to reduce superannuation balances below the $3 million threshold and limit the level of earnings that would otherwise attract an additional tax, might seek appropriate prior professional advice.
- There is no proposal to index the $3 million amount. The $3 million threshold will apply for the 2025-26 financial year – so it will not just impact those with $3 million in their superannuation today but also those that will have over $3 million in superannuation well beyond the commencement date.

Tax-effective complementary option to superannuation

Investment bonds are a legislatively stable, tax-effective solution that offer flexibility, control and a range of investment options to suit an investor's life stage needs. Unlike superannuation, investment bond funds are not locked away until preservation age and/or retirement, which means funds can be withdrawn at any time. They are popular with high-income earners seeking to reduce tax, protect assets and gain more certainty in estate planning outcomes.

Investment bonds offer a tax effective solution for building wealth, with tax on investment earnings capped at 30%. With Generation Life's tax optimised structures, effective long term average annual tax rates for Generation Life investment bonds can be less than 15% for growth orientated investment options.

Reducing tax even further

Generation Life's proven and market leading tax aware process, takes this one step further and allows us to significantly reduce the impact of tax on investment returns by reducing an investment's tax assessable earnings by offsetting capital investment losses against income. Through a disciplined tax aware approach to trading when we sell investments such as shares, our process ensures that we effectively manage our clients' portfolios, selling to deliver the best tax outcome.

The long-term expected increase in after-tax performance of Generation Life's Tax Optimised series is expected to be between 0.40% and 2.60% p.a.[7] when applying these tax aware principles to an investment bond structure. This builds upon the tax arbitrage already available to investors on higher personal marginal tax rates who use the Generation Life investment bond product. After all, investment returns go up when taxes go down. It's that simple.

Innovating tax-effective investing

We understand that finding the right investment partner is important to you. As the pioneer of Australia's first truly flexible investment bond, we have been at the forefront of providing innovative tax-effective investment solutions since 2004. We are a leading specialist provider of tax optimised investment and estate planning solutions – with over $2.8 billion invested with us to date.

As an award-winning provider of tax-effective investment solutions, our focus is to continue to provide Australians with market leading tax-effective investment solutions that provide a flexible investment alternative to meet both personal and financial goals. Our investment solutions are designed to help you grow your wealth, meet your day-to-day investment needs and to help plan for your future needs including the transfer of wealth to the next generation.

Generation Life investment bonds are investment-linked life insurance contracts governed under the Life Insurance Act 1995 and the Corporations Act 2001. The investment bonds operate under rules that are approved by APRA. Investment bonds follow legislated tax rules administered by the Australian Tax Office that set out how they are taxed and when tax is payable.

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Outthinking today.

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This information document has been prepared in relation to proposed Government changes to superannuation tax concessions. Other than in relation to Generation Life's Investment Bonds, information detailed in this communication is factual information only and is not intended to imply any recommendation or opinion about superannuation products or superannuation investment.

1. Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 and the Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023.
2. For simplicity, in this document "superannuation balance" is used instead of TSB.
3. Special rules apply to certain Commonwealth judges and justices, certain State higher level office holders, and non-complying funds such that no additional tax will apply, however, their balances will be used to determine if the $3m TSB threshold has been exceeded.
4. This formula is modified where an individual has eligible 'negative superannuation earnings' from a previous year.
5. Where an amount released under a valid release authority relates to a first home super saver (FHSS) determination, the amount to be included in withdrawals will be adjusted to reflect the value of the assessable FHSS released amount excluding the associated earnings.
6. Indicative effective average tax rates – these represent the estimated average annual tax as a percentage of earnings for each 12-month period over a forecast period of 15 years. Actual tax amounts payable are not guaranteed and may vary from year to year based on the earnings of an investment option.
7. Over backdated 10-year period (based on average return) on Funds launched in Tax Optimised series with no change to investment risk when you optimise for tax.

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