Director
Superannuation Tax Unit
Retirement, Advice and investment Division
Treasury
Langton Cres
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By email: superannuation@treasury.gov.au

Dear Sir/Madam,

Submission regarding proposed changes to superannuation tax

We are writing to provide our submissions on the *Treasury Laws Amendment (Better Targeted Superannuation Concessions)* Bill 2023 (**Bill**). We are members of a self-managed superannuation fund that will be affected by the proposed tax changes.

The implementation of a tax on unrealised capital gains would be a fundamental change in Australian tax law which is based on taxing income and profits not wealth. The proposed tax changes are perverse, unfair, and undermine confidence in the superannuation system.

We also believe that the Government has been dishonest and deliberately misleading in its communication of the proposed tax changes.

1. Taxing unrealised capital gains

Australia's tax system is built on the taxing of income and profits. The proposal to introduce a tax on superannuation balances above $3 million would result in the taxing of unrealised capital gains. Simply put, such an outcome is a wealth tax. This is a perverse change to Australia's tax laws.

In 1975, the Tax Review Committee, when considering the topic of the taxation of capital gains, commented that the "impracticality of taxing capital gains as they accrue is universally recognised: the tax can only attempt to deal with realised gains." The taxing of unrealised capital gains leads to unacceptable problems in the periodical valuation of assets and generates severe liquidity difficulties for taxpayers. Furthermore, assets fluctuate in value and an asset that eventually gives rise to no gain may nonetheless have given rise to tax liability. The Government's proposal would go against longstanding principles of tax law that only realised capital gains are taxable.

2. The proposed tax changes are unfair

The proposed changes are unfair for the following reasons:

a. taxing unrealised capital gains will create cash flow issues for taxpayers. It is unreasonable to expect taxpayers to fund a tax liability in respect of the appreciation in value of an asset when they have not sold the asset and received money with which to pay any tax liability;

b. taxing unrealised capital gains will expose retirees to the volatility of financial markets. For example, as market prices fluctuate, taxpayers may crystallise a significant tax liability only to find that the value of their investments have significantly declined when it comes time to sell those investments to fund the tax liability. This phenomenon will be accentuated by the fact that trends in financial markets tend to shift around year end dates (both calendar and financial). It is not hard to imagine a situation where a taxpayer will have to pay tax on an asset on which they ultimately lost money. Exposing taxpayers to this volatility is a particularly undesirable outcome for a long-term retirement savings system where stability and predictability are essential ingredients for success;

c. taxing unrealised capital gains denies members the benefits of compounding which is critical to long-term capital appreciation (and in turn, good retirement outcomes). This is because investors will need to sell assets that appreciate to fund the tax liability. It has been said that capital is a tree and income its fruit[1]. The proposal to tax unrealised capital gains would amount to pruning the tree before it bears its fruit;

d. taxing unrealised capital gains will introduce unpredictability into taxpayers' affairs;

e. taxing unrealised capital gains is unfair to affected Australian's who hold illiquid assets, such as interests in venture capital and private equity funds who may be unable to sell those assets, or unable to sell them without significant transaction costs, to fund the tax liability;

f. the changes will dramatically increase complexity and compliance costs;

g. deferring the proposed new tax for members of defined benefit schemes, which notably include the Prime Minister and other Members of Parliament, is deeply unfair. Deferring the tax for members of defined benefit schemes amounts to the Treasury providing an interest-free loan to such members. These members will not face the cash flow issues of other affected Australians and are also not denied the benefits of compounding;

h. by determining the percentage of the total superannuation balance that is above $3 million using end of year figures, rather than an average balance throughout the year, the proposed legislation overstates the percentage of the balance on which "taxable superannuation earnings" are made;

i. changing the rules of the superannuation system is unfair to Australians who have relied on those rules to make capital allocation and spending decisions, prudently choosing to forego spending today to save for tomorrow;

j. it is likely that for many affected Australians the effective tax rate will be higher than their marginal tax rate outside of super;

k. due to cash flow concerns, the proposed changes will encourage investment in less volatile assets, such as fixed income, which will reduce investment returns over time, erode tax neutrality, and lead to inefficient capital allocation decisions. This will also result in worse retirement outcomes for savers;

l. the proposed tax changes are particularly unfair to younger high-income earners who have not met a superannuation condition of release and will be unable to avoid the cash flows issues that the proposed new tax creates;

m. it is unfair for the Government to raise money from people who have invested in their retirements while at the same time not pursuing criminal Australians who committed a $4.6 billion TikTok GST fraud and others who, as widely reported, rort the National Disability Insurance Scheme (frauds that greatly exceed the revenue that will be raised from the proposed new tax), to give but two examples;

n. not indexing the proposed $3 million threshold is deeply unfair as it does not account for inflation. No indexing the threshold will result in the taxation of purely monetary gains rather than real gains. The threshold should be increased annually in line with the Consumer Price Index;

[1] Law – Complexity and Moral Clarity, dated 19 May 2013, Chief Justice Robert French AC, at [3].

o. the proposed changes amount to a broken election promise. Only in the minds of politicians, adept in doublespeak, could it be said that legislating a change to superannuation in one term which is to be implemented in the next is not making a change to superannuation as promised; and

p. the consultation period of 2 weeks is too short particularly as most of the period has been during the lead-up to the Voice referendum during which Australians and the news media have been engaged with that process.

3. The proposed tax changes undermine the superannuation system

The Australian superannuation system is for retirement saving. It is designed for long-term investments that grow over time. Stability is an essential feature of a retirement saving system. By changing superannuation tax, the Government undermines confidence in the superannuation system. This is particularly so where the change is not a simple change of the existing concessional tax rates but rather the imposition of an entirely novel and unprecedented wealth tax.

4. Government communication has been dishonest and deliberately misleading

The Government describes the proposed changes as "modest changes" to make the superannuation system "fairer" by "reducing tax concessions" by imposing a 15% tax on "earnings". The Government's description of the changes is simply untrue.

(a) The Government is introducing an unprecedent new tax on account balances, not "reducing tax concessions"

While personal income is generally taxed at an individuals' marginal tax rate, superannuation has tax concessions in the form of lower tax rates for contributions and investment earnings to support and encourage individuals to save for retirement. The proposed changes do not reduce these tax concessions.

Rather than reduce existing tax concessions, the Government is proposing introducing an entirely novel and unprecedented tax on account balances.

The Government could have proposed reducing tax concessions by, for example, increasing the tax rate on investment earnings on the proportion of superannuation account balances above $3 million. But that is not what it has done. To describe these changes as "reducing tax concessions" when they do no such thing is at best untrue, and at worst, intentionally misleading.

(b) The proposed tax changes are not to "earnings"

The Government is not proposing a tax on earnings as that word is commonly understood. While definitions of earnings can vary, they all have one common concept – that of money having been received. The Government is proposing a tax that would include unrealised capital gains in respect of which the individual taxpayer has not received any money to pay any tax with. To describe the tax as on "earnings" is simply untrue.

(c) The changes do not make the superannuation system "fairer"

Refer to section 2 above.

(d) The changes are not "modest"

The proposed changes are far from modest. An example is illustrative. Consider a super fund with $2 million in assets that appreciate 5% per year and $1 million invested in Microsoft stock. Adopting Microsoft's historical 20-year annual returns, the funds' assets under the current rules would appreciate to, assuming Microsoft is sold at the end of the period and the taxable gain is realised, $13.64 million. Under the proposed new tax rules, the funds assets would appreciate to only $6.84 million – a full $6.79 million less – due to a combination of higher taxes and, importantly, the loss of the benefits of

compounding. In fact, the majority of the difference is accounted for by the loss of compounding. What the example demonstrates is that while the Government asserts that the changes are "modest" the impacts are far from it.

Shockingly, members of defined benefit schemes can defer the proposed new tax creating extremely unfair outcomes. Using the above example, assuming the defined benefit scheme had made the same investments, a member of that scheme would be a full $3.92 million better off than an ordinary affected Australian. It would not be unfair to say that politicians are proposing "taxes for thee, but not for me."

5. Proposed tax changes undermine confidence in Australia's tax system

The proposal to tax unrealised capital gains represents an unprecedented wealth tax. Australians will rightly wonder whether the imposition of such a tax will set a dangerous precedent that will be used to justify other wealth taxes in the future. No doubt many Australians will be concerned that future Governments will use the precedent to impose a wealth tax on the family home. The imposition of a wealth tax on assets in super will greatly undermine Australians confidence in the entire tax system.

6. The budget papers forecast overestimates the revenue that will be raised

Budget paper forecast $2.3 billion revenue in the first full year of receipts collection in 2027-28 but this does not factor in behavioural changes in response to the proposed tax change. Many affected Australian's will assuredly withdraw money from super and shift it to other structures and assets. For example, it will make sense for many affected Australians to withdraw money from super and invest it into their primary residence to minimise tax. This will not only reduce tax receipts but also exacerbate the housing crisis.

For many affected Australians, it will make financial sense to withdraw money from super and re-invest it in very long-term assets which they intend to hold indefinitely (and thereby defer crystallising any capital gains) so that they can benefit from compounding. This will greatly reduce budgeted tax receipts.

7. Conclusion

We believe that the Government should not proceed with a tax on unrealised capital gains. If the Government wishes to reduce super tax concessions for accounts with balances above $3 million, it should do so within the existing framework.

Yours sincerely,

David Gibson

Rocklands Capital