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Additional tax for members with large superannuation balances.

In an attempt to address 'major structural issues in the budget' the Labor Government has recently announced that individuals with superannuation balances in excess of $3m will from 1 July 2025 will have their earnings taxed at 30% instead of the current rate of 15%. As for the detail underpinning this at the time of the announcement, there was not much at all. However, like all major policy changes around taxation, the devil is in the now subsequently released details.

The Government also announced it will embark on a consultation process on how best to implement the measure which is set to take place before the May 2023 Federal Budget. In a somewhat interesting move, the proposed start date of 1 July 2025 was deliberately chosen with the intention of taking the measure to the next Federal election.

Things we know so far

While there is some way to go before this measure is finalised and becomes law, following the release of a Treasury Fact Sheet titled "Better Targeted Superannuation Concessions" some of the details behind Tuesday's initial announcement are starting to become a little clearer. I fully expect further changes once it's realised how complex their proposal is.

Currently, fund earnings derived by assets held in the accumulation phase are generally subject to tax at a maximum tax rate of 15% within a superannuation fund – regardless of the member's fund balance. It appears that this will continue to be the case beyond 1 July 2025. Similarly earnings underpinning pension entitlements within a superfund will continue to remain tax free.

However, the Government's announcement will broadly see 'earnings' derived by a member's superannuation assets above $3m, subject to a new and additional 15% tax from 1 July 2025.

Importantly, it is not the member's actual earnings that will be subject to this additional tax, rather the proposal introduces a new methodology (which includes unrealised gains) to calculate the relevant earnings amount and the resulting tax liability for affected individuals which is based on an individual's Total Superannuation Balance (TSB) year on year. The new definition of earnings is completely unrelated to the actual taxable income earned by the fund.

Note also that it's a $3m per person threshold, not per fund. That means a couple could still have nearly $6m in super before being impacted, as long as it's split evenly between them and neither goes over $3m.

How will the earnings, and resulting tax liability be calculated?

It's worth noting that this is a member/individual tax, not a superfund tax. The current methodology for determining the tax liability/tax refund of a superfund remains unchanged. The superannuation fund will prepare and lodge a tax return on exactly the same basis as in the past.

The Treasury Fact Sheet outlines a proposed 3-step methodology that will be used to determine the amount of an affected **individual's** tax liability:

Step 1: Determine the relevant 'earnings' amount.

"Earnings are calculated with reference to the difference in TSB at the start and end of the financial year, adjusting for withdrawals and contributions."

To achieve this, it has been proposed that the following formula be used:

*Earnings = Current financial year's TSB – Previous Financial Year's TSB + Withdrawals – Net Contributions**

*Net contributions exclude contributions tax paid by the fund on behalf of the member.

Step 2: Determine the proportion of earnings that correspond to a member's TSB above $3m.

The result from Step 1 will broadly represent the total earnings for each affected member's superannuation interests across all their superannuation providers.

This next step (Step 2), is important to ensure that only the proportion of these earnings that relate to the member's superannuation benefits above $3m will be taxed.

This will be calculated as follows:

Proportion of Earnings = Current Financial Year's TSB – $3m / Current Financial Year's TSB

Step 3: Calculate the tax liability.

Tax Liability = 15% x Earnings (from Step 1) x Proportion of Earnings (from Step 2)

Example (from the Government Fact Sheet)

Louise is 40 and working. At 30 June 2026, she has a balance of $2m in an APRA-regulated fund, and a balance of $3m in an SMSF. At 30 June 2025, the balance of her APRA-regulated fund was $1.9m and the balance of her SMSF was $2.9m. She does not meet a condition of release, so she has no withdrawals during the year. She makes $20,000 of concessional contributions into her SMSF. Her contributions net of tax on contributions is $17,000.

This means Louise's calculated earnings are:

$5m – $4.8m – $17,000 = $183,000

Her proportion of earnings corresponding to funds above $3m is:

($5m – $3m) ÷ $5m = 40%

This means her tax liability for 2025-26 is:

15% × $183,000 × 40% = $10,980

Louise elects to pay $5,000 from her APRA-regulated fund and $5,980 from her SMSF.

Note

The Government's Fact Sheet indicates that if, as a result of applying this formula, an individual makes an earnings loss in a financial year, the individual will be able to carry this earnings loss forward to reduce this tax liability in future years.

Comments

1. As this formula for determining the relevant level of earnings references a member's TSB, this means both accumulation and pension phase assets will be counted toward this $3m cap.

2. Also worth noting is that this proposed formula will capture notional (unrealised) capital gains and losses.

3. What if the fund drops in value? Asset values at a specific point in time can sometimes be arbitrary. For many investments, particularly unlisted investments or property, it's only really possible to know what they're worth when they are actually sold. What if in the following year a superfund sells some of their assets and ends up getting much lower price than anticipated? Unfortunately, there will be no tax refund. The individual will only be allowed to carry this loss forward and use it to reduce earnings in a future year.

4. Further complicating matters is when an individual withdraws a large portion of their super during 2027/28 and by 30 June 2028 has less than $3m. At that point, the measure/new tax no longer applies and the loss carried forward cannot be offset. In essence, the individual has overpaid tax on a theoretical capital gain that never materialised.

How will the tax be levied?

Treasury has indicated that affected individuals will be given a choice of either paying this tax out-of- pocket or having it deducted from their superannuation fund(s).

Further, individuals who hold multiple superannuation funds will be able to select the fund from which the tax is deducted.

Comments

Based on the above example from Treasury's Fact Sheet (i.e. Louise), it appears that affected individuals will be able to choose to have the tax levied from multiple funds should they choose to do so. It's also worth noting that if the funds do not have the cash to pay it, Louise will have to pay it personally.

What about pension assets?

It is anticipated that the tax on earnings derived by assets supporting retirement phase pensions will not be impacted by this change.

That is, we would expect that these earnings will continue to be treated as Exempt Current Pension Income (ECPI) – noting of course that the amount a member can place into retirement phase pensions is already limited by the Transfer Balance Cap (TBC).

How will this measure be implemented?

Individuals with a TSB over $3m at the end of a financial year will be subject to this additional 15% tax on the relevant earnings (as discussed above) derived during that year.

As previously noted, this measure is proposed to commence from 1 July 2025, with application from the 2025-26 financial year onwards.

Because an individual's TSB is measured at 30 June each financial year, this measure will first impact those individuals whose TSB is over $3m at 30 June 2026.

As a result, the first tax liability notices are expected to be issued by the ATO in the 2026-27 financial year – i.e. these notices will relate to the additional tax liability incurred on earnings derived during the 2025-26 financial year.

From a fund reporting perspective, the proposed approach appears to be based on existing fund reporting requirements. As the ATO already uses this superannuation fund reporting to calculate the total amount that individuals have in the superannuation system across multiple accounts, the Government claims this will minimise the extent of any new reporting requirements.

Uncertainty remains

There are several areas which will no doubt be clarified as more details come to light, and others that may yet evolve as the consultation process runs its course.

As this is a cap on a member's total superannuation entitlements, including both pension and accumulation interests, the rationale for establishing $3m as the amount as a measure of high superannuation balances will likely face some scrutiny.

In addition, as things currently stand, the Government has stated that it **does not** intend for this threshold to be subject to indexation. In the absence of indexation, the relevance of this threshold as a cap on high superannuation balances will be further brought into question over time.

Finally, the notion of taxing 'unrealised' gains is likely to receive significant attention.

Where to from here?

Certainly, in the short to medium term, there is nothing that individuals need to do now in response to the announcement. There will most likely be tweaking of the final legislation which may result in significant changes being made to the initial proposal.

In terms of the introduction of this measure, the Government has indicated that legislation will be introduced as soon as practicable, following a period of consultation on implementation matters.

Early indications from the Treasurer are that the Government intends to finalise the details of this measure before the Federal Budget in May. However, it is difficult to meaningfully predict the timeframes as this measure is not proposed to commence before 1 July 2025 – which happens to be after the next federal election.

Interestingly, if this measure is introduced and passed into legislation during this current term of parliament, any subsequent removal of this measure would require a future Government to introduce, and successfully pass, separate legislation for its removal.

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