MLC TechConnect

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$3 million cap: proposed changes to super tax

This article summarises the proposed Division 296 tax which will change the taxation of super earnings for those with a balance above $3 million from 1 July 2025.

Note: At the date of publication this proposal is not law.

Contents

The Bill which proposes to cap tax concessions on certain high balance super accounts from 1 July 2025 passed the House of Representatives. The Bill will progress to the Senate for further debate. The additional tax liability is referred to as **Division 296 tax**.

Below, we explain who will be impacted, how the tax is calculated and levied, and options for paying Division 296 tax liability.

Key insights

Some of the main features of the Division 296 regime are summarised below.

- Division 296 tax will not limit the total amount that a person can hold in total super interests, but rather it limits the tax concessions available on calculated earnings for high balance individuals.
- There is no provision to **indexation** the *'large superannuation balance threshold*' which will be $3 million.
- Division 296 tax will be levied on the individual. The tax can be paid personally, or an election made to have this amount released from super.
- Division 296 tax associated with a defined benefit interest may be deferred.
- Total super balance (TSB) will form the basis of the calculation of fund earnings for the new tax, and actual fund earnings will be disregarded for this purpose. In effect this means that unrealised capital gains will be treated as earnings and may be subject to the tax.
- There will be some modifications to the definition of TSB, some of which will apply for all super purposes from 1 July 2025.
- The outstanding balance of a limited recourse borrowing arrangement (LRBA) will not be included in the definition of TSB for this purpose.
- Recipients of child death benefit pensions, members who die during a financial year and anyone who has received a structured settlement payment will be excluded from the tax**.**

Current vs proposed taxation

Tax on earnings within accumulation phase is currently capped at 15% and there is no limit on the total amount that an individual can hold in accumulation phase. There is no tax on earnings in retirement phase income streams.

Under the proposed changes:

- individuals with a TSB greater than the large superannuation threshold of $3 million at the end of a financial year (first tested on 30 June 2026), and with calculated earnings for the year greater than nil, will be subject to Division 296 tax
- the Division 296 tax rate is 15%
- additional tax will only be payable on the calculated earnings attributable to the portion of the balance that exceeds $3 million
- the $3 million threshold will not be indexed
- calculated earnings for this purpose will not reflect actual fund earnings, but will instead be based on the individual's TSB for this purpose, at the start and end of the year, after adjusting for certain contributions and withdrawals made
- if the individual has negative calculated earnings for a year, they may carry this forward to offset any additional tax which they become liable for in a future year
- existing capital gains tax concessions available to the super fund will not be impacted
- the additional tax will only apply to calculated earnings from the commencement date and not be applied retrospectively
- the additional tax will be able to be paid by the individual but can be released from superannuation. Division 296 tax will be imposed separately to personal income tax, and cannot be reduced by personal deductions, offsets or losses.

Can someone withdraw funds above $3 million to avoid the tax?

If a member has met a condition of release they may withdraw funds from super to avoid Division 296 tax. However, if a condition of release is not met, it will not be possible to remove amounts exceeding $3 million from super to avoid the Division 296 tax liability.

Exemptions and tax refunds

In certain circumstances an individual may be exempt from Division 296 tax or entitled to a refund of an amount paid.

Child pensions

Recipients of child death benefit income streams will be exempt from the tax. Further, where a child is in receipt of a death benefit income stream and continues the income stream beyond age 25 due to disability, they will continue to be exempt.

Structured settlement contributions

Recipients of structured settlement contributions are exempt altogether from Division 296. This ensures that individuals who have made very large contributions don't ever become subject to the provisions as a result of the accumulation of earnings within super.

Death of a member

Division 296 tax will not be payable by a deceased member for the financial year during which they die unless death occurs on 30 June.

Temporary residents

Temporary residents who receive a Departing Australia Super Payment and who make an application to the ATO will be entitled to have any Division 296 tax paid refunded. However, this will not apply to any amounts of Division 296 tax which relate to a period during which they were an Australian resident for tax purposes (as opposed to a temporary resident).

Determining Division 296 tax liability

Earnings for this purpose do not reflect actual fund earnings. Instead, calculated earnings are determined based on an individual's TSB with some adjustments. The steps are summarised below, and the Appendix sets out what's included as contributions and withdrawals for the purpose of modifying the TSB.

While a person will not have a Division 296 liability unless both:

- their end of year adjusted TSB is greater than $3 million, and
- they have calculated earnings greater than zero.

It's important to understand that the calculation below will still be relevant when calculating whether the 'negative calculated earnings' have arisen, which can be carried forward to offset future Division 296 liability.

Step 1: Determine the current year 30 June *adjusted TSB*. See Appendix A for a complete list of adjustments that can be made.

Step 2: Calculate 'basic superannuation earnings' for the year. This may be positive or negative. If a person has a Division 296 loss from a prior year, this will impact this calculation to reduce taxable earnings

Step 3: Calculate the percentage of the *adjusted TSB* that exceeds the $3 million cap (where end of year TSB is greater than $3 million and the person has positive earnings).

Step 4: Calculate the tax liability with reference to the percentage of earnings above the cap and the amount of calculated fund earnings, and then multiply by 15%.

Steps to calculating Division 296 tax liability	
Step 1: Determine current 30 June *adjusted* TSB	The TSB definition will be like the definition used for other superannuation purposes, with some adjustments. Broadly, the adjusted TSB will reflect the impact of contributions and withdrawals on the account balance and disregards the outstanding balance of all LRBAs. **See Appendix A** which outlines the specific amounts which are included and excluded from the definition of contributions and withdrawals for this purpose. **Adjusted TSB = TSB at end of year + Withdrawals for year – Contributions for the year** **Deducting net *contributions*** ensures that contributions don't inflate the calculated earnings, and the **inclusion of *withdrawals***, ensures that amounts no longer included in the TSB at the end of the year are captured for this purpose.
Step 2: Calculate basic superannuation earnings for the year[1]	Earnings may be positive or negative. Where a person's actual TSB in the previous year was less than $3 million but grows in the subsequent year to more than $3 million, an adjustment is made to the formula to ensure that earnings on amounts less than the threshold are not subject to tax. The person's TSB at the previous 30 June will be substituted with $3 million. Similarly, where the end of year adjusted TSB is less than $3 million, the starting TSB will be deemed to be $3 million for this calculation (which will result in a loss which can be carried forward). **End of year adjusted TSB –TSB at start of year[2]** Where earnings are positive, this amount will be used in Step 4 to calculate the Division 296 tax liability for the year. If the earnings are negative, this amount will form accrued transferrable negative superannuation earnings. Negative earnings can accrue to offset any future Div. 296 tax liability.

[1] Where the person has already accrued *'transferrable negative superannuation earnings'* (ie where under Division 296 they have negative calculated earnings that they have carried forward), a different calculation will apply. See page 3.

[2] Where TSB at the start of the year is not adjusted but is equal to the person's actual TSB for other super purposes (less the balance of LRBAs).

Steps to calculating Division 296 tax liability (continued)	
Step 3: Calculate the percentage of the TSB that exceeds $3 million which will be the percentage of earnings that are taxable	The following formula determines the proportion of the fund balance that exceeds the large superannuation balance threshold of $3 million. This percentage (rounded to two decimal places) is then used to determine what proportion of the fund's earnings will attract Division 296 tax. $$\frac{\textbf{TSB at end of the year} - \textbf{\$3 million}}{\textbf{TSB at end of the current year}} \times 100$$
Step 4: Calculate tax liability for individuals with positive calculated earnings	The Division 296 tax liability is calculated using the below formula. **15% x calculated earnings x proportion of earnings that are taxable**

Treatment of negative calculated earnings

Where a person's adjusted TSB is lower than their TSB at the beginning of the year resulting in negative calculated earnings, it will be possible to carry forward these negative earnings indefinitely, to offset positive earnings under this regime in future years. These amounts are referred to as 'transferrable negative superannuation earnings'. However, it is important to understand that this calculated loss will not offset an individual's personal tax liability, nor will it carry across to other fund members (eg in the case of an SMSF) to reduce any Division 296 tax that they are liable for.

If a person already has 'transferrable negative superannuation earnings', this amount will be deducted from their calculated 'basic superannuation earnings' to determine any Division 296 tax liability.

(End of year adjusted TSB –TSB at start of year) – unapplied 'transferrable negative super earnings'

Fund reporting processes and notification to individuals of tax liability

Division 296 will commence on 1 July 2025 and the 2026/27 financial year will be the first year that impacted individuals will be issued with a notice of tax liability by the ATO. The Government has previously indicated that it is expected that the first round of tax liability notifications will be sent in the second half of 2027 financial year.

When is Division 296 tax payable?

Division 296 tax is payable 84 days after receiving a notice of assessment from the ATO. For defined benefit funds this can be deferred until 21 days after the first benefit is paid from the interest (where a Division 296 debt account will accrue).

Failure to pay Division 296 tax

Where an individual doesn't pay their Division 296 tax on time (and the amount has not been deferred to a Division 296 tax debt account), interest will accrue on the unpaid tax at a new rate, called the 'Division 296 general interest charge'.[3] This amount is calculated using the formula below:

$$\frac{\textbf{Base interest rate for the day + 3 percentage points}}{\textbf{Number of days in the year}}$$

[3] Where a person has Division 296 tax liability as a result of an amended assessment, interest will instead apply at the rate of the Shortfall interest charge.

Impact on advice strategies if legislated

A range of advice opportunities may arise for higher super balance clients if the Bill becomes law. It will be important to review superannuation, investment and estate planning strategies to ensure they are appropriate for the client's individual circumstances, objectives and needs.

From a tax perspective, the proposed additional 15% tax on calculated earnings may still make super an attractive investment option for high income earners who are currently paying tax at the top marginal rate of 47% (including Medicare levy). However, the relative longer-term tax effectiveness and appropriateness of superannuation strategies will need to be considered. This may include high income individuals who have been impacted by the stage three tax cuts that took effect on 1 July 2024.

Other considerations may include:

- maximising total super tax concessions available between members of a couple by considering the appropriateness of spouse contributions and/or spouse contribution splitting strategies
- alternative investment options, eg investment bonds and other personally owned investments
- the timing of withdrawals and contributions to super, given the way in which the calculated earnings formula will work (ie no accounting for the period of time amounts were in the fund)
- cashflow considerations for impacted SMSFs, where both the fund and members personally may have restricted cashflow to pay additional tax (which may be due to the nature of the investments within the fund, and personal circumstances where for example these individuals are self-employed, own their business property within their fund and are asset rich but cash poor), and
- seeking tax and legal advice to assess the benefits of a family trust.

Next steps

The Bill will continue to be debated in Parliament. As more information becomes known, MLC TechConnect will keep you updated, and will provide deeper analysis of the strategies and advice considerations that are important.

Appendix A: Amounts included as contributions and withdrawals for adjustment of TSB for Division 296

Contributions	Withdrawals
Includes:	
Contributions made to the member's account (85% of concessional contributions)	Lump sum and income stream payments
Contributions split from a spouse	Amounts transferred by a spouse-splitting arrangement
Family law super payments received	Family law splits
TSB value of a death benefit when member becomes a retirement phase recipient	Amounts withheld from untaxed rollovers above the untaxed plan cap
Death and TPD insurance payments (excludes continuous disability payments, ie income protection payments)	Amounts released under a valid release authority (such as excess contributions tax or Division 293 tax)[4]
Transfers from a foreign super fund[5]	Other amounts prescribed by the Regulations (to be determined)
Amounts attributable to remediation payments, and compensation payments relating to loss from fraud or dishonesty	
Other amounts prescribed by the Regulations (to be determined)	
Excludes:	
Contributions to a foreign super fund	Rollover benefits
	Payments made under a continuous disability policy such as payments from an income protection policy
	Fraud and dishonesty payments
	Payments of unclaimed super benefits

[4] For amounts released under the First Home Super Saver Scheme, the amount included is equal to the assessable release amount, less associated earnings.
[5] Aside from this, contributions to and withdrawals from foreign super funds are ignored for Division 296 tax.

Appendix B: Examples of Division 296 tax

The below examples have been adapted from the [Exposure Draft Explanatory Materials] released on 3 October 2023. Please refer to the EM for additional worked examples.

Example 1: Jess has TSB of $4 million on 30/6/2025 and $4.5 million on 30/6/2026

Steps to calculating Division 296 tax liability	
Step 1: Determine 30 June adjusted TSB	**Adjusted TSB = TSB at end of year + Withdrawals for year – Contributions for year** Jess received concessional contributions (CCs) to superannuation of $27,500 in the 2025-26 income year, including $9,500 in salary sacrifice contributions. For Division 296 tax purposes, her total contributions for the year are $23,375 (adjusted for 15 per cent tax paid by her super fund on these CCs). Jess's adjusted TSB at the end of the year is: **$4.5 million - $23,375 = $4,476,625**
Step 2: Calculate basic superannuation earnings for the year	The next step is to calculate Jess's 'basic superannuation earnings'. This is done using the below formula. **End of year *adjusted* TSB –TSB at start of year** Use the adjusted TSB calculated in Step 1, as well as her actual TSB at the start of the year. **($4,476,625 - $4 million) = $476,625**
Step 3: Calculate the percentage of the TSB that exceeds $3 million which will be the percentage of earnings that are taxable	$$\frac{\textbf{TSB at end of the year – \$3 million}}{\textbf{TSB at the end of the current financial year}} \times 100$$ $$\frac{\textbf{\$4.5 million - \$3 million}}{\textbf{\$4.5 million}} \times 100$$ The percentage of Jess's superannuation earnings above the $3 million threshold is calculated as 33.33%, by calculating the percentage of her TSB at the end of the year over $3 million rounded to 2 decimal places.
Step 4: Calculate tax liability	The Division 296 tax liability is calculated using the below formula. **15% x calculated earnings x proportion of earnings that are taxable** Jess's tax liability is therefore: **15% x $476,625 x 33.33% = $23,829**

Example 2: MG has TSB on 30/6/2025 of $2.8 million and $3.2 million on 30/6/2026

Steps to calculating Division 296 tax liability	
Step 1: Determine 30 June adjusted TSB	Adjusted TSB = **TSB at end of year + Withdrawals for year – Contributions for year** MG has no contributions or withdrawals for the year, so his adjusted TSB at the end of the year is $3.2 million.
Step 2: Calculate basic superannuation earnings for the year	The next step is to calculate MG's 'basic superannuation earnings'. This is done using the below formula. **End of year *adjusted* TSB –TSB at start of year** Use the adjusted TSB calculated in Step 1. As his actual TSB at the start of the year was less than $3 million, we use $3 million in this formula to ensure that only earnings on amounts over $3 million are subject to tax. **($3.2 million- $3 million) = $200,000**
Step 3: Calculate the percentage of the TSB that exceeds $3 million, which will be the percentage of earnings that are taxable	**<u>TSB at end of the year – $3 million</u> x 100** **TSB at the end of the current financial year** **<u>$3.2- $3 million</u> x 100** **$3.2 million** The percentage of MGs superannuation earnings above the $3 million threshold is calculated as 6.25% per cent.
Step 4: Calculate tax liability	The Division 296 tax liability is calculated using the below formula. **15% x calculated earnings x proportion of earnings that are taxable** MG's tax liability is therefore: **15% x $200,000 x 6.25% = $1,875**

Example 3A: Jacob's TSB on 30/6/2025 is $9 million and $8 million on 30/6/2026

Steps to calculating Division 296 tax liability	
Step 1: Determine 30 June adjusted TSB	**Adjusted TSB = TSB at end of year + Withdrawals for year – Contributions year** Jacob made $150,000 of withdrawals and no contributions in 2025/26. Therefore, his adjusted TSB at the end of the year is $8.15 million ($8 million + $150,000)
Step 2: Calculate basic superannuation earnings for the year	The next step is to calculate Jacob's 'basic superannuation earnings'. This is done using the below formula. **End of year adjusted TSB –TSB at start of year** (**$8.15 million - $9 million) = - $850,000** Jacob has transferrable negative superannuation earnings of $850,000. Therefore he will not have a Division 296 liability for 2025/26, and this amount can be used in future years to offset any positive earnings.

Example 3B: Jacob’s TSB on 30 June 2027 is $8.5 million

Steps to calculating Division 296 tax liability	
Step 1: Determine 30 June adjusted TSB	**Adjusted TSB = TSB at end of year + Withdrawals for year – Contributions for year** Jacob made $150,000 of withdrawals and no contributions in 2026/27. Therefore, his adjusted TSB at the end of the year is $8.65 million ($8.5 million + $150,000).
Step 2: Calculate basic superannuation earnings for the year	The next step is to calculate Jacob’s ‘basic superannuation earnings’. However as he has unapplied transferrable negative superannuation earnings, a modified formula is used to determine his taxable earnings for this year. **(End of year adjusted TSB –TSB at start of year) – unapplied ‘transferrable negative superannuation earnings’** ($8.65 - $8 million) - $850,000 = - $200,000 As a result of the application of the transferrable negative superannuation earnings that Jacob had from the prior year, his taxable earnings this financial year are reduced to nil, and he continues to have unapplied transferrable negative superannuation earnings of $200,000.

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