LABOR DIVIDEND IMPUTATION ANNOUNCEMENT

On 13 March 2018 the Australian Labor Party (ALP) announced a policy to amend the current dividend imputation system to make excess imputation credits non-refundable.

This policy announcement, if implemented, could have a significant impact on retirement incomes by reducing cash refunds for excess imputation credits and impacting returns on superannuation savings.

Current dividend imputation system

Under the current imputation system, where a taxpayer receives franked dividends they are able to use the attached imputation credits, which represent tax already paid by the company, to offset any tax payable on the dividends in their hands. This ensures shareholders (whether individuals or superannuation funds) are not subject to double taxation and only pay tax on company profits at their relevant rate.

Where a shareholder's tax rate is less than the corporate rate, any excess imputation credits can be used to offset tax liabilities on other taxable income, such as salary and wages. On the other hand, where the value of a shareholder's imputation credits exceed their total tax liabilities they are entitled to a cash refund for the amount of the excess.

Depending on a client's circumstances, these cash refunds can make up a significant proportion of the return they receive on their share investments and on the level of income they are able to generate in retirement.

ALP policy announcement

On 13 March 2018 the ALP announced that if it wins the next election it will amend the imputation system to make excess imputation credits non-refundable from 1 July 2019. At the same time it confirmed this change would apply to all individuals and superannuation funds and that only certain bodies would be exempt. These included:

- ATO endorsed income tax exempt charities; and
- Not-for-profit institutions (eg universities) with deductible gift recipient status.

However, on 27 March 2018 the ALP announced an amendment to the original policy to provide an additional 'Pensioner Guarantee' to extend the exemption to:

- individuals that are 'pension or allowance recipients'[1], and
- Self-managed superannuation funds (SMSFs) with at least one 'pensioner or allowance recipient' before 28 March 2018.

As a result, individuals and superannuation funds not covered by the 'Pensioner Guarantee' with a tax rate below the corporate rate could be impacted by this potential change as it would mean they would not qualify for any cash refund for their excess imputation credits from 1 July 2019.

Impact on individual taxpayers

Whether the ALP policy announcement will impact an individual taxpayer will depend on a range of factors, including:

- whether the taxpayer qualifies for the proposed 'Pensioner Guarantee'
- the level of franked dividends received (either directly or via trust distributions)
- the level of other assessable income received
- the level of deductions
- their marginal tax rate
- whether the taxpayer qualifies for any tax concessions or offsets.

1 The ALP announcement on 27 March 2018 confirms the 'Pensioner Guarantee' exemption would apply to 'pension and allowance recipients'. However, it did not provide any further detail on whether this would apply to recipients of all Commonwealth Government pensions (including service pensions paid by Department of Veterans Affairs) and allowances or whether people receiving certain types of pensions or allowances would be exempt.

Example

The table below summarises the potential impact on an individual not eligible for the 'Pensioner Guarantee' that receives a fully franked dividend of $70.

TAX RATE (EXCLUDING MEDICARE*)

	0%	19%	32.5%	37%	45%
Dividend	$70	$70	$70	$70	$70
Imputation credit	$30	$30	$30	$30	$30
Assessable income	$100	$100	$100	$100	$100
Gross tax	Nil	$19	$32.50	$37	$45
Less imputation credit (tax offset)	-$30	-$30	-$30	-$30	-$30
Refund for excess imputation credits under current rules	$30	$11	Nil	Nil	Nil
Refund for excess imputation credits under the ALP proposal	Nil	Nil	Nil	Nil	Nil

* **Note** – At this stage it is not known whether the ALP proposal will allow a taxpayer to apply any excess franking credits to reduce their Medicare Levy. Therefore, we have not included any Medicare Levy in this analysis.

It is also important to take into account any tax concessions or offsets a person may be entitled to as these may increase their effective tax free threshold and potentially increase the impact of the proposed changes.

For example, depending on a person's age and income level they may be entitled to the following tax offsets:

- Low income tax offset (LITO)
- Low and middle income tax offset (LMITO)
- Seniors and pensioners tax offset (SAPTO).

The effective tax free threshold for 2018–19 financial year and amount of assets required to generate that income is summarised as follows:

Couple status	Tax offset applicable	Effective tax free threshold	Asset required to generate that level of pre-tax income*
Single or member of couple	LITO, LMITO	$21,595	$539,875
Single	LITO, LMITO and SAPTO	$32,915	$822,875
Member of couple	LITO, LMITO and SAPTO	$29,609	$740,225

* Assuming income yield of 4%, including imputation credits.

For example, under the current rules, a single person over age pension age that is eligible for LITO, LMITO and SAPTO has an effective tax free threshold of $32,915. Therefore, depending on the person's other assessable income[2], they could potentially receive fully franked dividends of up to $23,041 and receive a full cash refund for their excess imputation credits of $9,874 – resulting in net income of $32,915.

However, under the proposed changes, assuming this person is not eligible for the 'Pensioner Guarantee' they would not be eligible for any cash refund and their net income would fall by 30% from $32,915 to $23,041.

Impact on superannuation funds

While the ALP policy announcement has the potential to impact all types of superannuation funds, certain types of superannuation funds are much more likely to be impacted than others.

Large pooled superannuation funds

In large pooled superannuation funds such as master trusts, members generally have the option to invest their superannuation savings in a range of different investment options. In this case, the imputation credits received by a fund in relation to a particular investment option will form part of the option's unit price as they have a dollar value in the form of a tax benefit.

However, to ensure all members are treated fairly, trustees are required to calculate tax at the member and investment option levels as well as at the fund level to ensure that the members in each investment option pay the appropriate amount of tax and receive the appropriate amount of refund for any excess imputation credits.

For example, if a fund had a tax liability in one investment option (Option A) of $100, and excess imputation credits of $100 in another investment option (Option B), the fund as a whole would be in nil tax position. However, to ensure the members in Option A do not inappropriately benefit from the trustee using the excess imputation credits in Option B to reduce the fund's overall tax liability to nil, the trustee would deduct the $100 tax from Option A and then use those tax provisions to settle an internal $100 refund on Option B.[3]

For a case study on how imputation credits are accounted for in a large pooled fund with different investment options, please see Appendix 1.

Therefore, large pooled funds with significant numbers of members in the accumulation phase relative to members in the retirement phase are unlikely to be impacted by the ALP proposal as these funds will generally have sufficient levels of taxable income, including assessable contributions, to fully utilise any imputation credits received.

However, it's important to understand that this may not always be the case. Depending on the nature of a pooled fund's membership both now and in the future and the level of the fund's taxable income in any one year it's not possible to say that any large pooled funds may never be impacted.

For example, a combination of a greater proportion of retirement phase members, a lower inflow of assessable contributions and increasing deductible costs combined with negative or reduced investment returns could result in a fund being in an overall net refund position in a particular year.

In this case, the ALP proposal would result in the loss of cash refunds for impacted super funds and result in any investment options (including both retirement phase and accumulation phase options) with excess imputation credits having a reduced unit price and investment return.

2 Eligibility for SAPTO is based on a person's rebate income. Rebate income includes taxable income plus adjusted fringe benefits, reportable employer superannuation contributions, deductible personal contributions and net financial investment and investment property losses.

3 Trustees will effectively internally settle for the use of those excess imputation credits on a daily basis.

Finally, it's also important to understand that a member of a pooled super fund will never see an actual credit to their member account for the refund of any imputation credits. Instead, these amounts will be included in the assets of the relevant investment option and will therefore be reflected in the unit price.

Superannuation Wraps

Under a Superannuation Wrap structure, the Trustee holds specific assets for each member in an individual investment account.

However, to ensure all members are treated fairly, Trustees are required to account for tax at the individual account level as well as at the fund level to ensure each member pays the appropriate amount of tax or receives an appropriate amount of refund where they have excess imputation credits in their investment account.

For example, if a Superannuation Wrap had two member accounts and one of those (Member A) had $100 of excess imputation credits and the other (Member B) had a $100 tax liability owing, the fund would be in a nil tax position. However, to ensure that Member B does not inappropriately benefit from the Trustee using Member A's $100 imputation credits to reduce the fund's tax liability to nil, the Trustee will still deduct the $100 tax liability from Member B's account and then use that to internally settle a $100 cash refund on Member A's account.

In this case, it's important to note that unlike pooled super funds, members with excess imputation credits will actually receive a credit to their cash account for the value of their excess imputation credits – rather than the value of any excess credits being included in the unit price of a pooled investment option.

For a case study on how imputation credits are accounted for in a Superannuation Wrap with different investment accounts, please see Appendix 2.

Therefore, Superannuation Wraps with significant numbers of members in the accumulation phase relative to members in the retirement phase are unlikely to be impacted by the ALP proposal as these funds will generally have sufficient levels of taxable income, including assessable contributions, to fully utilise any excess imputation credits.

However, it is important to note that this may not always be the case. For example, a combination of a greater proportion of retirement phase members, a lower inflow of assessable contributions and increasing fund costs combined with negative or reduced investment returns could result in a Superannuation Wrap being left with excess imputation credits at the end of the year.

In this case, the proposals would result in the loss of cash refunds for any members (including both members in the retirement phase and the accumulation phase) with excess imputation credits in their investment account.

It is important to note Superannuation Wraps may be more exposed to the ALP proposals compared to large pooled funds as they tend to have larger proportions of older retired members with larger balances in the retirement phase compared to pooled funds. As a result, many superannuation wraps may already be in a net tax refund position due to having surplus imputation credits.

For example, in the previous case study, if the retirement phase member (Member A) had $200 of imputation credits instead of $100 due to having a much larger balance, the fund would be in a $100 net refund position taking into account Member B's $100 tax liability. In this situation, the fund would not qualify for a refund to its excess credits under the ALP proposal and Member A would only receive an internal refund of $100 instead of $200.

Self managed superannuation funds

Under the ALP's 'Pensioner Guarantee' exemption announced on 27 March 2018, any SMSFs that had one 'pensioner or allowance recipient' before 28 March 2018 will be exempt from the proposed changes. Therefore, all members of these funds will not be impacted by the ALP proposal.

However, other SMSFs that do not qualify for the 'Pensioner Guarantee' (referred to henceforth as 'non-exempt SMSFs'), such as funds with members who first started receiving a pension or allowance on or after 27 March 2018, will potentially be significantly impacted depending on their circumstances.

Impact on SMSFs fully in retirement phase

Where all members of a non-exempt SMSF are in the retirement phase, 100% of the fund's income will be segregated current pension income which is exempt from tax. Therefore, under the current rules, these funds will qualify for a full refund of their imputation credits.

However, under the ALP's proposed imputation credit changes, these funds would no longer qualify for any cash refund on their unused imputation credits and would effectively pay tax on 100% of their franked dividends at the relevant corporate tax rate.

Impact on SMSFs with members in both the accumulation and retirement phase

Where a fund has members in both the accumulation and retirement phase, the Trustee can generally elect to use either the segregated or unsegregated method to calculate its taxable income[4].

Unsegregated assets method

Where a fund uses the unsegregated method to calculate its taxable income, the Trustee will generally run one unsegregated investment pool and allocate any after tax investment returns on a pro-rata basis based on the value of the members' interests.

In this case, whether a member will benefit from any imputation credit refunds will depend on the fund's overall tax position. For example, non-exempt SMSFs using the unsegregated method may not be impacted by the ALP proposals where the majority of the members' interests are still in the accumulation phase and the fund will still have sufficient levels of taxable income, including assessable contributions, to fully utilise any imputation credits.

For a case study on how imputation credits are accounted for in a SMSF using the unsegregated method, please see Appendix 3.

4 Certain SMSFs will not be permitted to use the segregated assets method where the fund has a member with a total superannuation balance that exceeds $1.6M and the member is receiving a retirement phase income stream. For more information, please see the FirstTech SMSF Guide.

However, once again it is important to note this may not always be the case. In fact, given that approximately 90% of SMSFs have only one or two members, SMSFs will potentially be very exposed to any change in the member's circumstances which would result in a reduction in the level of the fund's assessable income.

For example, a member retiring and using 100% of their benefits to commence an account based pension during a year could result in a significant reduction in the level of the fund's taxable income due to the fund ceasing to receive assessable employer contributions and some or all of the fund's investment income becoming exempt.

Segregated assets method

Where a non-exempt SMSF adopts a segregated approach it will calculate tax for its accumulation and retirement phase pools separately.

To ensure all members are treated fairly the Trustee will generally calculate tax at the member and segregated pool level as well as at the fund level to ensure that each member pays the appropriate amount of tax and does not inappropriately benefit from any tax benefits, such as excess imputation credits, accrued in the other segregated asset pool.

For example, if a non-exempt SMSF had a tax liability on its assessable accumulation pool (Pool A) of $100, and excess imputation credits of $100 in its exempt retirement phase pool (Pool B), the fund as a whole would be in nil tax position. However, to ensure the members in Pool A do not inappropriately benefit from the trustee using the excess imputation credits in Pool B to reduce the fund's overall tax liability to nil, the trustee will generally still deduct the $100 tax from Pool A and then use those tax provisions to settle a $100 refund on Pool B[5].

Therefore, non-exempt SMSFs using the segregated method with significant amounts of taxable income, including assessable contributions, in the accumulation pool may not be impacted by the ALP proposal where the fund has sufficient taxable income to fully utilise any imputation credits.

However, as with all other fund types this may not always be the case and any change in either fund or member circumstances could result in a non-exempt SMSF being left with excess imputation credits at the end of the year.

Potential strategies to reduce impact of ALP's proposed changes

There are a number of strategies that clients and their advisers may consider to reduce or negate the impact of the ALP excess franking credit proposal.

Individual taxpayers

Under the proposed changes, clients who are pension or allowance recipients will be eligible for the 'Pensioner Guarantee' which provides an exemption from the excess franking credit proposal. This may encourage clients that are just over the assets and/or income test thresholds to implement a range of strategies to qualify for a pension or allowance. Strategies could include:

- Purchasing a lifetime income stream. The current assessment of lifetime income streams includes a depleting asset value and reduced income assessment. In addition, under proposed changes to the assessment of lifetime income streams purchased on or after 1 July 2019, asset tested clients may receive further concessions[6]
- Gifting within allowable limits
- Increasing discretionary spending, such as expenditure on overseas holidays or home renovations
- Not implementing strategies that may increase assessable assets, such as downsizing into a smaller less expensive home and investing the balance either directly or via super.

Self-funded retirees with low levels of taxable income that will potentially be impacted by the ALP proposal may also amend their personal investment strategy to reduce their allocation to Australian shares (held either directly or via trusts) and increase their allocation to other asset classes that don't pay franked dividends, such as global shares, fixed interest and property.

Clients and their advisers considering this approach will need to take into account any potential tax and transaction costs (such as CGT, brokerage and buy/sell spreads) and consider what impact changing their asset allocation will have on their expected investment return and risk profile to ensure any changes are appropriate.

Members in large superannuation funds

Members in large pooled funds and Superannuation Wraps that will be impacted by the ALP proposal may seek to implement a range of strategies:

- Switching to a different investment option or amending their investment account's asset allocation to reduce their exposure to Australian shares and increase their allocation to other asset classes that don't pay franked dividends, such as global shares, fixed interest and listed property.

  Members and their advisers considering this approach will need to take into account any potential tax and transaction costs (such as CGT, buy/sell spreads and brokerage) and consider the impact of changing their asset allocation on their expected investment return and risk profile.
- Making assessable contributions to a member's accumulation account in a Superannuation Wrap to increase the fund's taxable income so as to fully utilise their imputations credits.

  Members and their advisers considering this approach will need to take into account the level of assessable contributions that would be required to fully utilise any surplus imputation credits, the contribution eligibility rules, the contribution caps and potentially whether the client will be eligible to claim a deduction for any personal contributions[7].

5 Different SMSFs may account for excess imputation credits differently depending on the fund's circumstances and how the Trustee has elected to account for taxable income across different pools. Advisers may therefore need to check to confirm how a particular client's SMSF accounts for tax.

6 At the time of writing the Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018 which includes provisions to apply assets and income test concessions for lifetime income streams purchased from 1 July 2019 had yet to be passed by both houses of parliament.

7 At the time of writing the ALP had announced that it intends to reintroduce the 10% test for taxpayers to be eligible to claim a deduction for personal contributions.

- Withdrawing their super benefits from their current superannuation fund and rolling over to another superannuation fund, such as a large pooled superannuation fund or Superannuation Wrap with higher levels of taxable income that can fully utilise any excess imputation credits.

  In this case, members would need to consider all the issues associated with switching to a different super fund, including:
  - comparative costs of the different funds
  - whether the new fund offers equivalent benefits and features
  - whether the new fund is likely to continue to have sufficient levels of taxable income into the future
  - any potential tax implications or transaction costs associated with transferring to a new fund
  - potential loss of grandfathered status on existing account based pensions for social security and CSHC[8] income test purposes
  - maintaining any assets test exemption when rolling over complying income streams
  - the transfer balance cap implications of rolling over retirement phase income streams, including a capped defined benefit income stream
  - the impact on any insurances held in the fund
  - the member's estate planning requirements.
- Withdrawing some or all of their super benefits that are invested in Australian shares and investing the lump sum proceeds in Australian shares in their own name so as to qualify for a refund for their excess imputation credits under the proposed 'Pensioner Guarantee'.

  However, advisers and their clients considering this option would also need to consider a range of other issues, such as:
  - commutability of the member's pension interests[9] and the taxation of any lump sum super benefit payments
  - client's effective tax rate outside super taking into account relevant tax concessions and offsets, such as the tax free threshold, the low income tax offset, the low and middle income tax offset and the seniors and pensioners tax offset
  - any social security means test impact of withdrawing their superannuation benefits (for example moving out of a grandfathered income stream into deemed financial assets outside super) which could result in loss of age pension
  - eligibility to contribute to superannuation. It may not be possible to get amounts back into superannuation if a client's circumstances change in the future such that they no longer qualify for the 'Pensioner Guarantee'. For example, this could occur following the death of a spouse which then results in the surviving spouse failing to qualify for the age pension due to the application of a lower cut-off threshold for a single person
  - estate planning implications of moving assets out of superannuation and into their own name.

Members in SMSFs

Members of non-exempt SMSFs may also seek to implement a range of strategies:

- Amending an SMSF's investment strategy to reduce the weighting to Australian shares and to invest a higher proportion of the fund's capital in asset classes that do not pay franked dividends, such as global shares, fixed interest and property.

  Members and their advisers considering this approach will need to take into account any potential tax and transaction costs (such as CGT and brokerage) and consider the impact of changing their asset allocation on expected investment returns and risk profile.
- Making assessable contributions to the fund to increase the fund's taxable income so as to fully utilise any imputations credits.

  Members and their advisers considering this approach will need to take into account the level of assessable contributions that would be required to fully utilise any surplus imputation credits, the contribution eligibility rules, the contribution caps and potentially whether the client will be eligible to claim a deduction for any personal contributions[10].
- Rolling members out of an SMSF and transferring to a large pooled super fund or Superannuation Wrap that has sufficient amounts of taxable income to fully utilise any imputation credits.

  In this case, Trustees would need to consider all the issues associated with switching to a different super fund, including:
  - comparative costs of the public offer fund vs the SMSF
  - whether the new fund will offer the desired level of investment control
  - whether the large fund will continue to have sufficient levels of taxable income into the future
  - potential costs and tax implications associated with winding up their SMSF
  - maintaining any assets test exemption when rolling over complying income streams
  - potential loss of grandfathered status on existing account based pensions for social security and CSHC[11] income test purposes
  - maintaining any assets test exemption when rolling over complying income streams
  - transfer balance cap implications of rolling over retirement phase income streams (including capped defined benefit income streams)
  - impact on any insurances held in the SMSF
  - level of liquidity of the fund's assets, and
  - estate planning requirements.
- Transferring benefits back to the accumulation phase to increase the level of the fund's assessable income so as to soak up any excess imputation credits that would otherwise be lost.

8 Commonwealth Seniors Health Card.

9 Members holding a term allocated pension or a complying lifetime or life expectancy pension will be unable to commute and withdraw benefits as these pensions are generally non-commutable.

10 At the time of writing the ALP had announced that it intends to reintroduce the 10% test for taxpayers to be eligible to claim a deduction for personal contributions.

11 Commonwealth Seniors Health Card.

In this case, it will be important to note that this strategy will not generally provide any tax benefits as it involves transferring assets out of a tax free environment so that the fund can utilise any imputation credits to reduce its tax liability back to nil. However, this strategy could be attractive for some members that don't want or need the level of pension income they are currently receiving from their SMSF as any amounts moved back to the accumulation phase would not be subject to the minimum drawdown requirements.

Members and their advisers considering this course of action would also need to take into account a number of issues, including the pension commutation rules, any potential loss of grandfathered status on existing account based pensions for social security and CSHC[12] income test purposes and any additional costs the fund may incur, such as fund accounting costs and the ongoing cost of obtaining an annual actuarial certificate if the fund adopts the unsegregated method.

Note: many very large SMSFs with members impacted by the introduction of the $1.6M transfer balance cap may not be impacted by the ALP proposals as they will already have moved significant amounts of benefits back to the accumulation phase and may already have sufficient levels of taxable income to fully utilise their imputation credits.

- Admitting additional accumulation members, such as adult children, into an SMSF to increase the level of the fund's assessable income so as to fully utilise the fund's imputation credits.

  This strategy requires careful consideration of a range of factors, including;

  - whether the new members would be willing and able to take on the role of Trustee
  - potential impact of the admission of younger members on the fund's risk profile and investment strategy, and whether the fund would need to maintain separate investment strategies and the costs associated with that
  - whether the admission of new members would result in the fund generating sufficient taxable income to allow the fund to fully utilise its imputation credits
  - potential risks for Trustee dispute and how that would be managed
  - potential risks to the fund of admitting new Trustees that may not be familiar with the superannuation rules and who may expose the fund to the ATO's administrative penalties and compliance action in the event of any breaches
  - estate planning implications of admitting younger members who may end up controlling the fund in the event of the death of a member.

Impacted non-exempt SMSF members who qualify for a social security pension or allowance on or after 27 March 2018 may also consider withdrawing some or all of their super benefits and investing in their own name, so as to qualify for a refund for their excess imputation credits under the proposed 'Pensioner Guarantee'.

However, it will be important to consider a number of issues before implementing this strategy, such as:

- commutability of the member's pension interests[13] and the taxation of any lump sum super benefit payments
- client's effective tax rate outside super taking into account any relevant tax concessions and offsets, such as the tax free threshold, the low income tax offset and the seniors and pensioners tax offset
- social security means test impact of withdrawing superannuation benefits (for example moving out of a grandfathered income stream into deemed financial assets outside super) which could result in loss of social security benefits
- eligibility to contribute to superannuation. It may not be possible to get assets back into superannuation if a client's circumstances change in the future such that they no longer qualify for the 'Pensioner Guarantee'. For example, this could occur following the death of a spouse which then results in the surviving spouse failing to qualify for the age pension due to the application of a lower cut-off threshold for a single person.
- estate planning implications of moving assets out of super and into their own name.

Alternatively, members of either large funds or SMSFs impacted by these reforms may simply need to accept a reduced investment return and either reduce the level of their pension payments (where possible) or accept that they may not be able to save as much for their retirement or that their existing pension account may decline in value faster and potentially run out earlier than otherwise forecast.

12 Commonwealth Seniors Health Card.

13 Members holding a term allocated pension or a complying lifetime or life expectancy pension will be unable to commute and withdraw benefits as these pensions are generally non-commutable.

Appendix 1 – Pooled superannuation funds

Case study – ABCD Super Fund

The ABCD Super Fund is a pooled superannuation fund with four investment options – two in accumulation phase and two in retirement phase.

The tax position of each investment option and the fund as a whole is as follows:

	Accumulation phase (15% tax rate)		Retirement phase (0% tax rate)		ABCD Fund
Investment option	A	B	C	D	TOTAL
Assessable contributions	$200,000	$400,000	Nil	Nil	$600,000
Provision for contributions tax deducted	$30,000*	$60,000*	Nil	Nil	$90,000
100% franked dividends	$84,000	$77,000	$63,000	$77,000	$301,000
Other income	$20,000	$10,000	$15,000	$25,000	$70,000
Imputation credits (gross up)	$36,000	$33,000	$27,000	$33,000	$129,000
Taxable income	$340,000	$520,000	Nil	Nil	$860,000
Gross tax	$51,000	$78,000	Nil	Nil	$129,000
Less imputation tax credits (tax offset)	-$36,000	-$33,000	-$27,000	-$33,000	-$129,000
Net tax payable/(refund)	**$15,000***	**$45,000***	**($27,000)**	**($33,000)**	**Nil**

* **Note:** Where the net tax liability of an investment option is less than the value of the contributions tax deducted (Option A and Option B), the difference between the value of the contributions tax provisions and the option's net tax liability will remain an asset of the option and will be reflected in the option's unit price. This ensures that all members in the option benefit from the value of any imputation credits received and that any excess imputation credits do not just benefit members with assessable contributions in the form of reduced contributions tax liabilities.

In this case, the ABC Super Fund has a nil tax liability as the $60,000 tax liability on accumulation phase options is completely offset by the $60,000 of excess imputation credits from the retirement phase options.

However, to ensure all members are treated fairly, the Trustee will generally use any tax provisions deducted from the accumulation phase options (including any contributions tax provisions) to settle an internal refund on the retirement phase options for the effective use of their imputation credits to reduce the fund's tax liability to nil. This ensures the accumulation phase members pay the appropriate amount of tax and the retirement phase members receive the full benefit of their imputation credits.

For example, in this situation the Trustee could settle a total cash refund of $60,000 ($27,000 and $33,000) on the two retirement phase options using the $60,000 tax deducted from the two accumulation phase options ($15,000 and $45,000).

Therefore, in this scenario the members of the ABCD Superannuation Fund would not be impacted by the ALP proposal as it has sufficient taxable income to fully utilise its imputation credits. However, it is important to note that this is mainly due to the level of the fund's assessable contributions and that depending on any changes in the fund's membership structure this may not always be the case.

For example, if in the future the ABCD Super Fund ended up having significantly more members with larger balances in the tax-free retirement phase compared to members in the accumulation phase, the fund could end up in a net refund position due to having more imputation credits than tax liabilities.

To demonstrate this let's assume the ABCD Super Fund situation was as follows:

ABCD Super Fund Case Study (continued)

	Accumulation phase (15% tax rate)		Retirement phase (0% tax rate)		G Fund
Investment option	A	B	C	D	TOTAL
Assessable contributions	$50,000	$200,000	Nil	Nil	$250,000
Provision for contributions tax deducted	$7,500*	$30,000*	Nil	Nil	$37,500
Franked dividends	$35,000	$49,000	$91,000	$98,000	$273,000
Other income	$9,000	$6,000	$25,000	$40,000	$80,000
Imputation credits (gross up)	$15,000	$21,000	$39,000	$42,000	$117,000
Taxable income	$109,000	$276,000	Nil	Nil	$385,000
Gross tax	$16,350	$41,400	Nil	Nil	$57,750
Less imputation tax credits (tax offset)	-$15,000	-$21,000	-$39,000	-$42,000	-$117,000
Net tax payable/(refund)	**$1,350***	**20,400***	**($39,000)**	**($42,000)**	**($59,250)**

* **Note:** Where the net tax liability of an investment option is less than the value of the contributions tax deducted (Option A and Option B), the difference between the value of the contributions tax provisions and the option's net tax liability will remain an asset of the option and will be reflected in the option's unit price. This ensures that all members in the option benefit from the value of any imputation credits that exceed the tax liabilities on the option's investment income and that those excess imputation credits do not inappropriately benefit members with assessable contributions in the form of reduced contributions tax liabilities.

In this situation, the fund is now in a net refund position due to having less assessable contributions and investment income and more tax free retirement phase income.

Under the current rules, the Trustee of the ABCD Super Fund can refund the two retirement phase options the full amount of their excess imputation credits ($81,000 total) using:

- $21,750 tax deducted from the two accumulation phase options ($1,350 and $20,400), plus
- $59,250 cash refund from the ATO for the fund's excess imputation credits.

However, under the ALP proposal, the ABCD Fund would not be eligible for the $59,250 cash refund for the excess imputation credits. Instead, the Trustee could only use the $21,750 tax provisions deducted from the accumulation options to settle internal cash refunds on the two retirement phase options for the use of their imputation credits to reduce the fund's tax liability to nil.

In this case, the Trustee would allocate a portion of the $21,750 tax provision to each retirement phase option on a pro-rata basis based on their amount of excess imputation credits.

For example, Option C and D would only qualify for a refund of $10,472 and $11,278 respectively instead of $39,000 and $42,000 on the basis that Option C had 48.15% of the total excess imputation credits and Option D had 51.85% of the excess imputation credits.

Appendix 2 – Superannuation Wraps

Case study – GLAD Superannuation Fund

The GLAD Super Fund is a superannuation wrap with four members – two in the accumulation phase (Greg and Lisa) and two in the retirement phase (Alan and Diane).

The tax position of each individual account and the fund as a whole is as follows:

	Accumulation phase investment accounts (15% tax rate)		Retirement phase investment accounts (0% tax rate)		GLAD Fund
Assessable contributions	**Greg**	**Lisa**	**Alan**	**Diane**	**TOTAL**
Assessable contributions	$20,000	$40,000	Nil	Nil	$60,000
Provision for contributions tax deducted	$3,000	$6,000	Nil	Nil	$9,000
Assessable investment income					
Franked dividends	$8,400	$7,700	$6,300	$7,700	$30,100
Other income	$2,000	$1,000	$1,500	$2,500	$7,000
Imputation credits (gross up)	$3,600	$3,300	$2,700	$3,300	$12,900
Taxable income	$14,000[1]	$12,000[2]	Nil	Nil	$86,000[3]
Gross tax	$2,100	$1,800	Nil	Nil	$12,900
Less imputation tax credits (tax offset)	-$3,600	-$3,300	-$2,700	-$3,300	-$12,900
Net tax payable/refund on investment income	**($1,500)**	**($1,500)**	**($3,000)**	**($3,000)**	**Nil**

1 Excluding assessable contributions.

2 Excluding assessable contributions.

3 Including assessable contributions.

In this case, all of the members' investment accounts are in a net refund position based on the level of assessable investment income and imputation credits. However, the GLAD super fund has an overall net tax liability of nil due to the level of the accumulation members' assessable contributions.

To ensure all members are treated fairly, the Trustee would use the contributions tax provisions previously deducted from the accumulation member accounts to settle an internal cash refund on each investment account based on the level of excess imputation credits.

For example, the Trustee would use the $9,000 contributions tax provision to settle an internal cash refund on Greg and Lisa's accumulation phase accounts of $1,500 each and Alan and Diane's retirement phase accounts of $3,000 each.

In this scenario, the members of the GLAD Superannuation Fund would not be impacted by the ALP proposal as it has sufficient taxable income to fully utilise its imputation credits. However, this was mainly due to the level of the fund's assessable contributions and depending on a fund's membership structure this may not always be the case.

Many Superannuation Wraps could already be in a net refund position due to having more imputation credits than tax liabilities as Superannuation Wraps tend to have a higher proportion of older retired members with larger balances in the retirement phase compared to members in the accumulation phase.

For example, if the GLAD Super Fund only had one member in the accumulation phase compared to three members in the retirement phase, the outcome would instead be as follows:

	Accumulation phase (15% tax rate)	Retirement phase (0% tax rate)			GLAD Fund
Investment account	**Greg**	**Lisa**	**Alan**	**Diane**	**TOTAL**
Assessable contributions	$20,000	Nil	Nil	Nil	$20,000
Provision for contributions tax deducted	$3,000	Nil	Nil	Nil	$3,000
Franked dividends	$8,400	$7,700	$6,300	$7,700	$30,100
Other income	$2,000	$1,000	$1,500	$2,500	$7,000
Imputation credits (gross up)	$3,600	$3,300	$2,700	$3,300	$12,900
Taxable income	$14,000[1]	Nil	Nil	Nil	$34,000[2]
Gross tax	$2,100	Nil	Nil	Nil	$5,100
Less imputation tax credits (tax offset)	-$3,600	-$3,300	-$2,700	-$3,300	-$12,900
Net tax payable/(refund)	**($1,500)**	**($3,300)**	**($2,700)**	**($3,300)**	**($7,800)**

1 Excluding assessable contributions.

2 Including assessable contributions.

In this case, all of the members' investment accounts are in a net refund position based on the level of assessable investment income and imputation credits. However, in this scenario the GLAD Super Fund is also in a net refund position due to receiving less assessable contributions and investment income and more tax free retirement phase income.

Under the current rules, the Trustee of the GLAD Super Fund could refund each member the full amount of their excess imputation credits ($10,800 total) using:

- $3,000 contributions tax provisions already deducted by the trustee, plus
- $7,800 cash refund from the ATO

However, under the ALP proposal the GLAD Super Fund would not be eligible for the $7,800 cash refund for the excess imputation credits. Instead, the Trustee could only use the $3,000 contributions tax provisions already deducted to settle cash refunds on Greg, Lisa, Alan and Diane's investment accounts for their excess imputation credits.

In this case, the trustee would likely allocate a portion of the $3,000 to each investment account on a pro-rata basis based on their proportional share of the total excess imputation credits.[14]

For example, Greg, Lisa, Alan and Diane would likely only receive refunds of $416, $917, $750 and $917 respectively. As a result, each member would suffer a significant reduction in their investment account after tax return.

Appendix 3 – SMSF using the unsegregated method

Case study – the J&M SMSF

The J&M SMSF is a non-exempt SMSF and has two members (John and Mary) with identical account balances in the accumulation and retirement phases.

Neither John nor Mary were eligible for a pension or allowance prior to 28 March 2018 and therefore their fund is not exempt from the ALP proposal under the 'Pensioner Guarantee'.

The fund's tax position is as follows:

	Accumulation John	Pension Mary	J&M SMSF
Assessable contributions	$25,000	Nil	$25,000
Provision for contributions tax	$3,750	Nil	$3,750
Franked dividends			$14,000
Other income			$10,000
Imputation credits (gross up)			$6,000
Assessable income (excluding assessable contributions)			$30,000
Taxable proportion			50%[1]
Taxable income (excluding assessable contributions)			$15,000[2]
Gross taxable income (including assessable contributions)			$40,000[3]
Gross tax			$6,000
Less imputation tax credits (tax offset)			-$6,000
Net tax			**Nil**

1 Assumes John and Mary's respective superannuation interests are of equal value.

2 50% × (franked dividends + other income + imputation credits).

3 50% × (franked dividends + other income + imputation credits) + assessable contributions.

14 How a trustee will determine the value of any reduced cash refunds under the ALP proposal is yet to be determined at the time of writing.

In this case, the J&M SMSF's net tax liability will be nil.

However, to ensure John and Mary are treated fairly, the SMSF Trustee would generally deduct the $3,750 contributions tax provision from John's member account and credit that amount back to the unallocated investment earnings account to compensate all members for the use of the fund's imputation credits to reduce the fund's net tax liability (including on its assessable contributions) to nil. The Trustee would then allocate the net investment earnings to John and Mary on a pro-rata basis[15].

Therefore, in this situation, the J&M SMSF would not be impacted by the ALP proposal as it has sufficient taxable income to fully utilise its imputation credits. However, given the fact the fund only has two members it will be exposed to any changes in circumstances which could result in a reduction in the level of the fund's assessable income.

For example, if John had instead retired at the end of the previous financial year and commenced an account based pension on 1 July with 100% of his superannuation interest, all the fund's income in the year would be exempt current pension income and the fund would be eligible for a $6,000 cash refund for its excess imputation credits under the current rules. However, under the ALP proposal the fund would no longer qualify for a $6,000 refund.

15 Each SMSF trustee is responsible for determining how the fund will account for and allocate any tax liabilities or benefits. In this case, different funds and may apply different methodologies depending on their circumstances and which accounting software the fund's tax accountant uses. Therefore, advisers may need to confirm how their client's particular SMSF accounts for tax to understand the impact of the ALP proposal on the different members of the fund.

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