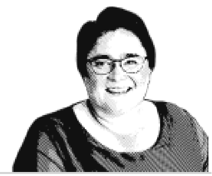
Why you should think twice about trying to avoid the $3m super tax



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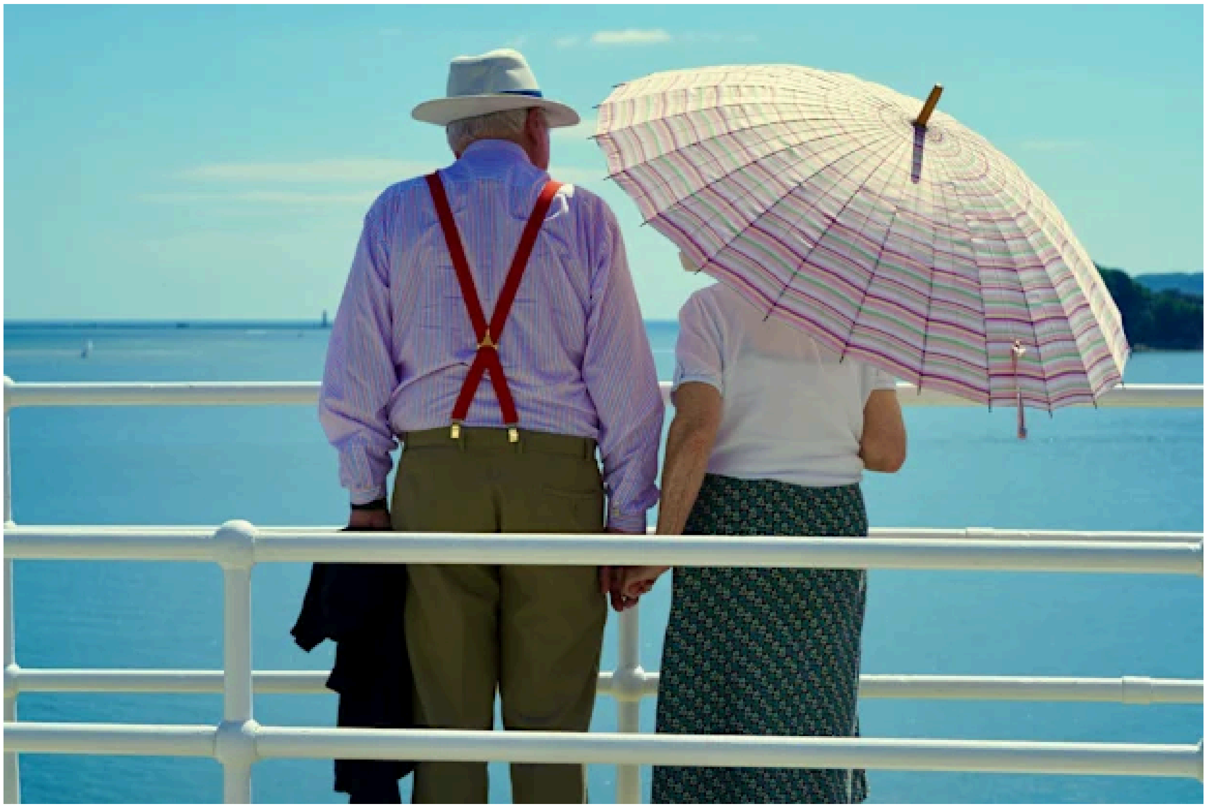
It now seems likely that a returned Labor government will dust off the Division 296 tax legislation (the extra tax on people with more than $3 million in super), which failed to make it all the way through the previous parliament. And it will probably do so with renewed vigour.

If we see it passed into law shortly [https://www.afr.com/politics/federal/chalmers-defiant-as-pressure-builds-on-3m-super-tax-20250513-p5lynl], what will it mean for large super balances in future? Let's assume it's introduced from July 1 as planned (though this will require a lot of planets to align, so surely it will be deferred until at least July 1, 2026?).

One group facing a lot of disruption is people whose super is invested in very volatile assets, i.e. the sorts of investments that might do well over the long term but where values can jump up and down a lot in the meantime. A small business is an example.



One group facing a lot of disruption is people whose super is invested in very volatile assets. **Getty**

Historically, super has been a great place for these investments because super is a long-term proposition [https://www.afr.com/wealth/superannuation/many-gen-zs-will-easily-breach-3m-super-tax-trigger-analysis-20250507-p5lx7k].

After all, a system that lets us put money in for our entire working life but does not let us take it out again until at least 60 does tend to reduce interest in checking what it’s worth every single day.

But Division 296 tax will be harsh here because it taxes unrealised capital gains. If investment values happen to hit a high note at the end of a given financial year, then hello large Division 296 tax bill. And the government is not offering a refund if the values collapse the next day.

How it works

Let’s say, for example, an individual’s super account grew from $3.5 million to $4 million during 2025/26. They did not put any contributions in or take any money out during the year – the whole $500,000 increase came from growth (or income) from the super fund’s investments.

The Division 296 tax bill for 2025/26 will be $18,750 (in addition to any tax paid by the fund itself). Ouch.

If you're wondering why it's not $75,000 (15 per cent of $500,000), don't forget that Division 296 tax is only applied to part of the growth in a member's super account. In this case, the tax is only levied on 25 per cent of the growth (i.e. it's 15 per cent times 25 per cent times $500,000 is $18,750) because only 25 per cent of the member's super account is over $3 million (i.e. $4 million minus $3 million is $1 million, which is 25 per cent of the super balance at June, 30 2026).

But let's say the peak of $4 million on June 30, 2026, is short-lived, and by August the super account has dropped back to $3.5 million.

Fast forward to June 30, 2027, and this member's super account is still sitting at about $3.5 million (again, there were no contributions made or benefits paid out, so over the 2026/27 year the member has lost $500,000). Then, this time there will be no Division 296 tax bill (because the super balance has gone backwards).

But logically, this member would expect to get the tax they paid for 2025/26 back. Because in that first year, they paid tax on $500,000 of growth that has now disappeared.

But nope. The Australian Taxation Office will keep track of the big loss made in 2026/27 ($500,000), and the loss can reduce future Division 296 tax bills.

Too bad if the member dies in the meantime or takes all their money out of super or even simply reduces their super balance below $3 million. Nothing will get that $18,750 back. They cannot offset this loss against other taxes they might be paying (for example, tax in the super fund or personal taxes) – it can only be used to reduce future Division 296 taxes.

Of course, we don't often see the ATO paying out tax refunds when our investments go backwards. But then we don't often get taxed when our investments go up either, unless we sell them.

At first glance, it's easy to assume that someone who has investments like these should withdraw them from super if they can (i.e. if they're old enough to make withdrawals from their super). But there's a catch here, too. When a super fund sells an investment (or even just transfers it to the member's own name), the fund has to pay capital gains tax.

Tax dilemma

So here's the dilemma – taking action to avoid one tax (Division 296 tax) might trigger another one (capital gains tax). What's worse is that capital gains tax works the same way as usual – for most super funds, it's between 0 per cent and 15 per cent tax on two-thirds of the growth in the investment ever since it was first bought.

So while Division 296 tax is effectively taxing "new growth" (i.e. growth in the investment from say July 1 onwards), capital gains tax also picks up "old growth" (growth in the investment ever since it was bought).

For investments that have done well already, the capital gains tax bill could be larger than the Division 296 tax bill. It may be necessary to balance a number of different considerations to make the right call, and sometimes that call will be to do nothing for now.

When it comes to doing nothing, there are two other important points to remember.

The first is that even if the new tax does start from 1 July, someone who decides to withdraw enough super to make sure their balance is less than $3 million (avoiding the tax) does not need to hit that target until the end of the financial year (June 30, 2026). There's no need to rush out immediately – it can happen over the next 12 months. (Personally I would at least wait until the tax is actually legislated.)

Secondly, I've modelled countless scenarios where even with the new tax, people are better off leaving their super intact. It all depends on what is done with the money when it's moved out of super. How will income be taxed? And sometimes even more importantly, how will capital gains be taxed when the investment is eventually sold?

To assume it's vital to avoid this tax in every case would be a mistake.

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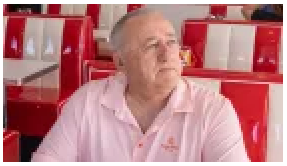

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