Twist in new super tax deals potential blow to those inheriting from deceased estates

By JAMES KIRBY

Federal Treasurer Jim Chalmers with new Secretary to the Treasury, Jenny Wilkinson. Picture: Martin Ollman/NewsWire

5 hours ago. Updated 3 hours ago

The new super tax will hit deceased estates. In a bizarre twist, the mechanics of the tax threaten to leave those who inherit super with a double sting where unused tax credits lapse but capital gains tax obligations remain in place.

Under the government's plan, profits, based on actual and unrealised (or paper) gains will be taxed, but losses will not be compensated. Rather, the losses can only be carried forward against future liabilities.

If the investor holding the tax credits in their super fund dies, the unused tax credits are left dormant. There will be no future profits in their super fund to set the credits against. In other words, the accumulated losses become valueless ... that's the first part of the double sting.

The second part is that the new super tax – tagged as Division 296 – is a completely new tax and runs independently of other taxes inside or outside super. Consequently, if the same investor leaves behind capital gains tax bills, they will still have to be paid in full, even if it so happens that the deceased estate is left holding a swag of tax credits relating to the super tax, they will have no relevance to other tax bills.

The new tax is due to effectively commence on July 1 with the first revenue collection commencing at the start of the next tax year on July 1, 2026 and it is to be applied on earnings on amounts in super above $3m.

The CEO of the Australian Shareholders Association, Rachel Waterhouse, has warned: “The treatment of unused credits remains unclear, particularly in cases where asset values fall or the investor passes away. This creates complexity and a potential mismatch between tax paid and actual financial outcomes.

“Existing precedent suggests that Division 296 tax credits may not transfer to a member’s estate, meaning tax already paid on unrealised gains could be lost upon death – while capital gains tax on those same assets may still be owed by the estate.”

Super is increasingly important to inheritance transfers across Australia, often replacing or outstripping the amounts held in traditional wills.

With the arrival of Division 296 there are now two effective wealth tax issues imposed on those inheriting super. First, the 17 per cent tax on super to be paid by adult children on the "tax free component" – which is usually the largest component in an individual's super savings. Second, the potential value destruction of tax credits relating to Division 296 in a deceased estate.

As Matthew Burgess of View Legal puts it: "The way tax credits are going to be dealt with is totally unfair, it's going to be another problem."

Investors in super are often surprised about the embedded inheritance tax within super.

Here's how it works: The funds that get hit with effective inheritance tax in super are amounts in the so-called taxable component. This is any accumulated super savings that gained from tax concessions during the accumulation period before retirement.

The majority of super savings accumulated over the past decade has been classified as taxable for two reasons. First, the steady expansion of the super guarantee charge (SGC) up to 11.5 per cent of all salaries. Second, the continuation of concessional super arrangement where you can salary sacrifice up to $30,000 a year on a concessional (ie pre-tax) basis.

On top of these costs the arrival of Division 296 creates a new layer of inheritance issues for super. Moreover, with no plan to index the new tax, the amount of people affected will increase every year.

James Kirby hosts the twice-weekly Money Puzzle podcast