Opinion Piece

The Overlooked Advantage in Labour's Super Tax Reform

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Franked dividends may become the most efficient way to manage tax inside large super balances.

Australia's superannuation system has grown into one of the largest asset pools in the country, now surpassing $4.2 trillion. Given this scale, it is inevitable that both sides of government will periodically revisit how super is taxed. While the objective will always be to preserve superannuation as the most effective vehicle for retirement savings, it is also clear that the system will increasingly be seen as a source of future revenue and reform.

Much has been written about the federal government's decision to introduce a new tax on earnings associated with superannuation balances above $3 million, particularly the decision to tax unrealised gains. But amid the outcry, there's been too little focus on a valuable mechanism that still helps investors navigate this higher-tax landscape: franked income.

If the legislation proceeds, total earnings attributable to super balances above $3 million will face an additional 15 percent tax from 1 July 2025 under a new regime known as Division 296 of the Income Tax Assessment Act 1997. This new tax is controversial not because of its rate, but because of how it is calculated. Unlike existing tax rules based on assessable income, Division 296 applies to the growth in an individual's total super balance across the financial year, adjusted for withdrawals and contributions.

This approach captures unrealised gains, even if the asset hasn't been sold. The tax is assessed to the individual but can typically be paid from their super fund. Importantly, the threshold is not indexed, meaning the number of Australians affected will increase sharply over time. Treasury modelling suggests that more than 500,000 Australians – including over 200,000 under the age of 30 – will breach the threshold during their lifetime.

Division 296 will apply regardless of how a fund generates returns. That's why franked dividends, while not a shield against the new tax, remain a vital part of managing a fund's total tax burden. Franking credits cannot reduce the Division 296 tax itself, but they can eliminate the 15 percent tax on assessable income for superannuants in accumulation phase – and have an even greater effect in pension phase, where income is not taxed at all.

In this way, franking credits improve the after-tax efficiency of a portfolio. They help preserve capital, particularly in accumulation phase, and generate valuable cash refunds in pension phase. These benefits matter more than ever when a second layer of tax is introduced.

The concern isn't just tax policy – it's liquidity. Because Division 296 is based on balance movement, not cash flow, it may trigger a tax obligation even where no income is realised. That poses a challenge for SMSFs invested in illiquid assets like property or private equity, and may result in suboptimal behaviour such as forced sales or withholding contributions to stay under the cap.

There are better ways to reform. One is to index the $3 million cap, just like other super thresholds. Another is to apply the 15 percent surcharge only to realised earnings. These refinements wouldn't erase the projected revenue but would strengthen confidence in the long-term integrity of the system.

In the meantime, investors shouldn't panic – but they should plan. Those approaching or exceeding the $3 million threshold should consider how their income is structured. Franked dividends may not directly lower Division 296 tax, but they remain among the most effective ways to reduce overall tax drag and preserve super balance growth.

I am an investment professional and director of a firm that manages systematic equity income strategies. While I have a vested interest in after-tax outcomes for superannuation investors, my broader concern is ensuring the system doesn't unintentionally penalise prudence or undermine public confidence in retirement policy.

Canberra may set the rules, but investors still make the decisions. And those who understand how franking fits into the new equation will be better positioned for what's ahead.

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