

EXCESS SUPER & DIV 296:

Why Lifetime Income Products Belong in Every Adviser's Toolkit.



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Introduction

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Labor's proposed Division 296 tax introduces fresh complexity for clients with super balances above \$3 million. Many are now asking what the impacts will be—and what options they have. For advisers, the challenge is clear: how to minimise excess super tax while still delivering sustainable retirement outcomes. Beyond familiar structures such as insurance bonds and non-super investments, non-super lifetime income products are an underutilised but powerful tool—capable in some cases of reducing first-year excess super tax liabilities by more than 80%.

In the following case studies, we illustrate how the proposed rules apply in practice and compare outcomes across different strategies, including lifetime income products.

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In the following case studies, we illustrate how the proposed rules apply in practice and compare outcomes across different strategies, including lifetime income products.

CASE STUDY

Retiree 'Bob' with \$5 million in superannuation (and minimal other savings):

	If Div 296 tax introduced			
Bob	Keep excess in super	Withdraw excess and invest outside super	Withdraw excess and invest in insurance bond	Withdraw excess and invest in non-super lifetime income product
Average tax rate on the "excess super" balance	Just under 30%	18%	20%	Tax amount increases over time
First year's tax on 'excess super'	\$45,864	\$29,188	\$32,000 (20% tax in bond)	\$5,931 See Table Note (i)
% reduction compared to remaining in super:		36.4%	30.2%	87.1%

Retiree 'John' on the highest marginal tax rate:

	If Div 296 tax introduced			
John	Keep excess in super	Withdraw excess and invest outside super	Withdraw excess and invest in insurance bond	Withdraw excess and invest in non-super lifetime income product
Average tax rate on the "excess super" balance	Just under 30%	18%	20%	Tax amount increases over time
First year's tax on 'excess super'	\$45,864	\$56,400	\$32,000 (20% tax in bond)	\$22,242 See Table Note (i)
% reduction compared to remaining in super:		-23% (i.e. more tax)	30.2%	51.5%

Table Note (i) The taxable income of a non-superannuation lifetime annuity/pension product works very differently to other investments – as explained below. Each annual annuity payment consists of a mix of a return of capital, investment income plus mortality or survivorship credits. For long lived, payments can continue long after the 'balance' in other products would have run out. See projections below.



Retirees know that once they leave the workforce, their nest egg has to fund their spending throughout retirement – supplementing whatever Age Pension they may receive. Lifetime income products offer an efficient way to provision for some of that spending. It's like having a salary but not having to work. By allocating some of a retiree's savings, and harnessing the investment returns on that investment, non-super lifetime products can deliver a sustainable income stream for the life of the customer (and a second person if you include a reversionary beneficiary¹).

This generally reduces the need to spend from the retiree's other assets and helps create confidence, stability of income, spending power and happiness. In this article we explain how non-super lifetime income products work, including the tax rules, and explore how advisers can make smart decisions, especially once the proposed \$3 million threshold in super has been reached.

[1] With a non-super lifetime policy it can be possible to have someone other than a spouse be the reversionary beneficiary eg an adult child. This option then becomes more than just about tax; it becomes a powerful estate planning strategy tool - by passing an income stream down to the next generation. Having a reversionary beneficiary will reduce starting income, however, as the policy is considering two lives, not just one. However, this may suit high income earners who may be generating enough income already.

How Div 296 Tax will work

Currently, earnings on pension accounts within the superannuation environment are generally tax free, subject to the Transfer Balance Cap when the account is first commenced.

Earnings on superannuation in the accumulation phase (less deductions and franking credits) get taxed at 15%. The proposed new tax (referred to as Div 296 tax) will mean an additional 15% tax is payable on superannuation earnings that are attributed to the proportion of a person's superannuation balance over \$3 million.

The example provided in the Explanatory Memorandum[1] is for a person with \$4 million in super on 30 June 2025. Her balance rises with investment earnings plus contributions to \$4.5 million by 30 June 2026. Her concessional contributions were \$27,500 for the year.

The worked example is as follows:

1. Her adjusted Total Super Balance at the end of the year is calculated by deducting the contributions (net of 15% contributions tax) from her final balance of \$4.5 million. This comes to \$4,476,625
2. Her Superannuation Earnings for the 2025-26 income year are then calculated as \$4,476,625 less her starting \$4 million balance = \$476,625.
3. The percentage of her earnings above the \$3 million threshold is calculated as 33.33% (= $(\$4.5 \text{ million} - \$3 \text{ million}) / \$4.5 \text{ million}$).
4. Her taxable superannuation earnings for Division 296 tax are calculated as 33.33% x \$476,625 = \$158,859.11.

Her Division 296 tax liability is \$23,828.85, being 15% of the taxable superannuation earnings figure (15% x \$158,859.11). This is on top of her existing 15% tax on earnings in accumulation accounts. It is a personal tax obligation, payable by the individual, but the person can elect to pay it from their superannuation balance.



Other Options

Where Could a Person's Excess Super Move To?

Superannuation is not the only option for retirement savings. Other options include withdrawing the excess and using one or more of the following instead:

1. Invest outside of super.

If retirement savings are moved outside the superannuation system, then the investment earnings on that money - such as bank interest, dividends, rental income and capital gains - become taxable at the individual's marginal tax rate.

Note that many retirees find their marginal tax rate falls significantly once they stop receiving a salary. This means their investment earnings are taxed more lightly, as they can use the lower tax brackets before moving into higher rates. Currently, taxable income up to \$18,200 attracts no tax, income up to \$45,000 is taxed at 16%, then 30% applies up to \$135,000, 37% up to \$190,000 and 45% beyond that. The 2% Medicare Levy is paid in addition. Retirees aged 67 or more may also benefit from the Senior and Pensioners Tax Offset (SAPTO) if their income is below an income test [2].

If bank interest rates were 5% p.a., a retiree would need around \$900,000 on deposit before the interest pushed them into the 30% tax bracket, and about \$2.7 million before reaching the 37% bracket.

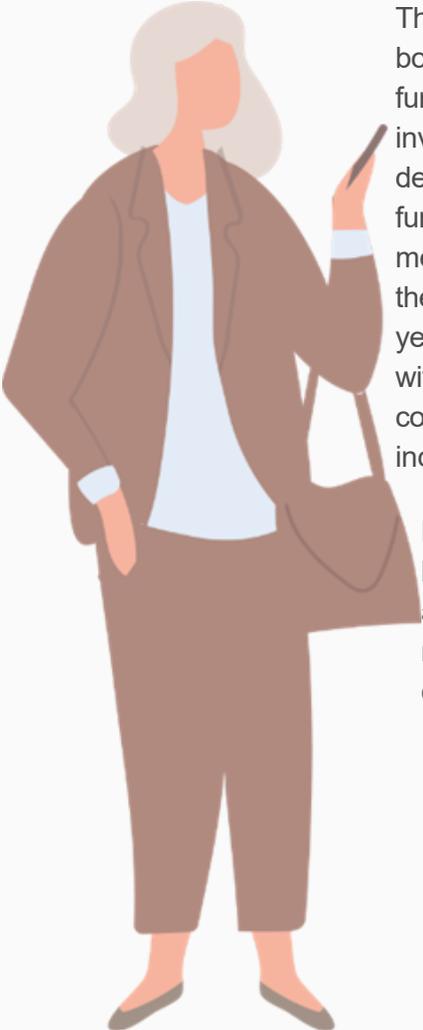
[2] <https://www.ato.gov.au/individuals-and-families/income-deductions-offsets-and-records/tax-offsets/seniors-and-pensioners-tax-offset>



Other Options

2. Invest in Insurance Bonds.

An insurance bond (also known as an investment bond or life insurance bond) is an investment held within a life insurance structure. The life insurer pays tax at a flat rate of 30% on the investment earnings within the fund – although franking credits on dividends and other tax optimisation strategies can reduce the effective rate well below 30%. Explanatory materials that we have seen from providers of these bonds indicate tax rates as low as 15% or even less are possible for long-term growth oriented insurance bonds.



This tax on insurance bonds is a life insurance fund tax - individual investors do not need to declare earnings or pay further tax provided they meet certain conditions. If the bond is held for 10 years or more, all withdrawals are completely tax-free- including capital growth.

Modern investment bonds offer flexible access and a large range of investment options.

3. Invest in Non-Super Lifetime Income Products or Annuities.

With an annuity, the amount you invest is converted into lifetime income payments that will get paid to you each year for the rest of your life. The initial level of payments will depend on your life expectancy and the product's design rules. There are lots of product options available, each often including a large range of investment options to choose from.

There is no tax on the investments supporting these annuities. However, with non-super lifetime annuities, each annuity payment made consists of:

- A tax-free Deductible Amount each year (this equals the purchase price divided by the annuitant's life expectancy from the Australian Life Tables when they purchased the annuity). It represents a return of capital over time.
- The remainder – which gets included in the annuitant's taxable income i.e. taxed at the individual's marginal rate. Note that, as above, retirees have the lower tax bands available before paying more than 30% tax on this). For lifetime annuity products where payments increase over time, this taxable amount will increase as the Deductible Amount does not change from year to year.

Worked Example: Retiree with \$5M Superannuation

In this example, we consider retired male homeowner, 'Bob' aged 62.

Bob has \$2 million of super in a pension account and \$3 million in an accumulation account. His \$3 million in the accumulation account currently incurs tax on the investment earnings at 15%, although with franking credits and capital gains concessions his effective tax rate might be 12%. Under the Div 296 tax rules his "excess super" is defined as \$5 million less \$3 million equals \$2 million.

A. Bob keeps his excess super where it is

If Bob earns 8% p.a. on his investment mix, then the tax relating to his 'excess super' for the next year would be:

- Accumulation account above \$3 million: \$2 million x 8% x 12% = **\$19,200 tax**
- Div 296 tax:
 - Earnings of \$5 million x 8% = \$400,000
 - Amount above the \$3 million cap = $(\$5.4M - \$3M / \$5.4M) = 44.44\%$
 - Tax = $\$400,000 \times 44.44\% \times 15\%$ = **\$26,664 tax**
- **Tax on "excess super" = \$45,864**

B. Bob removes \$2 million from super and invests outside of super

If Bob moved his 'excess super' of \$2 million into a non-super environment, and generated a return on it of \$160,000 (8% p.a.) then part of this return would be treated as taxable income.

The portion of this non-super investment income that is taxable might be, say, three quarters of the \$160,000 income (due to the reduction from the capital gains tax discount for example). This comes to \$120,000 taxable income.

He would avoid the Div 296 tax as well as the accumulation account tax rate on the \$2 million withdrawn from super.

His total tax on the 'excess super' he withdrew would, in the first year, be calculated by applying the \$120,000 firstly to his 0% tax band, then his 16% band and then his 30% tax band.

- **Tax on "excess super" = \$29,188** (including 2% for Medicare levy)

Note: This comes to an average tax rate of 18.2% of the gross investment return. For people who already had non-superannuation assets or income, the marginal tax rate on the additional amounts would be at 30%, 37% or 45% tax plus Medicare Levy – depending on which band it falls in.



C. Bob removes \$2 million from super and invests in an insurance bond

If Bob instead moved \$2 million of his super and put this into an insurance bond where the internal tax rate within the bond was 30%, then the tax in the first year might be:

- \$2 million x 8% x 30% = \$48,000 paid by the bond issuer

In practice, if Bob used a similar investment mix to his super, then the internal tax rate is likely to be less than 30%. If he holds the bond for more than 10 years, then he can fully encash the bond without paying any further tax personally. He is able to make withdrawals prior to 10 years but should carefully check the tax treatment.

If we use an internal tax rate of 20%, then his total tax for the first year would be:

- **Tax on “excess super”:** \$2 million x 8% x 20% = **\$32,000**



D. Bob removes \$2 million from his super and invests in a non-super lifetime income product

If Bob withdrew \$2 million from his super, he could use that money to buy a lifetime income stream outside of super, assuming he (and/or his reversionary beneficiary) was in good health. Some insurance companies offer investment-linked versions of this where the customer can choose an investment mix (e.g. similar investment options to their super) and adjust this over time by switching, when they want.

For \$2 million, Bob might be offered an annual income from this product type of \$135,120 p.a. This annuity rate is based on an investment-linked lifetime annuity offered by Generation Life, with 5% LifeBooster feature.³

There is no tax on the investment income within this product type, but part of the annuity payments received by Bob incur personal tax. The taxable component equals the income payment less the Deductible Amount, as follows:

Position in the first year (only)	Bob
Annuity income received	\$135,120
Statutory life expectancy factor (LE)	22.78
Tax free deductible amount (= \$2m / LE)	\$87,796 p.a.
Income above the deductible amount (this is taxable at marginal rates)	\$47,324 p.a.

His total tax on the ‘excess super’ would be calculated by applying the \$47,324 firstly to his 0% tax band, then his 16% band and then his 30% tax band.

- **Tax on “excess super” = \$5,931** (including 2% for Medicare levy)

Note: This comes to an average tax rate of 4.4% of the FIRST YEAR'S income payment. For people who already had non-superannuation assets or income, the marginal tax rate on the additional amounts would be at 16%, 30%, 37% or 45% tax plus Medicare Levy – depending on which band it falls in.

[3] <https://genlife.com.au/lifeincome>

Worked Example: Retiree on the highest marginal tax rate



In this example, we consider retired homeowner 'John', aged 62.

John also has \$2 million of super in a pension account and \$3 million in an accumulation account.

However, unlike Bob, John has other taxable income e.g. from other non-super financial resources, that mean he is already a highest rate taxpayer.

A. John keeps his excess super where it is

If John keeps his excess super where it is then the tax on his 'excess super' of \$2 million would be the same as Bob, \$45,864 in the first year.

- Accumulation account above \$3 million: \$2 million x 8% x 12% = **\$19,200 tax**
- Div 296 tax:
 - Earnings of \$5 million x 8% = \$400,000
 - Amount above the \$3 million cap = (\$5.4M – \$3M / \$5.4M) = 44.44%
 - Tax = \$400,000 x 44.44% x 15% = **\$26,664 tax**
- **Tax on "excess super" = same as Bob, \$45,864 in the first year.**

B. John removes \$2 million from super and invests outside of super

If John removes the \$2 million from super and invests it outside super then part of the returns generated would be treated as taxable income.

If the gross return on this \$2 million were the same as Bob (\$160,000) and \$120,000 of this is taxable, then John's tax would be \$120,000 x the highest marginal rate of 47% = \$56,400.

This equates to an average tax rate of 35.3% (less than 47% because of things like the capital gains tax discount etc).

C. John removes \$2 million from super and invests in an insurance bond

If John moved \$2 million of his super and put this into an insurance bond where the internal tax rate within the bond was 30%, then the tax would be the same as Bob - \$32,000 in the first year.

D. John removes \$2 million from his super and invests in a non-super lifetime income product

If we assume John buys the same type lifetime income stream as Bob with his excess super would receive the same starting income of \$135,120 p.a.

There is no tax on the investment income within this product but the taxable component in year one would, like Bob, be \$47,324. If John pays tax at the highest marginal rate of 47% then his tax in year 1 is \$22,242. The taxable part of his income payments would increase as his income increases over time.

Before making decisions – consider longer term impacts

It is vital to consider the longer-term tax implications of this decision as well. Each option will generate investment income, less tax and less any money that is withdrawn to spend.

The tax calculations can be substantially different for people with marginal tax rates that are higher than the above example. For example, due to other non-super income sources.

Let's touch on how the tax on each product will evolve over time:

A. Keeping money in super

The excess super amount that remains in Bob or John's accumulation account would grow with investment income, less any tax that is deducted from the balance, and less any withdrawals they make over time. But the 'average tax rate' applying to this 'excess super' might remain a little below 30%.

B. Investing outside of super

The average tax rate applying to Bob's excess super moved to outside of super will depend on his marginal tax rate and what tax band he's in. In turn, this depends on how his total taxable assets and income sources change over time.

Things that impact this are:

- Good investment returns – that flow through to higher taxable income amounts in the future. This may cause Bob to change into a different tax band.
- Spending – if Bob chooses to spend some of his assets – resulting in less investment income thereafter – then this could cause him to move into a lower tax band.
- Indexation of the tax band thresholds

If Bob's amount of non-super savings stayed broadly level in real terms, then he might remain in the same position relative to the tax bands and his average tax rate on this might remain the same in future years.

For John, however, we assume that he is always a high rate taxpayer, so the average tax rate applying to his 'excess super' if moved to non-super might remain around 35%.

C. Investing in an Insurance Bond.

A. The 'average tax rate' applying to the 'excess super' that Bob or John moves to an insurance bond is simply a flat rate depending on investment choice and the tax optimisation strategies that are used by the provider. This could be a maximum of 30% or as low as 15% or less. The actual rate may depend on actual returns generated over time, but isn't impacted by how much the customer has invested, or their broader financial position.

D. Use a non-super investment-linked annuity

The starting income for an investment-linked lifetime income product gets set by the provider based on actuarial assumptions for the customer's age and sex (life expectancy) and product design. However, different products increase the income level in different ways. A common feature with investment-linked lifetime products is known as the "hurdle rate". Hurdle rates play a crucial role in how most investment-linked lifetime annuities operate e.g. as in TIAA-CREF's products in the USA – one of the largest pension funds in the world.

A higher hurdle rate means a higher starting income is paid, but future income will then rise more slowly – being based on the underlying return on the assets supporting the product relative to the hurdle. Importantly, the hurdle rate is not a fee - it's a way of bringing forward some of the future expected income to enjoy higher income at the start of retirement and lower income at higher ages, for example to target an income that broadly keeps pace with inflation.

The product in our example has a 5% p.a. hurdle rate (referred to as the 'LifeBooster' feature). If the net return on the assets Bob or John has chosen is higher than the hurdle rate, then the level of annual income payments will increase. For example, if the net return was 7% p.a. then the income might increase by roughly 2% from \$135,120 to around \$137,694⁴.

If Bob or John's investment choices generated returns of 7% p.a. after fees etc then his projected income and projected tax would become:

Year	Annuity income [Note 1]	Taxable Income	Bob's Tax [Note 2]	John's Tax
1	135,120	47,324	5,931	22,242
2	137,694	49,897	6,755	23,452
3	140,316	52,520	7,594	24,684
4	142,989	55,193	8,449	25,941
5	145,713	57,916	9,321	27,221
10	163,179	75,383	14,910	35,430
15	179,323	91,527	20,076	43,018
20	197,065	109,269	25,754	51,356
30	237,987	150,191	39,912	70,590
40	287,408	199,612	59,955	93,817

With a lifetime income product, the annuity payments start to become very high relative to any measure of investment returns on the remaining purchase amount.

This occurs because the annuity payment is composed of:

- a return of capital,
- investment income, and
- survivorship credits (which become a high percentage later in life).

It hence becomes meaningless to express tax as a proportion of the 'balance' per se.

Note 1: Note that for longer living customers, a lifetime product pays a high level of income relative to what's remaining of the customers original investment – thanks to the longevity insurance.

Note 2: Bob's Tax is calculated using marginal income tax rates plus 2% for the Medicare levy. John's Tax is calculated using 47%. For customers with other taxable income, different rate bands may apply.

[4] The formula is $\$67,560 \times (1 + 7\%) / (1 + \text{hurdle})$ based on how the LifeBooster feature works.

Conclusion

Whilst super remains tax-effective for most, Div 296 creates a compelling reason for high-balance clients to consider options such as insurance bonds or lifetime income products

Labor's proposed Division 296 tax creates a new layer of cost for higher-balance clients to hold money in superannuation. Whilst super remains a tax-effective structure for most retirees, those with balances above \$3 million have good reason to explore alternatives. As our case studies show, moving some excess funds into options such as non-super investments, insurance bonds, or non-super lifetime income products can deliver meaningful tax savings, especially in the first year.

What's right for each client depends on what tax band they are in – which depends on their total taxable income outside of super.

Clients and their advisers should also consider non-tax objectives, such as estate planning. Insurance products — including bonds and non-super annuities — often have powerful estate planning features.

Ultimately, the right approach will depend on each client's circumstances, goals, and priorities. Advisers who understand and can model these strategies will be well placed to help clients optimise their income, protect capital, deliver confidence and navigate the changing retirement landscape.

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