THE TAX INSTITUTE

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24 October 2014

Mr Chris Timotheou
Manager
Contributions and Accumulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
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By email: ENCCTax@treasury.gov.au

Dear Mr Timotheou,

Reforming the Superannuation Excess Non-concessional Contributions Tax - Exposure Draft Legislation

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the *Tax and Superannuation Laws Amendment (2014 Measures No. 7) Bill 2014: Excess Non-concessional Superannuation Contributions Tax Reforms* exposure draft legislation (**Exposure Draft**).

The Tax Institute supports the Government's stated policy intention behind these measures, namely to:

> "*allow individuals the option of withdrawing superannuation contributions in excess of the non-concessional contributions cap made from 1 July 2013 and associated earnings, with these earnings to be taxed at the individual's marginal tax rate*".[1]

While we also consider that the Exposure Draft would give effect to this policy, we offer the following comments on specific provisions and technical aspects thereof for your consideration.

Associated earnings

Many of the draft provisions are broadly consistent with those currently applicable to the release of excess concessional contributions. However, there is a notable and significant difference between the determination of "associated earnings" on excess non-concessional contributions (**NCCs**) (proposed s 97-30 in Schedule 1 to the *Taxation Administration Act 1953* (Cth) (**TAA**)) and the calculation of excess concessional contributions charge under the existing legislation.

[1] Commonwealth Budget 2014-15, Budget Paper No.2

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Specifically, the amount of “associated earnings” is to be determined (at least in the first instance) by reference to the GIC rate, whereas the SIC is used for the purposes of the excess concessional contributions charge. The GIC rate is 7% above the 90 day bank bill rate and this rate can track significantly higher than average investment returns from superannuation assets.

We acknowledge that there is the ability under proposed s 97-30(2) for the Minister to determine a lower or higher rate (or even zero, as mentioned in the draft Explanatory Memorandum), but the prima facie difference between the GIC and SIC remains our prime concern. There is also guidance required on the circumstances under which the Minister would determine the applicable rate, e.g., as to when and why this would be exercised. Thus, a more appropriate rate of return would overcome this and the Commissioner should be given a discretion to reduce the rate of associated earnings if the fund, for example, made losses in that financial year.

In this vein, we offer the following comments:

- There is no offset, credit or adjustment to take into account that a superannuation fund itself might also have a 15% tax on its actual earnings. This makes the application of the GIC rate seem even more excessive.

- If the GIC rate rises from its current near historical low, then it could easily exceed the 10% assumed fair rate of return on superannuation that has been built into the Superannuation Guarantee (**SG**) law – fixing it to the rate set under SG law might be appropriate and could be simpler.

- Individuals should not have to bear the burden of the extra tax on additional “associated earnings” caused by any delays by the relevant fund reporting member contributions and by the ATO issuing determinations much beyond 31 October when member contribution statement reporting is due for the prior year.

- Perhaps a simple and suitable proxy for “associated earnings” could be to adopt a fixed percentage of the returned contribution as taxable to the individual based on an assumption that the fund should hold the contribution for no more than 18 months (or 1.5 years). This fixed rate of return could reflect a long-term average 3 year rate of return on private sector superannuation assets which is aligned to a relevant and respectable index.

- All superannuation funds should still be allowed the alternative of calculating the actual associated earnings – this might be most appropriate during periods of negative returns (like the GFC) when nil net earnings could be easily assumed.

- This overall issue could be streamlined and a lot of pressure and costs taken off superannuation funds, if individuals only had to elect to release the excess NCC with the “associated earnings” being taxed at the fund level. This would overcome the need for more complex and costly processes and the fund could then pay tax at say a 30% rate on a deemed rate of return as suggested above on the fixed rate.

- There seems no basis to apply an "all or nothing" regime, in that an individual cannot elect to release part of the amount of the determination. The excess concessional contributions provisions allow for an individual to elect for an amount “not exceeding” the determination to be released, so similar and consistent provisions in relation to NCCs should be contemplated.

Reporting and payment requirements

- The 7-day response time for superannuation providers under proposed s 96-12 of the TAA is unrealistic and unworkable. However, we acknowledge this is also the requirement for the current ECC charge regime, so there is the opportunity to review this for both concessional and NCCs. This is especially the case as the time starts from the ‘issue date’ and many ATO letters are not dispatched for many days after being approved and issued. We recommend that a minimum 30 day period apply here.

- Similarly, unsuccessful release notices are only required to be reported by the super provider to the ATO and not the individual. This doesn’t require a provider to explain an unsuccessful release, as it goes via the ATO. Once again, this is an opportunity to deal with concessional and NCCs at the same time.

- Should there be a form of self-assessment mechanism, i.e., if it becomes known that an excess NCC has been made, rather than wait for a determination to issue (which might take months if not more than a year), the individual could advise the ATO and request the issue of a release authority. This would reduce the time that the excess was in the Fund but also reduce the associated earnings amount. Obviously the individual should need to provide proof of the excess tally to the ATO (and there would need to be some penalty process for incorrect statements to the ATO, if not already covered by other legislation).
- The Commissioner’s discretion to disregard or reallocate contributions where special circumstances exist remains unchanged. However, it is unclear how the timing of such an application (which could take months to finalise) would correlate with the ability to elect to withdraw contributions (which must broadly be made within 60 days of issue of a determination).

- Note, the Commissioner has a discretion to extend the 60 day deadline and would hopefully do so if notified that an application to disregard or reallocate contributions was being made. However, we cannot say this for certain and time will tell.

- With regard to the interaction with the 3 year bring forward rule in s 292-85(3) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA**). Individuals should be given the opportunity of obtaining a release when they exceed their NCCs cap in the first year, for example, if an individual makes $181,000 in FY2015, then an election should be available in this instance. However, s 292-85(3) applies automatically and can give rise to adverse consequences. We note here that there are many other ways people accidentally exceed their NCCs caps, including:

- they are members of defined benefit funds and what they think is an employer contribution (i.e., a concessional contribution) is actually an NCC;
- they paid an expense on behalf of the fund and the accountant journalises it as an NCC;
- the member feels they made the contribution in one financial year but the superannuation fund does not recognise it until the next (for one illustration of this involving BPAY see *Liwszyc v Commissioner of Taxation* [2014] FCA 112); and
- the member simply forgot about a contribution, made a mistake in a calculation or received incorrect advice.

- Thus, what invariably occurs in some real life situations is that a person may plan to contribute $180,000 in FY-1 and then may then wish to utilise their bring forward rule by contributing say $540,000 in FY-2. However they overlook a $1,000 contribution for one of the above reasons. On its face, having to withdraw an NCC of $181,000 in FY-2 does not seem particularly problematic. However, the individual may now have attained 65 years and ceased gainful employment and it might be impossible for the amount refunded to re-contributed back into the superannuation system. We thus request that a release event be permitted in these circumstances.

- Proposed s 96-42 of the TAA contains the requirement for super funds to notify of successful releases. SMSFs should be excluded from this requirement since each member is a trustee in an SMSF.

- A general provision allowing super deeds and governing rules to make a release should be inserted to overcome the need for specific documents to be updated.

- We recommend the law be made retroactive to 10 May 2006 and refund past payments of excess NCCs tax given the harsh and unfair nature of this tax.

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If you would like to discuss any of the above, please contact either me or Tax Counsel, Thilini Wickramasuriya, on 02 8223 0044.

Yours faithfully,

Michael Flynn
President