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The Treasury
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Via email: ENCCTax@treasury.gov.au

Dear Sir or Madam

Reforming the Superannuation Excess Non-concessional Contributions Tax

EY welcomes the opportunity to comment on the exposure draft and explanatory memorandum released by Treasury on 10 October 2014 in respect of previously announced reforms to the excess non-concessional contributions tax regime.

Overall, EY welcomes the proposed changes and considers that they go a substantial way towards achieving a balance between penalising individuals that exceed their excess non-concessional contributions cap while allowing rectification of the situation in a fair and reasonable manner that is simple to administer.

We make the following specific recommendations:

1. Only the non-concessional contribution component should be released from the superannuation fund and not the deemed earnings component. Superannuation funds may be adversely impacted by having to pay out deemed earnings at an earnings rate above that enjoyed by the fund. Further, stipulating that the release of funds (including the deemed earnings component) must be paid from the tax-free component of the interest held by the superannuation fund for the individual adversely impacts the individuals bona fide tax-free amounts.

2. The inclusion of the deemed earnings component in an individual’s assessable income can result in effective “double taxation” and a possible disproportionate burden of tax across the affected taxpayers. It is suggested that a tax offset be available to reduce this inefficiency.

3. Further guidance is requested in respect of the application of the proportioning rule once an income stream has commenced in the context of the proposed amendments.

4. Guidance on the consequences of withdrawing greater than 10% of a pension account balance for a member with a transition to retirement income stream is also necessary.

Legislative references are to the Income Tax Assessment Act 1997 (ITAA 1997) unless otherwise specified.

Release of deemed earnings amounts

The proposed legislation increases an individual's assessable income by the deemed earnings amount under the following two scenarios:

1. Where an amount of excess contributions is released from the superannuation fund; or

2. Where an individual elects not to release an amount from super and the Commissioner has directed that the value of the individual's superannuation interest is nil.

We consider that use of a notional earnings amount as a methodology to approximate the amount that would have been earned from the investment of released excess non-concessional contributions while they were held by the superannuation fund is appropriate. The use of a proxy for this amount is necessary to avoid the complexity associated with precise calculation of the actual earnings associated with these excess contributions.

We agree that an individual should be assessed on the deemed earnings amount however we do not believe that the deemed earnings should be required to be paid from superannuation.

Through the operation of section 96-20(1A) of the proposed amendments, all amounts released under a release authority (i.e. both non-concessional contributions and the deemed earnings component) must come from the tax-free component in preference to taxable components. We agree that a payment of non-concessional contributions in response to a release authority should be paid from the tax-free components of the interests held before being paid from any taxable component. This is appropriate on the basis that non-concessional contributions form part of a tax free component of a superannuation interest by virtue of section 307-220.

However, any underlying earnings of the superannuation fund effectively form part of a taxable component for an individual in accumulation phase. If the deemed earnings amount is released from the tax-free component, this has the result of reducing bona fide tax-free amounts. If the individual then commences an income stream, the tax-free component of the income stream will be less than what it would have been had the individual only contributed up to their concessional contribution cap. We consider that this has the result of disproportionately penalising those individuals who commence income streams subsequent to releasing excess non-concessional contributions.

In addition, superannuation funds may be adversely impacted by having to pay out deemed earnings in the event that those deemed earnings represent an earnings rate that is higher than that enjoyed by the fund. While we agree that the deemed earnings component should incorporate a penalty aspect for the purposes of including an amount in the individual's assessable income, the current mechanism has the potential of also penalising the superannuation fund by requiring the fund to release earnings beyond what they have been able to earn on the non-concessional contributions amount.

It is for these reasons that we submit that the amount released from the superannuation fund should be limited to the amount of excess non-concessional contributions and should exclude the deemed earnings component.

Double Taxation

The inclusion of the deemed earnings amount in an individual's assessable income results in "double taxation" for the following reasons:

- Generally, the value of a member's superannuation interest is often reduced by an amount attributable to current and future taxes payable by the superannuation fund on its investment earnings. This is typically the case for large funds operating in a unitised environment.

- Further, although a member's superannuation interest may include an amount related to an excess non-concessional contribution, the superannuation fund will nevertheless include any taxable investment earnings on that amount in its assessable income which will be subject to tax at the rate of 15% to the extent it does not relate to assets supporting current pension liabilities. Payment of this liability is funded from the amounts deducted from the value of the member's superannuation interest (as noted above).

- Subsection 303-70(2) of the proposed amendments include an amount in an individual's assessable income to the extent it relates to the deemed earnings component paid from a superannuation fund in relation to a release authority. The superannuation fund will deduct this payment from the value of the member's superannuation interest which has previously been subject to, or otherwise reduced, for the tax payable on the investment earnings of the superannuation fund, resulting in double taxation to the individual.

Through the tax levied on the member's superannuation interest and the amounts included in their individual taxable income, it is possible for a member to be subject to tax rate of up to 64%[1] on the earnings component of a release authority. Those on lower marginal tax rates or subject to lower effective tax rates within their superannuation fund will pay less, resulting in disproportionate burden of tax across affected taxpayers.

We suggest a change to the proposed amendments to allow for a tax offset to be claimed by the individual in the amount of 15% the deemed earnings component to reflect the fact that tax will have been paid by the superannuation fund on the actual earnings.

Allowing an offset of 15% of the deemed earnings component should ensure that the overall rate of tax suffered in relation to the deemed earnings component equals the individual's marginal tax rate. Whilst it is acknowledged that the offset amount will not match the tax paid by the fund (because one is based on a deemed earnings component and one on actual earnings), it is expected that this will 'go both ways' (i.e. in some cases the offset will be more than actual tax paid by the fund and in some cases less).

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[1] Assumes 15% taxation on earnings in the superannuation fund and a 49% individual tax rate (including applicable levies)

Further guidance required

Further guidance is requested as to how the release of excess non-concessional contributions impacts the proportioning rule,[2] particularly when an individual has already commenced an income stream.

We would also welcome guidance on the potential consequences of where a release causes an individual to withdraw greater than 10% of their pension account balance.

Please do not hesitate to contact me on 07 3243 3711 to discuss any aspect of this submission.

Yours sincerely

Ian Burgess
Partner

[2] Section 307-125