



Melbourne
Casselden
Level 39, 2 Lonsdale Street
Melbourne VIC 3000

Canberra
Level 3,
39 Brisbane Ave
Barton, ACT 2600

24 October 2014

Manager
Contributions and Accumulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ENCCTax@treasury.gov.au

Re: Exposure Draft -- Excess non-concessional superannuation contributions tax reforms

Dear Sir or Madam,

ISA appreciates the opportunity to comment on the proposed changes to superannuation tax concessions.

In its current form, we are concerned that the exposure draft legislation would undermine incentives to comply with the tax laws and further threaten the sustainability of superannuation tax concessions, including by exposing it to gaming behaviour.

Making non-concessional contributions into superannuation can result in substantial tax concessions to contributors, because of tax concessions on earnings and retirement income. Unlimited tax concessions on earnings and retirement income present a threat to the public interest, because they have a high risk of being both inequitable and a significant drain on the Government's fiscal position. Existing law places a cap on non-concessional contributions and penalises those who exceed the cap.

Very few people are in a position to violate the non-concessional contributions cap. The draft legislation therefore addresses an issue that is confined to a very small number of typically very wealthy people.¹

The proposed legislation would enable these few to engage in gaming behaviour in respect of excess non-concessional contributions. In this "game," there are a number of ways to win:

- The ATO may not detect or enforce tax liability against an excess contribution. If this happens, individuals who breach the law get to enjoy significant tax concessions on earnings and income arising from these unlawful contributions.²

¹ The draft legislation only affects persons who make superannuation contributions in excess of the non-concessional contributions cap. In effect, this legislation relates only to those who (i) have the capacity to place over \$205,000 into their super fund in a single year, and (ii) have violated the law by exceeding the contributions cap, notwithstanding the capacity to obtain financial advice and tax advice and preparation assistance.

Only a small fraction of Australians receive \$205,000 in income in a year. Only 7.4 per cent of *households* (not individual) had an annual gross income above \$208,000. See, ABS 6532.0 Household Income and Income Distribution, Australia, 2011-12.

² The existing law is already quite generous toward individuals who break the law: excess non-concessional contributions are only subject to a penalty if detected by the ATO and a notice is issued to the taxpayer. Moreover, the

- Even if a violation is detected and the ATO seeks to impose a tax liability, individuals who breach the law are given a free pass: they can have the excess contribution returned to them with no penalty.
 - In fact, if a person elects to withdraw the excess contribution and implied earnings, they only need to withdraw the amount included in the ATO notice. As a result, amounts earned on the excess contribution and associated earnings included in the assessment remain in the super system and would receive ongoing earnings tax concessions.
- Moreover, the unlawful excess contributions receive concessional tax treatment on associated earnings. If these concessions are larger than the penalty for the excess non-concessional contribution, then individuals who breach the law are better off.

The draft legislation creates perverse incentives by giving an individual who has broken the law the option to choose between (i) withdrawing the excess contribution (which returns the individual who has breached the law to an approximation of the same position they would have been in had they not violated the cap, *plus* any earnings that accrue between the assessment date and the withdrawal date, compounded over time), and (ii) paying the penalty and keeping the concessional treatment on earnings and retirement income.

Further arbitrage opportunities are available under the proposed legislation because earnings for tax purposes are calculated by reference to a formula (the average General Interest Charge for the relevant financial year) rather than the actual earnings received. As a result, if the constructed earnings are less than the actual earnings, a further benefit is possible.

A person who breaches the non-concessional contributions cap under the proposed legislation only has upside. As a result, the proposed legislation eliminates the incentive to obey a law designed to more fairly allocate earnings tax concessions in super.

Recommendations and alternatives

The reforms should not eliminate the incentives to obey the law. At a minimum, the legislation should remove the ability for excess non-concessional contributions to receive earnings tax concessions. In this way, individuals who have broken the law and are caught would not be able to arbitrage tax rates on earnings insofar as the earnings on their unlawful excess contributions are so large that the concessions on them exceed the amount to be paid on the excess contributions.

The explanatory memorandum is coloured by the assumption – without a factual basis – that many of the relevant tax law violations are inadvertent. We note that most individuals in a position to exceed the non-concessional contributions cap are likely receiving professional advice and tax preparation assistance. If there is a legitimate concern around inadvertent violations, more moderate and targeted reforms could be contemplated, such as granting the ATO the authority to release excess non-concessional contributions and apply marginal rates to earnings for the first violation only, where the individual who breaches the law can provide a reasonable basis to believe that the excess non-concessional contribution was accidental.

taxpayer can avoid the penalty if they have no remaining superannuation interest (e.g., they have taken it as a lump sum before the ATO has issued a notice).

Other amendments that should be considered include a more realistic measure for the calculation of earnings, and a method of removing the benefit of additional earnings in super that accrue after an assessment of excess non-concessional contribution arise.

We are concerned that existing legislation does not establish a suitably large penalty to deter excess non-concessional contributions because the earnings tax concessions and retirement income tax concessions are of such potential significance. The draft legislation doesn't address the current circumstance where an individual might determine to place excess contributions in their super and pay the excess non-concessional contributions tax, anticipating that the long term earnings tax concessions and retirement income tax concessions outweigh the excess contributions penalty.

There also should be a mechanism to monitor for and prevent repeat breaches of the cap.

Public policy priorities

The proposed reforms would improve the circumstances of a small, typically very wealthy subset of individuals who have breached the law. We are concerned that this issue is a priority, particularly given elimination of the Low Income Super Contribution, which will have a significant detrimental effect on millions of Australian low income earners, and over two million women.

Very truly yours,



Zachary May

2