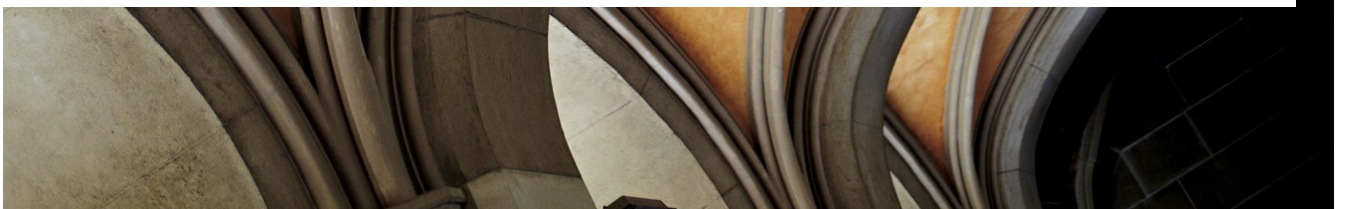




Reforming the superannuation excess non-concessional contributions tax

Submission by UniSuper

24 October 2014



About UniSuper

UniSuper is the superannuation fund dedicated to people working in Australia's higher education and research sectors. With more than 448,000 members and \$41.3 billion funds under management (as at June 2014), UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes. We have a strong history of providing retirement incomes to members for over 30 years.

This submission has been prepared by UniSuper Management Pty Ltd (ABN 91 006 961 799), which acts as the administrator of the Trustee, UniSuper Limited (ABN 54 006 027 121).

We welcome the opportunity to discuss the submissions further and to provide additional information in respect of our comments. Should you have further queries, please contact Benedict Davies, Manager, Government & Industry Policy, on (03) 9910 6670 or benedict.davies@unisuper.com.au

Overview

UniSuper understands the policy principles behind the capping of contributions to superannuation; but in our experience, members do not deliberately set out to exceed their caps. Most members, in fact, find themselves exceeding their caps simply through miscalculating their entitlements. This can happen in a number of situations, including:

- Failing to correctly calculate their entitlements under the ‘bring forward’ provisions, particularly where members turn 65
- Failing to include an excess concessional contributions in the calculations
- Failing to take into account contributions across *all* funds
- Problems with foreign transfers, particularly with currency variations.

The current consequence of exceeding the NCC cap is a ‘punitive’ tax of up to 95% in total. We, therefore, strongly support reforming the excess non-concessional contributions tax (ENCCT).

Despite the best attempts of superannuation funds, no one fund possesses sufficient information to assist members in monitoring their caps because the caps by their very design apply across *all* funds and include amounts that funds can never be sure of e.g. excess concessional contributions, amounts reallocated by the Commissioner.

To this end, we believe most of the problems associated with the excess non-concessional contributions tax (ENCCT) could be ameliorated if the ATO were to take a more proactive approach by advising taxpayers on how they are tracking relative to their caps.¹ This regular communication should also include notifying taxpayers when they trigger the bring forward provisions. We note that this was Recommendation 2.2(c) of the Inspector General of Taxation in a recent report on the operation of the tax.²

We submit that this recommendation needs to be given serious consideration urgently.

¹ UniSuper takes a proactive approach by contacting members who we estimate are likely to exceed their concessional caps each year. But we do not possess all information and do not know what contributions, concessional or non-concessional, members make to other funds.

² Inspector General of Taxation, ‘Review into the Australian Taxation Office’s compliance approach to individual taxpayers – superannuation excess contributions tax. A report to the Assistant Treasurer, Recommendation 2.2(c), March 2014
http://www.igt.gov.au/content/reports/ATO_contributions_tax/ATO_contribution_tax.pdf

Exposure draft and explanatory memorandum

Excess non-concessional contributions determination and election

UniSuper supports the policy that it should be voluntary for Trustees to release monies from defined benefit funds. There a number of reasons for this, but the simple explanation is that defined benefit funds were not designed to release regular amounts to members to satisfy present tax obligations. It is important to note that in the case of UniSuper, we cannot envisage a situation where a member will even be able to make an excess non-concessional contribution to our defined benefit division because members can only make a maximum 7% of salary non-concessional contribution.³

However, it is important to note that defined benefit funds can and do release monies from the associated accumulation accounts of defined benefit members. This happens currently for both excess concessional contributions and Division 293 tax.

While we believe that this exposure draft envisages such withdrawals, we believe it would be helpful to have this confirmed in the explanatory memorandum. Further, spelling this out clearly would help the ATO in developing the paperwork release authorities which need to be flexible enough to allow members of defined benefit funds to make withdraws from any associated accumulation accounts they may have.

To this end, we would like to highlight a possible drafting issue with subsection 96-25(3) which requires superannuation providers to make payments ‘from the tax free component of *each of those defined benefit interests* before being paid from the taxable component of any of those interests.’

This appears to assume that the defined benefit component of a superannuation fund is a separate superannuation interest. In the case of UniSuper, and we suspect many other private sector defined benefit funds, this will not be the case. Most of our defined benefit members have two parts to their interest: a defined benefit and an associated accumulation account, both of these components form a single superannuation interest i.e. we do not calculate a separate tax free / taxable amount for the defined benefit component and the accumulation component under the proportioning rules in ITAA 1997.⁴

We submit that the proposed section 96-25(3) should either be removed, or if retained, it should not refer to a ‘defined benefit interest’ as an interest that is distinct from the broader superannuation interest but should simply recognise the superannuation interest as follows:

³ Based on a \$180,000 cap, a member would need to receive a salary in excess of \$2,500,000 and make a 7% post-tax contribution to the defined benefit division to exceed the cap. Given that the non-concessional contributions cap applies across all funds, non-concessional contributions to a defined benefit, albeit themselves within the cap, ultimately can be excess non-concessional contributions as a result of excess contributions being made to an accumulation account within the same fund or to another fund altogether.

⁴ These are not distinct products and are part of a single product disclosure statement

*A payment under subsection (2) must be paid from the *tax free component of each of the individual's *superannuation interests held by the *superannuation provider, before being paid from the *taxable component of any of those interests.*

This change, we believe, will ensure that funds can release monies voluntarily from a member's defined benefit as well as giving the option to release monies from a member's accumulation component.

Associated earnings

As we understand the proposals, the associated earnings referable to excess non-concessional contributions will be calculated by effectively using a deemed rate of return (i.e. the General Interest Charge) backdated to 1 July of the relevant financial year, even if the relevant contribution was made some time after this.

In most cases, this will be punitive since most of the contributions received during the course of a financial year would not in actual fact be received on the first day of the financial year. Indeed, most non-concessional contributions would be received closer towards the end of the financial year. The proposed provisions therefore assume that members were earning returns for a period of time which significantly preceded the actual date of contribution. This will potentially be unfair from the perspective of most members in this situation.

This can also potentially give rise to a different type of inequity and unfairness. The associated earnings would continue to accrue until the excess amounts have been released. An outworking of this is that the tax liability of a particular member is highly sensitive to the amount of time that it takes the ATO to notify the member and to issue the relevant assessment. It is conceivable that two members in identical circumstances could make identical excess non-concessional contributions on the same date, but if one member receives their assessment later than the other, they would have a greater tax liability than the other solely on account of ATO processing delays.

Another observation can be made: if members become aware that they will be taxed on deemed earnings backdated to 1 July, this may incentivise some members to bring forward the date of their non-concessional contributions closer to 1 July (since this is when they will be deemed to have started generating earnings) rather than leaving their contributions to the very end of the financial year, as is typically the case. In other words, the proposed provisions arguably incentivise and could lead to excess contributions being within the superannuation system for a longer period of time than would otherwise be the case.

Finally, we reiterate the point which we understand Treasury is already aware of – that any proxy for the real rate of investment returns will inevitably understate or overstate the actual amount of earnings in any particular case.

In cases where the amount is overstated, this results in members paying tax on earnings which were not in fact earned. The unfairness will be most pronounced in cases where the member in actual fact suffered investment losses during the relevant period.

In extreme cases, the proposed regime could potentially be manipulated to facilitate early access to preserved benefits. A member who was aware of the deemed rate of earnings might consider intentionally making a very large excess non-concessional contribution (e.g. by borrowing and contributing \$1 million) and investing it in a low-yielding investment strategy (i.e. one which would generate significantly lower returns than the General Interest Charge), knowing that releasing the deemed rate of associated earnings on the contribution would necessarily involve releasing an amount which far exceeds the actual earnings – i.e. which would have to be funded by releasing preserved benefits. Some members could potentially be willing to pay the tax on the deemed earnings in order to gain early access to benefits which would otherwise be preserved for 20 years or more.

On a related point, the method of calculating the associated earnings, we submit, needs to be based on a measure commensurate with the likely returns members will actual receive. To that end, the General Interest Charge (GIC), currently 9.66% p.a., is not the most appropriate proxy for fund earnings.

Given that associated earnings withdrawn are 100% taxable (i.e. no tax offset is given for the 15% tax a fund would already have paid on the earnings), it seems more reasonable to use a lower interest charge. We submit that the Shortfall Interest Charge (SIC), currently 5.63%, would be a more appropriate proxy for earnings. A further benefit of using the SIC is that this rate is used for excess concessional contributions.

We believe that, wherever possible, the excess non-concessional contributions rules should be based as closely on the existing rules for excess concessional contributions. This will minimise the compliance burden of funds, the need to build new processes and will allow funds to communicate with members more simply.

Release of amounts from superannuation

For the sake of simplicity, we believe that wherever possible the excess non-concessional contributions rules should follow as closely as possible the existing rules for excess concessional contributions.

The exposure draft includes rules that would give superannuation funds only seven days to act on a release authority issued it to by the ATO. We submit that this timeframe is far too short. Twenty-one days is more appropriate and better aligns the proposed changes with those previously made to excess concessional contributions which allows funds 21 days.

We also note that the exposure draft and the explanatory memorandum do not make any references to the anti-money laundering and counter-terrorism financing obligations imposed on superannuation funds. These additional obligations need to be considered when setting legislative timeframes for funds to release monies from either a superannuation interest or a pension interest to a member. Such payments are ‘designated services’ and generally require funds to establish the identity of a member before making a payment. In our experience, this can add a substantial amount of time to the process of releasing monies, and we believe this gives further justification to a longer time (i.e. 21 days rather than seven days) for funds to comply with the ATO-issued release authority.

To this end, we also encourage Treasury to work with the ATO to see if there are ways that ATO release authorities can highlight AML-CTF issues to taxpayers, so that they are aware of the obligations imposed on funds. In our experience, some members having read the ATO's paperwork expect monies to be released immediately, and are unaware that funds have additional obligations to meet as well as those to the ATO.

Application and transitional provisions

Once the law is settled, we believe there needs to be sufficient time for funds to make changes to their administrative systems to give effect to these reforms. We submit that three months - at a minimum - would be required; however, we believe that six months is preferable given the existing competing demands on fund resources to implement a number of outstanding Stronger Super reforms.

We understand that the ATO will not issue assessments until May next year; therefore, we would prefer to see the policy decisions taken and legislation passed in the Spring sitting of Parliament. To that end, the applicable regulations to give effect to these measures should be registered with these time frames in mind.

SIS regulations to give effect to these reforms

To give effect to these reforms, changes to the SIS regulations will also need to occur. In giving consideration to these changes, we would like to highlight an ongoing issue that we believe should be addressed when the regulations are being drafted.

In December 2013, the Superannuation Legislation Amendment (2013 Measures No 2) Regulation amended the SIS Regulations to enable amounts to be paid from an individual's superannuation or income stream under a release authority to meet certain tax liabilities (viz: excess concessional contributions and Division 293 tax). While SISR 1.06(2)(e)(vi)(c) was inserted as a new type of permissible release authority, we remain concerned that, on one reading, only full commutations from lifetime pensions are permissible. SISR 1.06(2)(b), which allows for variation to the size of a benefit, allows for commutations to pay a superannuation contributions surcharge but makes no reference to other similar amounts released.

As a result of this, we are concerned that funds may not be able to offer a partial commutation to a member because if monies were released from the pension interest, an adjustment to its ongoing value will need to be made. Thus, in effect, these regulations seem to work only for full commutations from a pension to lump-sum i.e. the termination of a member's defined benefit pension (which is ordinarily payable for the life of the member and his or her spouse) to a lump-sum benefit instead.

We submit consideration should be given to amending SISR 1.06(2)(b)(ii) to explicitly allow commutations for release authorities - for the purposes of excess concessional and non-concessional contributions and Division 293 tax - because many defined benefit funds do not contain rules in the trust deeds allowing members to commute and re-start lifetime pensions, although many could accommodate partial commutation subject to the above changes.

A related issue arises under the Social Security Act which itself outlines consequences for the commutation of long term assets-test exempt income streams. Section 9A of the Social Security Act 1991 contains the rules for lifetime income streams that are exempted from the assets test. Allowable commutations include 2(h)(iv) “to the extent necessary to cover any superannuation contributions surcharge relating to the income stream”. We understand, however, that commutations for the purposes of Division 293 are currently treated as “non-allowable” by the Department of Social Services (DSS) and commutations to give effect to this policy need to also be expressly allowed under Social Security law.

Amounts transferred from foreign superannuation funds

The exposure draft appears to be silent on the issue of amounts transferred from foreign superannuation funds to an Australian superannuation fund. We believe that releasing monies to members that were ultimately sourced from foreign fund transfers is likely to create problems for members as taxpayers in other jurisdictions.

Firstly, UniSuper receives foreign fund transfers from the UK into our members’ existing accounts. As a QROPS, we are required to report payments made to members to Her Majesty’s Revenue and Customs for 10 years. We submit that releasing monies under these proposed changes is likely to lead to tax issues for members in another jurisdiction, namely the UK.

Secondly, we remain concerned that if funds were to release non-concessional contributions that were sourced from Kiwisaver monies, there will need to be a specific condition of release to allow for it given that Kiwisaver monies are subject to different preservation requirements (i.e. 65).

We believe that the problems with foreign fund transfers could be addressed by exempting from the release requirements the corpus of monies sourced from foreign fund transfers. Superannuation funds already notify the ATO on a Member Contribution Statement (MCS) of amounts transferred from foreign funds. We encourage Treasury to discuss this further with the ATO to see if these amounts can be exempted and not included in the release authorities issued by the ATO.