Mercer (Australia) Pty Ltd
ABN 32 005 315 917
33 Exhibition Street Melbourne VIC 3000
GPO Box 9946 Melbourne VIC 3001
+61 3 9623 5552
Fax +61 3 8640 0800
john.ward@mercer.com
www.mercer.com.au

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

By email: recc@treasury.gov.au

Subject: REFUNDED EXCESS CONCESSIONAL CONTRIBUTIONS

Dear Sir/Madam

We welcome the opportunity to comment on the exposure draft of the Tax Laws Amendment (2012 Measures No.1) Bill 2012: refunded excess concessional contributions.

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide. Mercer consultants help clients design and manage health, retirement and other benefits, and optimise human capital. The firm also provides customized administration, technology and total benefits outsourcing solutions including the running of the Mercer Super Trust in Australia with over $15 billion of assets. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.

Executive Summary

We note that we have previously submitted comments on this proposal in our submission dated 4 October 2011 on the discussion paper covering the proposal.

As indicated in that submission, we continue to have serious concerns with the policy in that, whilst increasing complexity in an already extremely complex environment, it will **not**:

- solve the major problems arising from accidentally exceeding contribution caps including the imposition of taxes which can, in some circumstances, only be described as excessively penal
- solve the problems which cause accidental excess concessional contributions

We expect that the number of excess concessional contribution cases will rise further due to:

- the expiry of the transitional provisions providing higher limits for those age 50 and above
- the implementation of the Government's highly complex proposal to provide a higher limit for those age 50 and above with account balances of less than $500,000
- the proposed increases in the Superannuation Guarantee

We have not commented further on these concerns and the general shortcomings of this proposal in this submission as they were fully detailed in our earlier submission together with actions that are necessary to reduce the problems currently caused by excess contributions.

Our major concerns with the drafting of the Bill are as follows:

- unnecessary additional complexity for superannuation funds which will increase costs and could be avoided by minor changes to the Bill
- concerns with the tax return requirement
- ambiguous drafting of some provisions
- concerns over the proposed treatment when excess contributions tax has already been paid
- unfair outcomes for some members due to the double counting of contributions in various income tests (the amendments avoid double counting in many but not all cases)
- significant additional complexity for members

These concerns are outlined in more detail below together with our recommendations.

Unnecessary complexity for superannuation funds

Whilst the general policy has been developed with a view to minimise costs to superannuation funds, there are several aspects of the Bill which create concerns:

Section 292-420(4)

This section imposes requirements which are quite different from the requirements for paying amounts under the current excess contribution release authorities:

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292-420(a): Payment will be required within 30 days of the release authority **being issued**. This differs from current requirements where payments must be made within 30 days of **receiving** the authority.

292-420(b): Funds will need to provide a statement to the Commissioner within 30 days of the release authority being issued or 7 days of the payment being made (whichever is the earlier). This compares to current reporting requirements where the statement must be provided within 30 days of making the payment.

These differences will not only add to confusion but will also require trustees to change existing processes and procedures which could otherwise have been easily adapted to apply to the new type of release authorities. These differences are unnecessary and will increase administrative costs for superannuation funds.

Recommendation:

To avoid unnecessary costs to funds and greater confusion, the payment and reporting requirements in the Bill should be changed to be consistent with the requirements for normal excess contribution release authorities.

Section 292-420(5) & (6)

These sections also impose requirements which are quite different from the requirements for paying amounts under the current excess contribution release authorities:

Firstly, funds will generally not be able to make the payment from a pension interest. This differs from the current requirements where payments under excess contribution release authorities can be generally be paid from non-defined benefit pension interests.

Secondly, where there is insufficient money in the relevant member accounts to make the full payment under the release authority, the release authority must be returned to the ATO and no payment made. This differs from current requirements where a part payment can be made (equal to the amount in the member's accounts).

Again, these differences will not only add to confusion but will also require trustees to change existing processes and procedures which could otherwise have been easily adapted to apply to the new type of release authorities. These differences are unnecessary and will increase administrative costs for superannuation funds.

Recommendation:

To avoid unnecessary costs to funds and greater confusion, the accounts from which payments can be made and the processes where the account balance is insufficient should be consistent with the requirements for normal excess contribution release authorities.

Impracticality of variations processes

Section 292-468 allows the Commissioner to revoke a determination in certain circumstances before receiving a refund payment from a fund. On the surface, this appears reasonable however it fails to address the situation where the fund has processed the payment and the payment and the revocation "cross in the mail".

We note that the Bill does not even contemplate such a scenario occurring and hence there are no provisions to return a payment that had been made on the basis of a subsequently revoked determination.

We also note that fund administrative practices will generally make it difficult to immediately put a stop to a payment under an earlier release authority when a variation notice is received. Processing payments would generally be conducted by a different team to the team which receives notifications from the ATO. In any event, there will be cases where the payment has been approved, a cheque drawn or instructions given to electronically transfer monies and it may not be feasible to stop the payment.

Provided that the new notice merely requires the payment of an additional amount, this should not cause concern. The practical difficulties referred to above will typically only arise where a lower payment amount is determined.

Recommendation:

Funds should be able to finalise processing of any initial release authority even if a revocation notice is issued. The fund should not be subject to any penalty in such circumstances. Funds would be able to disregard the earlier notice where they are readily able to stop processing. Where a payment has been made which is higher than the amount in the revised notice, the payment should be allowed to stand.

We note that we find section 292-468(8) very confusing. It is not clear:

- whether the amount referred to in (8)(a) is meant to be the original amount that the fund was to release (ie 85% of the excess contributions) or the total excess contributions
- why a difference is to be shown and what is required if the difference is negative

Recommendation:

Greater clarification should be provided together with the requirements for funds receiving such notices

Other issues for funds

In some cases, it will not be possible for the trustee to make a payment within the required time. These include situations where there Family Law requirements may prohibit the payment, and where Division 6.5 of the SIS Regulations relating to illiquid investment provisions apply.

Recommendation:

Greater protection or clarification is required where trustees are unable to make a payment due to other legislative requirements.

We also note that changes will be necessary to the conditions of release in the SIS Regulations to enable payments to be made by funds.

Impact where excess contributions tax has already been paid

Section 292-420(3) has the effect of reducing the amount to be released by the amount of any excess contribution tax already paid for the year. We note that the amount already paid can include both excess concessional contributions tax and excess non-concessional contributions tax. We consider that this provisions as drafted might be appropriate in the circumstances where the only excess contributions are excess concessional contributions. However, we are not convinced that the approach works appropriately where there are also excess non-concessional contributions.

Example 1: Frankie has excess concessional contributions of $10,000 and excess non-concessional contributions of $5,000 (after taking into account the excess concessional contributions). An amount of $2,325 representing the non-concessional contributions tax has already been paid. Presumably the ATO would determine that the amount to be paid by the fund becomes:

85% x $10,000 - $2,325 = $6,175

The ATO would then have effectively received the full refund. However, we would then consider that the member would be entitled to a refund of overpaid non-concessional contribution tax after the excess concessional contributions are disregarded. In effect, the ATO would then be $2,325 "out of pocket".

Example 2: Viv has excess concessional contributions of $10,000 and excess non-concessional contributions of $20,000. An amount of $9,300 representing the non-concessional contributions tax has already been paid. Presumably the ATO would determine that the amount to be paid by the fund becomes:

85% x $10,000 - $9,300 = - $800.

It is not clear how a negative amount can be refunded. Again there seems to be no means of properly adjusting the excess non-concessional contributions tax.

Recommendation:

Section 292-420(3) needs to be amended to ensure an appropriate outcome.

Requirement to lodge a tax return

The refund option will only be available if the member lodges a tax return within 12 months of the end of the year or such longer period as the Commissioner allows. This is a concern, particularly in view of the Government's proposals to significantly increase the income level at which tax returns are required. We are particularly concerned for those who are not legally required to lodge a tax return. Many such people will be totally unaware of the refund of contribution option (and may also be unaware that they have exceeded the concessional contribution limit). As a result, they will not lodge a return and hence miss out on the ability to take up the refund of contributions option.

In other words, a member who has legally not lodged a tax return may be unfairly excluded from the refund option. Whilst it is unlikely that many low income earners (who do not need to lodge a tax return) will have received excess concessional contributions, it is important to acknowledge that this could arise. For example:

1. Eric has assessable income of $15,000 for the year after salary sacrificing $30,000.

2. Joanna retires in July 2012 and receives an additional discretionary defined benefit in that month (or an allocation from the superannuation fund's reserves. The additional benefit or allocation is counted as a concessional contribution in the 2012/13 year. Joanna has very little other income in that year.

3. John retires in July 2012 and his salary sacrifice contributions for the 2011/12 year and SG contributions for the June 2012 quarter are received by the superannuation fund in July 2012 and hence are treated as concessional contributions in the 2012/13 year.

   Recommendation:

   The ATO should be required, where the other conditions have been satisfied, to issue a notice offering the refund option irrespective of whether a tax return has been lodged. The notice should make clear that the option is only available subject to the lodgement of a tax return within the 12 month period. However, where the notice is provided more than, say 9 months after the end of the relevant year, the notice should also provide the Commissioner's agreement to an extension of that 12 month period which would provide the member with at least three months to lodge a return.

Various income tests

Paragraph 1.47 of the EM indicates that double counting of the excess contributions will be avoided due to the consequential amendments (Part 2 of the Bill).

Paragraphs 1.48 and 1.49 indicate that two specified tests will not be reassessed following a refund of excess contributions.

Double counting can arise where the excess contributions are counted in the relevant income definition as well as in Reportable Employer Superannuation Contributions (RESCs) or Reportable Superannuation Contributions (RSCs).

We believe that:

- in some cases, the amendments fail to achieve the avoidance of double counting as specified in the EM
- the wording intended to avoid a redetermination of the tests referred to in paragraphs 1.48 and 1.49 is extremely ambiguous and needs to be clarified.

Before we consider each income test that might be affected, it is worth noting that excess concessional contributions can result from a number of different sources, eg

- employer contributions
- deductible member contributions
- notional taxed contributions (relating to defined benefit interests)
- allocations from fund reserves
- a part of a benefit transferred from a foreign superannuation fund

The last three of these would generally not be included in RESCs or RSCs and hence will not be double counted. Likewise, employer contributions which are not RESCs will not be double counted. This means that consideration needs to be given to employer contributions which are RESCs and deductible member contributions. We consider that the amendments generally result in an avoidance of double counting of RESCs but not deductible member contributions.

We consider below a number of income tests that might be impacted by a refund of excess contributions.

Deductibility of personal contributions (10% rule)

The EM states that the refund will not be used to reassess whether an individual is entitled to deduct personal contributions. This appears to be a reasonable outcome:

- it will avoid the need to unwind any deduction previously allowed
- if a reassessment resulted in an increased deduction becoming available, then this would potentially lead to an increase in the excess contributions

However we have difficulty interpreting Part 2 Item 8. Whilst it seems clear that the excess contributions disregarded will be excluded from assessable income (ie part (a) of the definition), the wording is far less clear in respect of RESCs where it would appear that the proposed wording requires a reduction in the RESC component.

Recommendation:

*Item 8 needs to be rewritten in a clearer manner to avoid confusion. For example, "For the purposes of paragraphs 2(a) and (c), disregard any changes in the amounts determined that result from excess concessional contributions being disregarded under section 292-467 for you for the *financial year corresponding to the income year."*

Superannuation co-contribution

The EM states that the refund will not be used to reassess whether an individual is entitled to deduct personal contributions under the 10% rule.

However we have difficulty interpreting Part 2 Item 11. Whilst it seems clear that, for the purposes of Section 6(1)(b) if the Superannuation (Government Co-contribution for Low Income Earners) Act the excess contributions disregarded will be excluded from assessable income (ie part (a) of the definition of total income), the wording is far less clear in respect of RESCs where it would appear that the proposed wording requires a reduction in the RESC component. This would result in an inappropriate reduction in total income.

However, for the purposes of Section 6(1)(c) and Section 10 of that Act, in some cases, total income will increase following the refunding of excess contributions. This is because the increase in assessable income will be greater that the reduction in RESCs. This will potentially result in a loss or reduction in any co-contribution paid. (It appears that the new level of total income will be used to:

- determine eligibility under the eligibility test in Section 6(1)(c) of the Superannuation (Government Co-contribution for Low Income Earners Act); and
- determine the maximum co-contribution payable under section 10 of that Act.)

This will presumably result in additional work for superannuation funds in refunding such co-contributions. (However, we accept that there is not double counting of excess contributions.)

Recommendation:

Item 11 needs to be rewritten in a clearer manner to avoid confusion. Similar changes to that suggested for Item 6 would be appropriate. Similar amendments should be applied to the definition of total income for the purposes of Section 6(1)(c) and Section 10.

Spouse contribution tax offset

The income test for this purpose is based on assessable income plus RESCs (plus other items).

We consider that Part 2 Item 9 of the exposure draft satisfactorily avoids the double counting of contributions.

Mature Age Worker Tax Offset

The income test for this item is based on the individual's net income from working which includes components of assessable income + RESCs (+ other items).

We consider that Part 2 Item 6 of the exposure draft satisfactorily avoids the double counting of contributions.

Income tests based on taxable income + RSCs (+ other items)

The EM indicates that Items 6, 8 and 9 will avoid amounts being counted twice, once as income and once as superannuation contributions in relation to various other income tests. We believe that the exposure draft fails to achieve this outcome in relation to the following:

- Medicare Levy Surcharge
- Senior Australians Tax Offset
- Commonwealth Seniors Health Card
- Pensioner Tax Offset
- Dependant Tax Offset
- Family Tax Benefits
- Child Support Payments

These income tests for these items are based on taxable income + RSCs + (other items).

In each case, taxable income will be increased by the amount of excess contributions.

RSCs will be reduced by the amount of excess contributions, but only to the extent of any RESCs. As indicated above, excess concessional contributions can consist of a number of items other than those related to RESCs. This is particularly relevant to self-employed members.

Consider the case of a self-employed individual whose concessional contributions relate purely to deductible member contributions.

Taxable income will be increased by the amount of the excess contributions but there will be no corresponding reduction in RSC. In other words, the excess contributions are counted twice, once in taxable income and also in RSC.

We note that where the excess contributions relate to amounts transferred from a foreign fund, notional taxed contributions (relating to a defined benefit arrangement that are not classified as RESCs and allocations from reserves) will only be counted once (as part of taxable income).

Recommendation:

Provisions need to be included to reduce RSCs by any refunded deductible member contributions (as well as the proposed reduction in the RESC component of the RSC definition).

Complexity for members

It is a concern, that, despite the severe restrictions on the ability to refund contributions, the implications for individuals are extremely complex. Detrimental flow on effects potentially include significant increases in Medicare Levy Surcharge, a reduction in various tax offsets and other tax and family benefits and increased Child Support payments, even when double counting is avoided. These changes can be very significant in some instances. For example, if the member's income increases sufficiently to exceed the income threshold for the Medicare surcharge, then this alone could result in an additional $1,600 in liabilities (in a couple situation).

The complexities of the significant tax and other issues that would be affected are unlikely to be understood by many members without significant tax advice. Whilst our concerns on this are more general, a particular concern relates to the acceptance of offer provisions where, under the terms of the Bill, members will only have 28 days to determine whether they should accept the offer to claim a contribution refund and respond to the ATO (although the Commissioner may use its discretion to allow a longer period).

This standard 28 day period is not a long time for members to understand the implications and make their decision, particularly where it may be important to obtain tax or other advice. The shortness of this period will be exacerbated in cases where there are delays in the member receiving the notification from the ATO, eg because they are travelling and unable to receive their mail.

This may be particularly critical in light of the issues raised earlier in this submission under which members could be significantly worse off by accepting the refund offer.

Recommendation:

If there are no changes to the Bill in this regard, it will be important that the ATO adopts a reasonable and fair approach in determining whether extensions to the 28 day period will be allowed. A 60 day period might be more appropriate.

It would also aid members considerably if the ATO, when making a refund offer, could provide details of how this would impact on the individual's tax liabilities. This should include, for example, Medicare, Medicare surcharge, Family Tax benefits, reduction in co-contributions..

Recommendation:

The ATO should be required to provide full details of the tax impact of refunding contributions on an individual as part of any offer. The ATO should also be required to warn members about other potential impacts such as Child Support payments.

If you would like to discuss our submission or require further information, please contact me on 03 9623 5552.

Yours sincerely

John Ward
Manager Research and Information