



AIST submission

**Response to Consultation Paper: Refund of
Excess Concessional Contributions**

September 2011

Background

On 1 July 2007, measures took effect to limit the amount of contributions that Australians were able to make into their superannuation. For the first time, contributions could be subject to tax in addition to the ordinary 15% concessional tax rate on contributions that originated from employers where contributions were received in excess of a legislated limit.

Two of the caps that were introduced were the cap on concessional contributions, originally set at \$50,000 (indexed), except for taxpayers aged 50 and over, for whom the cap was transitionally set at \$100,000, not indexed and due to expire on 30 June 2012; and the cap on non-concessional contributions which was originally set at a multiple of three times the concessional cap.

In 2009-2010, the concessional cap was halved to \$25,000 (indexed) (or \$50,000 non-indexed for taxpayers aged 50+) and the corresponding multiple for the cap on non-concessional contributions was doubled (i.e. six times the concessional cap).

The Excess Contributions Tax (ECT) applies to contributions in excess of these caps and the ECT on concessional contributions is levied at 31.5% in addition to the 15% paid in the fund. This tax can cause angst to taxpayers, in particular where the breach of a cap comes through no fault of their own. The excess amount also counts towards an individual's non-concessional contributions cap and there are instances where taxpayers have incurred heavy tax burdens due to very small breaches of the concessional cap limit.

It is understood that regarding Excessive Contributions Tax (ECT), 88% are related to concessional cap breaches. The median value of concessional breach is \$1,900 (tax payable) and the \$10,000 limit will cover the vast majority of breaches.

This consultation paper¹ seeks to consult on making a one-off provision for taxpayers to have an amount of \$10,000 or less that is contributed over the concessional cap refunded and assessed at the taxpayer's marginal rate of tax, rather than incurring ECT.

¹ Treasury, The 2011, *Refund of Excess Concessional Contributions Consultation Paper*, Commonwealth of Australia, Canberra.

AIST

The Australian Institution of Superannuation Trustees (AIST) is a national not-for-profit organisation whose members are superannuation fund trustee directors and officers of industry, public sector, and corporate superannuation funds who operate with a representative Trustee Board of Directors.

AIST advocates on behalf of its members, it undertakes research, develops policy and provides professional training, consulting services and supports trustee directors and staff to help meet the challenges of managing superannuation funds and advancing the interests of their fund members. AIST members manage \$450 billion of retirement savings for Australian workers.

AIST is represented on the Federal Government's Stronger Super Peak Consultative Group, and on the SuperStream working group, where a consistent, integrated approach to the various elements of the Stronger Super reforms will be further supported.

Contact

Fiona Reynolds	CEO	03 8677 3805
Tom Garcia	Policy and Regulatory Manager	03 8677 3804

1 Executive Summary

AIST broadly supports this proposal; however we believe that the following would improve the effectiveness of this position:

- We recommend this refund be made ongoing; We don't support this refund being made available where the cap has been breached due to a late payment or a mandated concessional contribution;
- We recommend that indexation be applied to the \$10,000 amount;
- We support the process as outlined in the paper and believe it to be consistent with existing processes such as co-contribution eligibility;
- We recommend that measures be put in place to ensure that one-off refunds cannot be used to facilitate the movement of illegal funds; and
- We believe that further consideration and direction is required with regards to the question of investment returns on eligible refundable amounts.

We would also take this opportunity to draw your attention to our proposal of earlier this year² where we outlined introducing a 'bring forward' rule on concessional contributions. AIST continues to support such a measure as the most elegant solution to this problem.

Lastly, we note that the paper does not provide a disincentive for high income earners where there is no tax differential. Consistent with our previous positions, we note that this proposal also has the potential for unforeseen consequences of this nature.

² AIST 2011, *AIST Submission: Response to Treasury: Concessional Superannuation Contribution Caps for Individuals Aged 50 and over*, (accessed 29/08/2011) <http://tinyurl.com/3c4fy8o>

2 Background and Context

2.1 Recent submissions

AIST has already made a number of submissions that are relevant to our position on this matter.

In our submission³ to the Federal Treasurer, Wayne Swan MP of February this year, we wrote about the need to ensure that the system does not continue to punish those who are ‘attempting to “do the right thing” to accumulate adequate retirement savings after benefiting from compulsory superannuation contributions for the least amount of time.’

This is consistent with our submission in response to *Concessional caps for Individuals aged 50 and over*⁴ of earlier this year, where we reiterated the importance of making the superannuation system more equitable for low to middle income earners. In our submission, we recommended that the current Bring Forward Rule for non-concessional contributions be similarly applied to concessional contributions. This equates to people under the age of 65 being able to bring forward two (2) years worth of entitlements of concessional contributions allowing them to contribute a greater amount in a given financial year (i.e. \$150,000 for a person aged between 50 and 65). **The benefit of applying this rule is that it will dramatically reduce the number of Australians breaching the caps and being charged excess contributions tax.**

This rule would provide greater flexibility around the concessional contribution limits and mean that those who breach their caps (inadvertently or otherwise) would avoid being penalised, assuming they limit their contributions to the maximum amount over the next two (2) years and may exclude them from any indexed increases in the cap during this time. This means that once a person has triggered the bring-forward in a year, any indexation of the concessional contributions cap for the subsequent two years does not apply. This rule would effectively give qualifying people more time (an additional two years) to adjust their contributions before any penalties for breaching concessional caps would apply.

AIST also recommended that indexation be extended to additional amounts presently not indexed. We do not retreat from this position.

³ AIST 2011a, *AIST Submission: 2011-2012 Commonwealth Budget Submission to the Treasurer*, (accessed 29/08/2011) <http://tinyurl.com/3rhwcmz>

⁴ AIST 2011, *ibid.*

2.2 Concessional contributions

On 1 July 2007, new contribution types came into effect. Whilst there are many contributions that fall into this category, the major types follow the general rule of normally being deductible in the hands of the entity making the contribution (this list is not exhaustive).

Amounts contributed may be **mandated**:

- Amounts contributed on behalf of an eligible employee mandated by the Superannuation Guarantee (currently 9%, proposed to increase to 12% by 2019) (“SG contributions”); and
- Amounts contributed on behalf of an eligible employee in excess of the SG minimum mandated by an award or other industrial agreement (“award contributions”).

However, they may also be **non-mandated**. In these cases, the taxpayer may have the option to receive the contributions as cash.

- Amounts contributed voluntarily by an employer on behalf of an eligible employee in excess of mandated minimums specified under either the SG or an award (or similar) (“employer voluntary contributions”);
- Amounts contributed in lieu of taxable income on behalf of an eligible employee under an approved arrangement between the employer and the employee (“salary sacrificed contributions”);
- Amounts contributed on behalf of an eligible employee in excess of the SG minimum under an award or other industrial agreement where the eligible employee is able to elect to receive taxable income in lieu of part or all the contribution being made (“optional employer contributions”); and
- Amounts contributed by eligible self-employed or substantially self-employed persons where a tax deduction is expected to be claimed by the person making the contribution (“self-employed contribution”).

Some other payments may be treated as concessional contributions once received by a super fund. Contributions that fall under the above categories are subject to tax upon contribution into taxed superannuation funds of 15%. Concessional contributions are not assessable income, nor are they exempt income and therefore, do not contribute to taxable income.

Salary sacrifice, optional employer and self-employed contributions form part of most definitions of adjusted taxable income (“ATI”). Employer voluntary contributions may form part of ATI if the eligible employee has the option to be paid in lieu of the contribution being made.

3 Position

Notwithstanding our recommendation for a Bring forward rule for concessional contribution, AIST broadly supports this measure. However, we believe that some fine-tuning may be appropriate and are in particular concerned about the 'one-off' offering of the refund.

AIST has concern that the taxpayer has no choice in choosing when they want to utilise the refund option. Paragraph 25 states that the individual who does not choose the refund option will not be offered another refund in the future. Further, it appears in the reading of 17.2, that if a taxpayer breaches the concessional contribution by more than \$10,000 then not only are they not eligible for the refund option but they also lose eligibility for the refund option in further years. This seems a very draconian approach. AIST recommends that the refund option be offered on an ongoing basis.

We support the measure, outlined in paragraph 11 of the consultation paper where the return of funds will be treated as assessable income in the year when it was contributed.

Such a measure ensures that the amount returned is paid to the taxpayer as if it was earned in the year it would otherwise have been paid. We consider this to be reasonable.

3.1 Late or mandated contributions

Already an issue for certain taxpayers is the possibility that they breach their concessional contributions cap because of contributions that are paid out of the normal cycle.

Consider the following situation:

Glenys is an engineer with XYZ Widgets, aged 30 and earns \$110,000 per annum. Glenys is employed under an EBA which mandates that a total of 12% of her salary (\$13,200) must be paid into her superannuation fund.

Glenys is a member of Widget Superannuation. This year she notices that for the 2009-2010 financial year, XYZ Widgets doesn't appear to have paid her any super.

She contacts the payroll officer and is told that for some technical reason, Glenys' contributions haven't been made for a year and they will fix it up straight away.

This means that with \$13,200 contributed to her account as per normal, together with the short payment of \$13,200 from the previous year Glenys will breach her concessional contributions cap for the year with concessional caps totaling a little over \$26,400.

The tax office offers Glenys a refund for the amount over her cap and she accepts.

In Glenys' situation she has breached the cap through no fault of her own. Ordinarily, the contributions are a combination of payments mandated by the SG and her EBA and as such, Glenys would never have the option to be paid cash in lieu of the contribution.

Consistent with our views below, we recommend that allowance should not be made for the return of amounts that are in breach of the cap purely because of late payment. Furthermore, we believe that the situation where one may breach a concessional cap due solely to a late payment is manifestly unjust. Whilst we're aware that this is outside the scope of this submission, we believe that this situation should be raised as an example of an unintended consequence of contribution caps and exempted.

The primary historical reason for superannuation is as a form of 'forced retirement savings'. The reason for the existence of the superannuation guarantee, and over-SG award requirements, is to ensure that money that would otherwise be received by a taxpayer as cash is mandatorily diverted into superannuation. That is, the taxpayer has no option to receive these amounts as cash.

In 1999, amounts contributed into superannuation were subject to mandatory preservation, regardless of the source. The reasoning for this is that super should be seen as a vehicle for retirement saving, and early access ahead of retirement is incompatible with this.

As identified earlier, certain types of concessional contribution exist where one has the option to receive cash in lieu of the contribution being made.

AIST also recommends that allowance should not be made for return of mandated amounts, due to the character of these contributions. SG and award contributions would not ordinarily be exchangeable for cash payments, and it is clear that even a one-off return of these contributions is contradictory to the intended mandatory nature of these payments.

3.2 Higher income earners

The stated reasoning behind the existence of contributions caps is to act as a disincentive to taxpayers to prevent the low-tax environment of super being misused.

The tax rate on amounts over the concessional cap is the same as the highest marginal tax rate. It must be emphasised that given this lack of a difference where one is on the highest marginal tax rate, there is no discernable disincentive in contributing to superannuation in excess of caps.

AIST recommends again this measure should be made available on an ongoing basis as an attractive option designed to reduce misuse of the superannuation environment, in particular, where taxpayers are on the highest marginal rate of tax.

3.3 Indexation

In June 2009, the concessional caps were halved to \$25,000 indexed (normal cap) and to \$50,000 not indexed (50 years and over cap). In the process, the indexation clock was reset back to zero.

To put this another way, since 1 July 2007, the cap on concessional contributions was halved and indexation was not carried out for two years, despite this being one of the more progressive features of Simpler Super

AIST recommends that the \$10,000 refund be indexed. We notice that the concessional contribution cap is set to increase through indexation in lots of \$5,000 increments, representing 20% of the current cap's value.

To ensure that fairness is applied to people breaching the cap for the first time in the future, we propose that an identical factor – 20% be used for indexation of the \$10,000 refund as explained in paragraph 10

3.4 Processes

AIST supports the process as outlined in the consultation paper. We believe that the process outlined – where the ATO requires the filing of an individual's tax return together with member contribution statement (MCS) data and consider this to be wholly consistent with other measures, such as co-contribution eligibility.

3.5 Anti-money laundering and counter-terrorism financing

AIST is concerned about the potential of this measure for misuse in the instance of certain illegal transactions. Under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* ("AMLCTF Act"), certain transactions are regarded as designated services, where entities who provide these services are deemed to be 'reporting entities' and thus covered under the Act.

The payment of superannuation benefits is an example of such a service, although the Act doesn't cover SMSFs. AIST is concerned that providing this option will provide an incentive for payments to be structured in a way that could feasibly form links in an ML/TF chain. We note that a combination of a self-employed person and a SMSF fund does not contain a touch point where transactions that may be potentially suspicious can be reported, and we also note that the threshold for mandatory transaction reporting is set at \$10,000 – coincidentally the upper limit of the refund amount.

AIST recommends that measures be put in place to ensure that any one-off refund cannot be used to facilitate the movement of illegal funds. Such movements threaten the integrity of the superannuation system.

3.6 Investment returns earned

AIST notes that the question of investment returns earned on the excess contributions within the fund has not been dealt with in the paper. Considering that the vast majority of excess concessional contributions are less than \$10,000 and a significant proportion of such contributions would be made towards the end of the financial year, perhaps the amount of returns earned from these monies is deemed to be minor. However, for the sake of clarity, AIST feels that the paper should cover this aspect and give direction.