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The Hon. Chris Bowen MP
Minister for Financial Services, Superannuation and Corporate Law, and Minister for Human Services
Parliament House
CANBERRA ACT 2600

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Dear Minister

Further to the Taxation Institute of Australia's (**Taxation Institute**) meeting with you on Friday 10 July 2009, please find set out below some additional information in relation to three issues which are of particular concern for our members.

Impact of new contributions caps

As from 1 July 2009, the concessional contribution cap has been reduced from $50,000 to $25,000 per person. Further, the transitional concessional contribution cap until 30 June 2012 for persons aged 50 or over has been reduced from $100,000 to $50,000.

The Taxation Institute understands this policy change has been a result of a need to reduce the cost of the taxation concessions provided to superannuation generally and to limit the extent to which these concessions may disproportionately benefit wealthy Australians as opposed to those of more limited means.

However, in the Taxation Institute's view there is likely to be an adverse impact on the ability of many Australians saving for their retirement who would fall more appropriately into the category of "limited means" rather than into the category of "wealthy". By way of explanation, the Taxation Institute considers that over many decades, little has changed in the economic life cycle of the average working family. In the earlier years, the family income is generally directed towards repaying a home loan and meeting the expenses of raising children. This phase can extend well into middle-age depending upon various factors including level of income, number of children and the home loan level. It is often not until the family income earner is in their 50's that they are in a position to direct more of their income into superannuation for their retirement. It is then during the ensuing period up until retirement that they are in a position to make sufficient contributions to enable a meaningful level of superannuation benefits to be accumulated for retirement.

Accordingly, the Taxation Institute considers it imperative that the superannuation/ taxation regime contains sufficient incentive and flexibility for the average person in the above category to make higher superannuation contributions during the latter part of their working life. This applies both to

employees who may wish to enter into legitimate salary sacrifice arrangements or self-employed persons who wish to make higher concessional contributions.

In light of the above, the Taxation Institute recommends that consideration be given to reinstating a higher concessional contributions cap for persons 50 years of age or older. For example, one suggestion would be to simply make the $50,000 cap permanent (and subject to indexation) for persons over 50 years of age as opposed to a transitional measure terminating on 30 June 2012. So that this measure remains consistent with the underlying Government policy which pre-empted the change to the contributions cap (ie preventing wealthy Australians from exploiting this concession), the measure could be subject to a life time cap which is indexed over time (ie the concession will only apply to a certain specified amount which may be contributed at any time during an individual's working life).

Excess contributions tax

The Taxation Institute has identified two key areas where this tax is either oppressive or inequitable.

By way of background, under the current taxation regime, concessional contributions are initially subject to 15% tax and non-concessional contributions 0% when received by a complying superannuation fund.

If the level of contributions exceeds either the concessional cap, non-concessional cap or both, then the relevant fund member is subject to excess contributions tax as follows:

1. The amount of concessional contributions in excess of the concessional contributions cap is subject to penalty tax at the rate of 31.5%. This excess then also counts towards the non-concessional contributions cap.

2. The amount of non-concessional contributions in excess of the non-concessional contributions cap is subject to penalty tax at the rate of 46.5%.

The first area of concern is where a member is already close to both the concessional contributions cap and also the non-concessional contributions cap. This could occur, for example, where the person has more than one position of employment and has salary sacrificed to the $25,000 limit with one position and then be subject to compulsory superannuation guarantee contributions with one or more other positions. At the same time they may have also contributed close to the non-concessional cap amount (being currently $150,000 p.a. or $450,000 if the person is 65 years or younger and the three year average rule is utilised). This might be a result of contributing funds available from say an inheritance or sale of a business or another investment. In such a case, the additional superannuation guarantee amounts may be subject to a total tax impost of 93% (being the initial 15% tax on contributions at the superannuation fund level, plus a personal excess concessional contributions tax of 31.5%, plus a personal excess non-concessional contributions tax of 46.5%). The Taxation Institute considers this to be an unduly onerous outcome.

The second associated area of concern is simply where the new concessional contributions cap of $25,000 is inadvertently exceeded as a result of a person having employer contributions in excess of this amount due to a combination of factors such as two or more unrelated employers meeting their respective superannuation guarantee responsibilities in respect of the person, pre-existing salary sacrifice arrangements and/or fixed contribution arrangements to meet the cost of ancillary benefits such as death and permanent disablement insurance. In this case it seems quite inequitable that the member might be subject to penalty tax of 31.5% as a result of matters largely outside their control.

The Taxation Institute notes that under the old "Reasonable Benefit Limit" regime there was scope for an employer to cease making superannuation guarantee contributions in respect of the employee if notified by the employee that the value of their accumulated superannuation entitlement(s) was already in excess of their Reasonable Benefit Limit. This facility then minimised

the likelihood of penalty tax rates on excess benefits. However, under the current excess contributions tax regime there is no comparable relief from the imposition of penalty rates of tax.

The Taxation Institute considers that both the above examples are exacerbated by the reduction in the concessional contributions cap to $25,000. However, regardless of this, the Taxation Institute recommends that consideration be given to introducing some form of relief from excess contributions tax via refundable contributions (ie allowing the member to withdraw the excess contributions within 12 months of the financial year in which they were made) and excising superannuation guarantee contributions from the calculation of excess contributions tax. As these matters may unfairly impact on employees in the current financial year, the Taxation Institute suggests that action may be required prior to the outcome of the Henry Review.

Related areas of concern

The Taxation Institute would also like to take this opportunity to mention two further areas of concern in relation to superannuation.

The 10% Rule

Firstly, the Taxation Institute see no further role for the 10% rule in section 290-160 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) which precludes many employees from accessing their full concessional contributions cap of $25,000 (or $50,000 if they are over 50 years up to FY2012).

Broadly, the 10% rule precludes a person from claiming a tax deduction for a concessional contribution if the person's assessable income (together with any salary sacrifice super contributions and reportable fringe benefits) as a result of activities as an "employee" exceeds 10% of their overall assessable income (together with any salary sacrifice contributions and reportable fringe benefits). With the reduced contributions cap and the inability for many employees to obtain any additional super, other than the minimum 9% super guarantee contribution from their employer, there is no longer any need for the 10% rule. It adds unnecessary complexity and limits many who should be encouraged to provide for their own future retirement.

Taxation of non-complying self managed superannuation funds

If a superannuation fund becomes a non-complying fund (typically this will only occur for self managed superannuation funds), in the following financial year the fund's assessable income will be taken to include, broadly, an amount referable to the market value of the fund's assets (less any tax free component) (see sections 295-320 and 295-325 of ITAA 1997). This means that all of the tax concessions that were previously available to the fund whilst it was a complying fund are effectively recouped and, in effect, the entire asset base of the fund becomes subject to taxation at the rate of 45% (together with an additional amount of 15% tax already paid in respect of concessional contributions). There is no discretion given to the Australian Taxation Office (**ATO**) to impose a lesser rate of tax.

This seems to be the key penalty which the ATO seeks to impose in the circumstances where there are breaches of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**). There are other options available to the ATO for dealing with breaches including disqualifying, suspending or removing trustees, instituting court proceedings to seek penalties in respect of offences under the SIS Act and freezing the assets of a fund. However, these kinds of options are typically used in addition to the ATO making the fund a non-complying fund.

The Taxation Institute has recognised a recent increase in the number of self managed superannuation funds that the ATO is making non-complying. Given that the Taxation Institute understands the average self managed superannuation fund now has a net asset base of in the order of $900,000 the imposition of a 45% tax appears unduly onerous. Further, the imposition of such taxation has a deleterious effect on the retirement savings of members of a fund who are affected by such a finding. The Taxation Institute accepts that there needs to be a significant

penalty to deter trustees from breaching the SIS Act. However, the Taxation Institute considers that the removal of the taxation concessions available to complying funds (and those contributing to them) is of itself a significant deterrent in addition to the other penalties available to the ATO. In any event, the Taxation Institute asks that consideration be given to reducing the 45% tax on the asset base of a fund if it is found to be non-complying.

The Taxation Institute recommends that the top tax rate should apply to the fund's taxable income during the financial years that the fund remains non-complying and that alone will generally be sufficient to penalise funds. If an extra monetary penalty above this needs to be imposed then it should be in line with having a deterrent effect, but not a punishment so large that wipes out almost half of a taxpayer's retirement savings. This monetary amount could be in the order of, say, $10,000 to $20,000 – or based on a scale of the assets in the fund.

If you require any further information or wish to discuss the above matters further, please contact Joan Roberts on 03 9611 0178.

Yours sincerely

Joan Roberts
President