

REFUND OF EXCESS NON-CONCESSIONAL CONTRIBUTIONS

This article reviews the legislation which will finally provide an option to avoid the draconian penalties for contributions to superannuation in excess of the non-concessional contributions cap.

After almost 8 years, and many hard earned dollars in punitive taxes, the opportunity to avoid very hefty penalties for excess non-concessional contributions is close.

Legislation

On 3 March 2015, the *Tax and Superannuation Laws Amendment (2014 Measures No. 7) Bill 2014* passed both Houses of Parliament.

Among other matters, the Bill amends '... the *Income Tax Assessment Act 1997* and *Taxation Administration Act 1953* to provide individuals with an option to be taxed on the earnings associated with their excess superannuation non-concessional contribution at their marginal tax rate ...'.

That may not seem to be very helpful, but it also provides the opportunity to withdraw excess non-concessional contributions, avoiding penalty tax on those contributions.

The legislation, having passed both Houses of Parliament, now awaits Royal Assent by the Governor-General before becoming law. When it comes into law, it will apply to excess non-concessional contributions made from 1 July 2013.

Regulations

Draft Regulations, titled *Tax and Superannuation Laws Amendment*

(*2015 Measures No. 1 - release conditions for non-concessional contributions*) Regulation 2015, amending the SIS Regulations, have also been released. It is expected the final version will come into effect at the same time the legislation receives Royal Assent.

The regulations mainly cover the addition of a Condition of Release to enable the release of the excess non-concessional contributions and 'associated earnings amount' (see below).

Process

The legislation changes both the *Income Tax Assessment Act 1997* (ITAA 97) and the *Taxation Administration Act 1953* (TAA 53) and, in the process, impacts both:

- the individual contributor; and
- the superannuation fund.

The TAA 53 sets out the process for calculating the 'associated earnings amount' and releasing the funds from superannuation.

1. The individual

If the non-concessional contributions made by an individual in the 2013/14 or later years exceed the relevant cap, the individual will be given the opportunity, in the form of a release authority issued by the ATO, to withdraw the excess amount from their superannuation fund.

Along with the excess contributions, the election by the individual will include 85% of the 'associated earnings amount'.

Alternatively, the member may elect not to use the withdrawal option, in which case the excess contributions will be taxed in the fund as previously - i.e. at the top marginal rate plus Medicare levy.

2. The fund

If the member elects to withdraw the excess non-concessional contributions and the 'associated earnings amount', no tax on the excess will be levied in the fund on that money.

However, more than the excess contributions will need to be paid, as the 'associated earnings amount' will be added to the excess contributions amount and paid to the ATO under the release authority.

The fund's trust deed must permit the payment of both the excess contributions and the 'associated earnings amount'.

Although a new condition of release will be added to the SIS Regulations, some SMSF deeds can be very prescriptive as to what may be paid under a condition of release and, in particular:

- to whom funds may be paid (i.e. the ATO?);

Current as at 11 March 2015.

Please note this article is for information purposes only and does not constitute financial or legal advice.

REFUND OF EXCESS NON-CONCESSIONAL CONTRIBUTIONS

- including the 'associated earnings amount'.

Associated Earnings Amount

The news is positive so far, but the sting is that the calculation of the associated earnings amount can prove costly - certainly not to the extent of the potential 93% tax, but costly all the same.

Bearing in mind that the change in legislation needed to include a disincentive to 'shift' income by depositing large contributions to superannuation, having the income taxed at low, or zero rates, and withdrawing the funds when 'caught', the introduction of the associated earnings calculation can be understood.

Calculation of the associated earnings amount is based on a nominal interest rate to reflect the earnings received on those excess funds in the period they are held by the super fund.

That still seems reasonable, but the sting comes from the method to calculate the earnings amount.

The interest rate applicable is the lower of a rate specified by the Minister (if any) and the average ATO General Interest Charge (GIC).

Subsection 8AAD of the TAA 53 sets the GIC rate as the average of 90 day bank bills, plus 7% (i.e. in the vicinity of 9% to 10%).

The formula for calculating the earnings amount applies the GIC rate at the first day of the year in which the excess non-concessional contributions were made, and applies interest on the contributed amount for the whole year, regardless of when the excess non-concessional contribution occurred.

For example, if a contribution was made in June of 2014, the earnings amount will be calculated from 1 July 2013, through until the ATO makes an excess non-concessional contributions determination.

Payment from fund

If the member elects to have the excess non-concessional contributions, and the associated earnings amount released, the amount to be paid to the ATO will comprise:

- the amount of excess non-concessional contributions as determined by the ATO; and
- 85% of the associated earnings amount.

Note: only 85% is paid as it is presumably assumed that tax of 15% has been paid on the earnings.

Taxation of member

The ATO will adjust the member's income tax return for the relevant year to include the total of the associated earnings amount (i.e. the grossed up amount) in the assessable income of the member.

That grossed up amount will be taxed at the member's marginal rate and, because of the assumption tax of 15% has been applied at the SMSF level, an offset of 15% will be applied to the assessed amount.

In practice

How the calculation of the associated earnings amount will work in practice could be as detailed in the example below:

- Member makes \$100,000 excess non-concessional contribution in June 2014;

- Assume income on \$100,000 for remainder of June is \$100 - not of any relevance;
- Associated earnings amount is calculated for whole year through to the ATO determination - assume \$5,000;
- Amount to be released by super fund is \$104,250 (\$100,000 + 85% of \$5,000);
- Member's assessable income is increased by \$5,000;
- Member's tax is recalculated and 15% tax offset is applied to tax on \$5,000;
- Member receives adjusted tax assessment and, presumably, a payment which includes receipt by ATO of \$104,250, less adjusted tax.

Conclusion

Although the legislation provides significant relief from excess non-concessional contributions tax, clients and advisers need to continue to monitor the level of contributions.

Whilst the opportunity of a refund is available, the payment of the associated earnings amount from superannuation and the adjustment to the individual's income tax return could still prove to be costly and an unnecessary waste of retirement funds.

Trust deeds should be reviewed to ensure they empower the payment and, if not, updated (the Topdocs SMSF deed does contain the necessary provisions).

More information

Should you have any queries or require more information, please contact the team at Topdocs on 1300 659 242.

Current as at 11 March 2015.

Please note this article is for information purposes only and does not constitute financial or legal advice.