



May 2007

**TECHNICAL UPDATE  
CONCESSIONAL CONTRIBUTIONS AND DEFINED BENEFITS  
CHANGES FROM 1 JULY 2007**

**The Issue**

From 1 July 2007, Concessional Contributions, (the old Maximum Deductible Contributions to employers), on which the normal 15% contributions tax is payable, will be limited to the first \$50,000 of contributions paid on behalf of employees. Contributions in excess of this limit will be taxed a penalty rate of 46.5% (i.e. the normal 15% tax plus a penalty tax of 31.5%). Up until the year ending 30 June 2012 in respect of employees over age 50 there is a transitional concessional limit of \$100,000. Employers will receive a tax deduction for all concessional contributions paid, whether they exceed these new limits or not. The additional tax will be paid at the member level rather than the employer losing tax deductibility for these “excess” contributions.

The question we were waiting to be answered was how these new concessional contribution limits would apply to defined benefit members?

**How does it apply to Defined Benefit Plans?**

The Income Tax Assessment Amendment Regulations 2007 gives us some answers to this. It sets out a method of calculating Notional Taxed Contributions (“NTC”). A defined benefit member’s NTC is the calculated notional amount of contribution (including any compulsory member contribution paid by salary sacrifice) that will be deemed to be paid by the employer to meet that employee’s defined benefit from the Fund and hence the amount that will count towards the concessional limit of \$50,000 (or \$100,000).

The first point to note is that provided (broadly) benefits are not improved then no member who was a member of a defined benefit fund at 30 June 2007 will have a NTC greater than \$50,000 (or \$100,000). In this case, no matter what the NTC calculation comes up with, the NTC will be deemed to be no more than the concessional limit. Of course, if additional contributions are made by the employer (salary sacrificed or otherwise) these could well take the contributions above the concessional limit and result in a tax liability to the member, albeit payable from the member’s benefit in the Fund.

**How is the NTC Calculated?**

In calculating the NTC the actuary has to first calculate the average age at entry of all current members (at 1 July 2007) of the particular benefit category of the Fund. The NTC for the year is, in most cases, calculated as:

$$1.2 \times (\text{New Entrant Rate} \times \text{Superannuation Salary}) - M$$



where M is the amount, if any, of the member compulsory contribution if paid on an after tax (non-salary sacrifice) basis.

The New Entrant Rate (NER) is the rate of contribution per annum (expressed as a percentage of salary) required to be paid by the employer to provide the promised benefits to a new entrant who joined at that average age. The NER will be the same for all members of a particular benefit category. The factor of 1.2 makes allowance for tax and expenses.

The NTC (limited to the concessionally taxed limit) together with any other employer contributions for the member will then be reported by the Trustee to the ATO who will calculate and advise trustees of any further tax liability. As the calculation is based on the average age at entry of members as at 1 July 2007 it will not be possible for individuals to be given information about their NTC until some time after that date.

### **Example**

ABC Limited's employee Jim (aged 52) is a member of the company's defined benefit fund. Jim's salary is \$1,000,000 and the calculated NTC for Jim is \$120,000 (which includes member compulsory contribution paid by salary sacrifice). His reported NTC will be restricted to \$100,000, and provided no additional contributions are made by the employer (by salary sacrifice or otherwise) these contributions will be taxed at the concessional rate of 15%.

However, if a further \$75,000 employer contribution was paid into superannuation on behalf of Jim then his superannuation fund would be required to pay tax on this \$75,000 such that the total tax paid (including the contribution tax of 15%) would be 46.5%. If Jim's NTC had been \$80,000 and an additional \$75,000 had been paid by his employer then only \$55,000 ( $\$80,000 + \$75,000 - \$100,000$ ) would be taxable at 46.5%.

### **FOR FURTHER INFORMATION**

These are still draft regulations and there are many areas of uncertainty to be resolved. The Institute of Actuaries of Australia is working with Treasury on these matters and further "clarification" could well follow. Under these circumstances we may not be able to answer all your questions but if you have any, please call either David Lewis or Brendan Paddison at NFC on (02) 9929 2700, e-mail us at [info@northbridgeadmin.com.au](mailto:info@northbridgeadmin.com.au) or visit our website [www.northbridgeadmin.com.au](http://www.northbridgeadmin.com.au).

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