THE TAX INSTITUTE

6 June 2018

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee

Email: Economics.Sen@aph.gov.au

Dear Mr Fitt

Inquiry into the Treasury Laws Amendment (2018 Measures No. 4) Bill 2018

The Tax Institute acknowledges the invitation to make a submission to the Senate Economics Legislation Committee in relation to the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018 (**Bill**).

We received this invitation on Monday, 4 June 2018 and were only given until 6 June 2018 to respond. The Tax Institute does not consider that a three-day consultation period represents legitimate consultation. A three-day consultation period has not provided The Tax Institute with sufficient time to consider all the issues that arise in relation to the Bill. We are disappointed with this process and strongly advise the Committee to reconsider such time periods in the future if the Committee genuinely wants a legitimate consultation. As a general observation the absence of appropriate consultation time may require future legislative amendments for measures introduced.

Given the circumstances, we have made our best endeavours to provide some comments in relation to the Bill. Please note that these are not necessarily the only issues we would like to raise, they are simply the issues we had time to address.

Superannuation Guarantee amnesty

The Tax Institute understands that the objective of the amnesty provisions is to encourage employers to self-correct historical SG non-compliance for the benefit of employees who are legitimately entitled to their employer superannuation contributions.

We consider that to achieve the objective of the amnesty provisions, the amnesty should apply equally to all employers who have failed to comply with their SG obligations irrespective of whether they come forward voluntarily for the first time or have had an examination or audit by the ATO. In our opinion, the objective of correcting all outstanding SG obligations cannot be met if the amnesty provisions are confined to employers that the ATO is unaware of (ie those who have not come forward previously and those who have not been subject to an examination by the ATO).

In this regard, The Tax Institute notes that the amnesty will only benefit employers who “first” report a superannuation guarantee (**SG**) shortfall to the Commissioner during the

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amnesty period (ie 24 May 2018 to 23 May 2019) (see proposed section 74(1)(a)(ii) of the *Superannuation Guarantee (Administration) Act 1992* (**SG Act**)).

Further, proposed section 74(1) of the SG Act provides that an employer will only qualify for the amnesty, amongst other conditions, if:

> "the Commissioner has not, at any time before the disclosure, informed the employer that the Commissioner is <u>examining, or intends to examine</u>, the employer's compliance with an obligation to pay the superannuation guarantee charge for the quarter. [our emphasis]

The Explanatory Memorandum to the Bill (**EM**) describes the operation of this provision at paragraphs 1.24 to 1.27. The provision is summarised at paragraph 1.24 as follows:

> "1.24 For a disclosure in respect of a quarter to qualify for the amnesty, the Commissioner must not have, at any time before the disclosure, informed the employer that they are examining, or intend to examine, the employer's compliance with their obligation to pay SG charge in relation to the quarter."

Paragraph 1.25 of the EM suggests that the reference to any "examination" must relate to "ATO compliance activity". However, paragraphs 1.26 and 1.27 suggest that a very broad interpretation should be given to the meaning of "examination" - extending "examination" to include "reviews, audits, verification checks, record-keeping reviews/audits and other similar activities".

The Tax Institute is concerned about the possible breadth of the reference to "examination". Employers need to be provided with appropriate guidance on the possible application of these provisions and the scope of the meaning of "examination" for these purposes. In its current form, the scope that might be given to section 74(1)(c) of the SG Act is potentially very broad. This will cause uncertainty. Accordingly, employers may not be properly incentivised to take advantage of the amnesty if there is a risk that the ATO may take a view that it does not apply due to past interactions that the employer has had with the ATO. This would defeat the purpose of the amnesty.

In particular, The Tax Institute considers that based on the current drafting of the Bill, employers are likely to be uncertain as to whether they would be entitled to the benefit of the amnesty if they have had an ATO representative visit their premises or contact them with a view to encouraging them to consider reviewing their service contracts to potentially re-classify contractors as employees or with another similar educative objective or they have had such an interaction at any time in the past.

The Tax Institute recommends that amendments be made to the Bill and EM to make it clear that such interactions would not preclude employers from taking advantage of the amnesty. Should our recommendation not be accepted by the Committee, at a minimum, we consider that further guidance needs to be provided by the ATO in the form of confirmation that general discussions held with employers or "friendly" visits with a view to assisting employers with their SG compliance will not constitute an "examination" or an "intent to examine" an employer's compliance with SG.

NALI Provisions

In this regard, we note that on 19 February 2018, we made a submission in relation to the Superannuation Tax Integrity Measures and we specifically addressed the non-arm's length income (**NALI**) provisions. We have attached this submission in Annexure A (**Previous Submission**).

Our Previous Submission contains comments that are relevant in relation to the NALI provisions in the Bill. Therefore, we request the Committee to review the comments in our Previous Submission.

In addition to the Previous Submission, we have outlined the following points for your consideration.

Practicality of Transitional Relief

The Bill does not provide any grandfathering of current arrangements or any transitional time to comply with the provisions of the Bill. The Tax Institute considers that the provisions should only apply to transactions occurring from the date the Bill receives Royal Assent.

Paragraph 3.52 of the EM refers to the application of the proposed NALI provisions. It states that the amendments will apply to income derived in the 2018-19 income year and later years (regardless of the start date of the scheme/investment). The issue with this start date is that even though it is prospective, it practically has a retrospective application. Further, it does not allow taxpayers any transitional relief to re-organise their affairs to ensure that any relevant schemes are rectified so that they better reflect arm's length terms (assuming such rectification can be achieved which will not be possible in all circumstances – for example, in the case of an asset acquired from a third party many years ago such rectification would not now be possible).

An example of the issue is highlighted by the EM in example 3.1 which references an SMSF which has invested in property. The SMSF in the example would not practically have time to apply rectifications by 30 June 2018 to make their transaction 'an arm's length dealing'. In order for this to be achieved, documentation to change the loan agreement would need to be drafted, as well as preparation and registration of a mortgage on title.

The Tax Institute suggests that a transition period should be applied in relation to the measures in the Bill (we would suggest a period of at least 2 years is appropriate). This will provide adequate time for all SMSFs to assess whether their investments and transactions are carried on at arm's length. Further, to the extent possible, it will also provide a reasonable time-frame to unwind or amend those transactions to ensure that any related income is not subject to the proposed section 295-550 under the Bill.

Retrospective Nature of Amendments

Paragraphs 3.9 and 3.18 of the EM have the effect of retrospectively applying the proposed legislation and the proposed NALI concepts to existing transactions and structures. These paragraphs specifically state that the EM intends to change the way that the current NALI laws apply to certain existing arrangements. It is possible that fund trustees and other taxpayers may have received advice on these arrangements in relation to the current NALI provisions, and therefore established lawful structures and transactions as a result of that advice.

It is unfair that certain taxpayers, having exercised relevant planning, care and diligence to establish structures and arrangements, moving forward will automatically be caught by the proposed NALI provisions.

Fund trustees who have previously received advice (particularly in relation to the issues referred to in paras 3.9 and 3.18 of the EM) are likely to require further updated advice in relation to the application of proposed laws to investments previously made and whether it is possible to make relevant changes to existing investment structures and arrangements so as to not be caught by the proposed provisions.

Notwithstanding any transitional relief that might be made available, it is noted that in some cases (particularly where an asset has been acquired on more favourable terms – for example, from a co-investor under the exercise of pre-emptive or similar buy-out rights arrangement) it may not be possible for there to be any restructuring of the past acquisition or investment and the proposed NALI laws will be left to apply retrospectively and adversely to these funds.

The Tax Institute recommends a grandfathering of existing arrangements to ensure an orderly transition for arrangements that have been entered prior to this change. A comparable significant change that involved complex and often non-market listed investments was the 2009 change to the definition of *in-house assets*. The changes to section 71 of the *Superannuation Industry (Supervision) Act 1993* (**SISA**) provided a 10 year transition for existing arrangements to allow an orderly restructure or exit. We propose that a similar timeframe is implemented in respect of the proposed amendments to section 295-550 of the ITAA 1997.

Whole transaction tainted as a result of minor NALI

It is acknowledged that one of the proposed changes to the concept of NALI is that non-arm's length expenditure now is captured by the NALI definition. However, the proposed outcome of minor non-arm's length transaction expenditure can result in excessive adverse tax outcomes relating to an SMSF's investment moving forward.

Paragraphs 3.29 and 3.30 of the EM, as well as Example 3.2, outline a scenario where brokerage is not charged to a retail superannuation fund at arm's length. As a result, the retail superannuation fund in the example will derive income that is classified as NALI. In addition, the same example also states that the net capital gain from the investment may also be considered as non-arm's length.

The outcome of Example 3.2 of the EM is that the 'penalty disproportionately outweighs the crime'. The non-arm's length component of the transaction was a minor part of the overall investment. Therefore, it seems unreasonable that all income and capital gains derived from the investment should be tainted by only a minor non-arm's length component of the transaction.

In relation to SMSFs, there are additional risks. If an SMSF were to invest in a private unit trust (analogous to the example outlined in Example 2), there may be a risk that a minor part of the SMSF's dealing with the trust would not be at arm's length. This may be an oversight between the parties, as opposed to a pre-meditated scheme, that results in a non-arm's length component. For example, similar brokerage may not be factored into the purchase price (ie costs to issue unit certificates and update the trust's records), or some trust transfer formalities could be relaxed due to the private nature of the transaction – and these examples could be construed as not being at arm's length.

In accordance with the EM, the minor examples outlined above would have significant adverse tax consequences for the SMSF in relation to deriving income, and even disposal of the unit trust investment. These tax outcomes appear to be excessive in relation to what may be a slight oversight by the SMSF.

The Tax Institute recommends that the Bill be amended so that minor oversights do not result in significant tax outcomes for SMSFs.

Internal arrangements

We refer to point 4 on page 4 of the Previous Submission regarding 'Free and Discounted Services'. In addition to those points, we draw your attention to the comments outlined below in relation to internal arrangements.

Paragraphs 3.31 – 3.37 of the EM indicate that certain tasks undertaken by trustees in relation to an SMSF's compliance activity may be considered as being subject to the non-arm's length income rules.

There appears to be a great deal of uncertainty for SMSFs in relation to what may trigger the non-arm's length income rules in relation to 'internal arrangements'. For example, the EM does not provide a specific benchmark which could cause a trustee's usual functions to trigger the NALI rules.

Trustees undertake numerous tasks on behalf of their SMSF. Examples include book-keeping (as outlined in paragraph 3.34 of the EM), investment decisions, meeting facilities, and review of accounts. Some trustees may undertake tasks which overlap as part of that person's specific professional training or vocation. In these circumstances, the EM appears to be ambiguous in relation to what trustee tasks may constitute NALI.

Paragraph 3.36 of the EM outlines that paragraph 17A(1)(f) of the SISA requires trustees to not charge for trustee services. However, unless this area is clarified further, there is a risk that a trustee may charge for services with the intention of satisfying the proposed NALI provisions, and may inadvertently contravene paragraph 17A(1)(f) of the SISA.

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If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on [redacted].

Yours sincerely

[redacted]

Tracey Rens
President