ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Inquiry into Treasury Laws Amendment (Small Business and Charities and Other Measures) Bill 2023 [Provisions]

Department: Department of the Treasury
Topic: Solution proposition
Reference: Spoken (13 Nov 23)
Senator: Dean Smith

Question:

Senator DEAN SMITH: Thank you, officials from the Treasury, for making yourselves available this evening. Mr Hawkins and Mr Thomson, because we are short of time, in the letter to Minister Jones on 21 February the variety of peaks, of which I think there are seven, put a formal proposition to the government in terms of a solution. On notice, could you provide me with an explanation to what degree was that particular proposition considered? Also, what were identified as some of the deficiencies in that particular proposition? And if you could be expansive on this particular occasion, just to assist us with our deliberation, that would be much appreciated.
Mr Hawkins: Happy to take that on notice.
Senator DEAN SMITH: Thank you, Mr Hawkins.

Answer:

The Government published a consultation paper on non-arm's length expense (NALE) rules for superannuation funds for a 4-week consultation from 24 January to 21 February 2023. During this consultation process, Treasury conducted two Roundtables on 17 February and 20 February which were attended by representatives from all of the organisations which put forward the alternative solution, namely Chartered Accountants Australia and New Zealand, CPA Australia, Institute of Financial Professionals Australia, Institute of Public Accountants, National Tax & Accountants Association, SMSF Association and the Tax Institute ('the Joint Bodies'). This follows extensive engagement with these bodies since the NALE rules came into effect in 2019.

On 22 February 2023, Treasury received a submission to the consultation paper from the Joint Bodies. This submission proposed an alternative to the potential approach outlined in the consultation paper. The alternative approach would involve the complete repeal of the NALE rules. The Joint Bodies suggest that integrity concerns related to NALE are appropriately addressed through the existing contributions rules. They also suggest that provisions in *Superannuation Industry (Supervision) Act 1993* ('the SIS Act') could be amended to impose penalties on the trustees of self-managed superannuation funds and small APRA-regulated funds which engage in NALE arrangements.

Treasury subsequently met with representatives of Chartered Accountants Australia and New Zealand, the Tax Institute and CPA Australia on 16 March 2023. The submission was discussed at this meeting.

Treasury carefully considered the proposal outlined in the joint submission when providing advice to the Government. The Joint Bodies' proposal would involve the repeal of anti-avoidance provisions that have been in place since 2019. This presents a number of concerns:

- Existing ATO guidance on in-specie contributions is not fit-for-purpose for NALE. According to the ATO guidance, in-specie contributions only applies where the shortfall is 'provided by a person whose purpose is to benefit one or more particular members of the fund or all of the members in general'[1]. This purpose will not be present in arrangements where an expense is incurred by a fund at below arm's-length terms, unless there is evidence demonstrating the shortfall was intended to benefit members of the fund. The ATO guidance does not provide funds with a basis to retrospectively treat a NALE shortfall amount as a contribution when that was not the intent of the arrangement. Additionally, any amendments to existing contribution rules which involve assigning NALE shortfall amounts as contributions to particular members would result in complex and burdensome administrative interactions between superannuation fund contributions, fund transactions and personal income tax settings.

- The NALI and NALE provisions are contained in the Income Tax Assessment Act 1997 ('the ITAA') rather than the trustee penalties framework in the SIS Act due to the substantial opportunities for non-arm's length dealings to generate illegitimate tax advantages for the fund. Addressing non-arm's length arrangements directly through the ITAA allows these illegitimate tax advantages to be unwound by taxing income in future years at the highest marginal tax rate. Regulatory consequences under the SIS Act would involve more uncertain outcomes as the tax treatment of the arrangement would not be affected. This may mean a one-off trustee penalty is outweighed by the ongoing benefits from superannuation tax concessions for the rest of the life of the related asset.

Under Schedule 7 of the *Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023*, the NALE rules for self-managed superannuation funds and small APRA-regulated funds will be retained as a targeted and proportionate anti-avoidance measure.

[1] Taxation Ruling 2010/1, paragraph 4