Parliamentary Joint Committee on Corporations and Financial Services

Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013

March 2013

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Chapter 1

Introduction and conduct of the inquiry

1.1 On 14 February 2013, the House of Representatives referred the Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013 to this committee for inquiry and report.

1.2 The Bill amends various taxation and superannuation laws to implement a number of changes, which include:

- ensuring that income tax is generally not payable on the interest paid by the Commonwealth on unclaimed moneys from 1 July 2013;
- aligning the special rules for calculating airline transport fringe benefits with the general provisions dealing with in-house property fringe benefits and in-house residual fringe benefits, and updating the method for determining the taxable value of airline transport fringe benefits;
- allowing participants in the Sustainable Rural Water Use and Infrastructure Program (SRWUIP) to choose to make payments they derive under the program free of income tax (including capital gains tax), with expenditure relating to the infrastructure improvements required under the program then being non-deductible;
- prescribing requirements for acquisitions and disposals of certain assets between self-managed superannuation funds (SMSFs) and related parties, to ensure that these transactions are conducted with transparency and are not used to circumvent the requirements of the superannuation law; and
- allowing corporate tax entities that have paid tax in the past, but are now in a tax loss position, to carry their loss back to those past years to obtain a refund of some of the tax they previously paid.

Conduct of the inquiry

1.3 The committee advertised the inquiry on its website, and wrote directly to a range of individuals and organisations inviting written submissions by 1 March 2013.

1.4 On 4 March 2013, the committee sent potential submitters a written reminder regarding the inquiry, and indicated that the committee would still receive written submissions on the Bill.

1.5 The committee received seven submissions, which are listed at Appendix 1.

1.6 The committee thanks all who contributed to the inquiry.

Financial Impact

1.7 According to the Explanatory Memorandum, the financial impact of the various schedules to the bill will be as follows:

(a) Schedule 1, which relates to the taxation of interest on unclaimed moneys, has nil financial impact. The Government's intention to exempt interest paid by the Government in respect of unclaimed money from income tax was reflected in the financial impact of the *Treasury Amendment (Unclaimed Money and Other Measures) Bill 2012*.

(b) Schedule 2, which relates to the reform of airline transport fringe benefits, has an unquantifiable financial impact.

(c) Schedule 3, which relates to the SRWUIP, will have the following financial impact across the forward estimates:

2012-13	***2013-14***	***2014-15***	***2015-16***
-$35m	-$30m	$5m	$15m

(d) Schedule 4, which relates to acquisitions and disposals of certain assets between SMSFs and related parties, has nil financial impact.

(e) Schedules 5 and 6, which relate to the loss carry-back measures, will have the following financial impact across the forward estimates:

2012-13	***2013-14***	***2014-15***	***2015-16***
-	-$150m	-$250m	-$300m

(f) Schedule 7, which makes a number of miscellaneous amendments to the taxation laws, will have a minimal impact on revenue over the forward estimates.

Chapter 2

Overview of the Bill

2.1 As noted in the previous chapter, the Bill has seven schedules, which relate to:

(a) the taxation of interest paid by the Government on unclaimed money (Schedule 1);

(b) the reform of airline transport fringe benefits (Schedule 2);

(c) the tax treatment of payments and related expenditure made under the Sustainable Rural Water Use and Infrastructure Program (Schedule 3);

(d) acquisitions and disposals of certain assets between related parties and SMSFs (Schedule 4);

(e) the introduction of a loss carry-back tax offset (Schedules 5 and 6); and

(f) miscellaneous amendments to various taxation laws to address minor technical issues and legislative uncertainties (Schedule 7).

2.2 This chapter provides an overview of the background and operation of these schedules.

Schedule 1: Taxation of interest on unclaimed money

2.3 Schedule 1 of the Bill amends the income tax and superannuation law to ensure that income tax is generally not payable on the interest paid by the Commonwealth on unclaimed money from 1 July 2013.

2.4 Part 1 of Schedule 1 amends the *Income Tax Assessment Act 1997* (ITAA), *Superannuation (Departing Australia Superannuation Payments Tax) Act 2007*, and *Superannuation (Unclaimed Money and Lost Members) Act 1999*, to make interest paid by the Commonwealth on unclaimed superannuation (other than interest paid on unclaimed superannuation belonging to former temporary residents)[1] a tax-free component of a superannuation benefit. Consistent with other tax-free superannuation benefits, these interest payments are non-assessable non-exempt income.

2.5 Part 2 of Schedule 1 amends the ITAA to make interest paid by the Commonwealth on forms of unclaimed money other than unclaimed superannuation – such as unclaimed bank accounts, corporate property, First Home Saver Accounts and life insurance moneys – exempt income.

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1 Payments of interest by the Commonwealth on the unclaimed money of former temporary residents reclaimed after 1 July 2013 are a taxable component of a superannuation benefit that has been untaxed in the fund and are subject to Departing Australia Superannuation Payments tax at a rate of 45 per cent. Explanatory Memorandum, p. 17.

Background and context of the amendments

2.6 In the 2012-13 Mid-Year Economic and Fiscal Outlook (MYEFO), the government announced new unclaimed moneys measures. These measures included the payment of interest from 1 July 2013 on unclaimed money for the period the money is held by the government. The government further announced that the interest rate would be calculated according to regulations, with the intention being that the rate would be calculated in accordance with the Consumer Price Index (CPI).

2.7 According to the Explanatory Memorandum, the payment of tax-exempt CPI interest is intended to preserve the real value of unclaimed money. Under the current law, any interest paid by the government would be subject to income tax. This taxation of this interest would be:

> …inconsistent with the Government's objective of ensuring the real value of unclaimed money is preserved, as individuals would receive the real value reduced by the relevant tax on the amounts of interest. To achieve its objective, the Government is legislating to ensure that interest paid by the Commonwealth on unclaimed money is generally not subject to income tax.[2]

2.8 The *Treasury Amendment (Unclaimed Money and Other Measures) Act 2012* gave effect to the new unclaimed moneys measures, but did not deal with the taxation of interest paid on unclaimed money.

Schedule 2: Fringe benefits tax – reform of airline transport fringe benefits

2.9 Schedule 2 of the Bill amends the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to align the special rules for calculating airline transport fringe benefits (as currently contained in Division 8 of Part III of the FBTAA) with the general provisions dealing with in-house property fringe benefits and in-house residual fringe benefits.

2.10 Schedule 2 also updates the method for determining the taxable value of airline transport fringe benefits to, according to the Explanatory Memorandum, 'simplify the practical operation of the law and to better reflect the economic value of the benefit.'[3]

Background and context of amendments

2.11 An airline fringe benefit may arise when an employee of an airline or travel agent is provided with free or discounted travel on a stand-by basis – that is, travel in which seating is subject to availability and is not guaranteed for the employee. The

2 Explanatory Memorandum, p. 12.

3 Explanatory Memorandum, p. 21.

taxable value of airline transport fringe benefits is currently the stand-by value of the benefit less the employee contribution.[4]

2.12 According to the Treasurer's media release on the planned changes, the current method of calculating the fringe benefit value:

> …was developed when stand-by travel was a feature of commercial airline pricing and staff could be displaced from a flight up to the time of boarding. The concept of stand-by travel, however, is no longer commercially relevant as airlines now use discounted pricing to optimise passenger levels.[5]

2.13 According to the Explanatory Memorandum, stakeholders from the airline industry had also raised concerns about the time and resources required to calculate the taxable value of the benefit, particularly given stand-by travel is no longer offered by airlines commercially to members of the public.[6]

2.14 The Explanatory Memorandum further explains that the government announced the reforms in the 2012-13 Budget in response to these concerns.[7]

2.15 The amendments also progress recommendation 9(a) of the *Australia's Future Tax System Review*, which stated that 'market value should generally be used to value fringe benefits.'[8]

Schedule 3: Sustainable Rural Water Use and Infrastructure Program (SRWUIP)

2.16 Schedule 3 of the bill amends the ITAA 1997 to allow participants in SRWUIP to choose to make payments they derive under the program free of income tax (including capital gains tax). If the payment recipient chooses this approach, expenditure that is made because of the payments is non-deductible and does not form part of the cost of any asset it is spent on.

2.17 Alternatively, payment recipients can choose the existing income tax treatment of payments they derive under the SRWUIP. Under these arrangements, payments under the SRWUIP are generally taxable in the year they are received, either as a subsidy included in assessable income or, to the extent that the payment is

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4 Free or discounted travel provided to employees *without* stand-by restrictions is not an airline transport fringe benefit, but is instead taxable under the ordinary in-house property and residual fringe benefits rules. Explanatory Memorandum, p. 21.

5 The Hon Wayne Swan MP and the Hon David Bradbury MP, '2012-13 Budget builds on growing record of tax reform,' *Joint media release*, 8 May 2012.

6 Explanatory Memorandum, pp. 22–23.

7 Explanatory Memorandum, p.23.

8 Report on Australia's Future Tax System, December 2009, *Part One: Overview*, p. 82.

deemed consideration for the supply of surrendered water rights, as a capital gain. The expenditure on improvements is usually then deductible over time.

2.18 The amendments commence on Royal Assent but apply in relation to payments made by the Commonwealth on or after 1 April 2010.[9]

Background and context of the amendments

2.19 SRWUIP is a component of the Commonwealth's *Water for the Future* program. SRWUIP payments from the Commonwealth are used to upgrade irrigation and other rural infrastructure to improve water efficiency and sustainability. A set part of the water saved as a result of these improvements is then transferred to the Commonwealth, which in turn uses the water for environmental purposes.

2.20 Under the current income tax treatment of SRWUIP payments (see above), recipients of payments may need to fund the gap between incurring the tax liabilities and expenditure obligations associated with the payment and fully realising the tax effect of the expenditure that corresponds to the payments.

2.21 The Government announced on 18 February 2011 that it would amend the taxation law to remove the timing discrepancy between when SRWUIP payments are taxed and when deductions are available for grant applications for expenditure under the program.[10]

2.22 Under the arrangements in the bill, the taxpayer can either:

(a) chose the existing treatment of their SRWUIP payments and related expenditure; or

(b) make the subsidy part of their payment non-assessable non-exempt income, and disregard any capital gain or loss from transferring the water rights. If the taxpayer chooses this option, expenditure that is made because of the payments is not deductible and does not form part of the cost of any asset it is spent on.

2.23 The Explanatory Memorandum notes that some taxpayers would choose the existing tax treatment, given 'the amount included in their assessable income could be less than their deductions for expenditure on infrastructure improvements because they can access a CGT concession for the transfer of their water rights (for example, the rights might be a pre-CGT asset that is exempt from CGT or there might be a reduction in any capital gain on disposal of rights, such as the 50 per cent discount available to individuals and trusts).'[11]

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9 For more detail on the application and transitional provisions, see Explanatory Memorandum, pp. 51–52.

10 The Hon Tony Burke MP and the Hon Simon Crean MP, 'New approach to water recovery in the Murray Darling Basin,' *Joint media release*, 18 February 2011.

11 Explanatory Memorandum, p. 40.

2.24 However, as the Explanatory Memorandum further explains, other taxpayers would choose the new treatment, given that under current arrangements they 'could find themselves being taxed on the payments they receive in a year before they can deduct all the related expenditure. Because they are required to spend an amount equal to the Commonwealth payment on infrastructure improvements, having to pay the tax could create a financial gap that is only made good when the deductions are eventually available.'[12]

Schedule 4: Self-managed superannuation funds (SMSFs) – acquisitions and disposals of certain assets between related parties

2.25 Schedule 4 of the bill amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to prescribe requirements for acquisitions and disposals of certain assets between SMSFs and related parties.

2.26 Specifically, Schedule 4:

(a) amends the existing prohibition on superannuation funds acquiring assets from related parties so that it applies to all regulated superannuation funds other than SMSFs;

(b) introduces a specific prohibition against trustees and investment managers of SMSFs acquiring assets from related parties, subject to certain exceptions;

(c) introduces new rules for SMSF trustees and investment managers when disposing of assets to related parties;

(d) introduces a prohibition on schemes which avoid the operation of the new rules regulating SMSF related party transactions; and

(e) introduces administrative and civil penalties for contravention of these new rules.

Background and context of amendments

2.27 As the Explanatory Memorandum notes, the *Super System Review* (the Review) expressed concerns that the off-market acquisition and disposal of assets between related parties and SMSFs, where the buyer and seller are effectively the same person, 'lacks transparency, is inherently risky and is open to greater abuse that non-related party transactions.'[13]

12 Explanatory Memorandum, p. 40.

13 Explanatory Memorandum, p. 55. The Review was announced by the government on 29 May 2009, and provided its final report to the government on 30 June 2010.

2.28 In particular, the Review suggested that current provisions regulating SMSF related party acquisitions are insufficient to mitigate the risk of transaction date and asset value manipulation to illegally benefit the SMSF or a related party.[14]

2.29 The Review considered prohibiting all SMSF related party transactions, but concluded that SMSFs should have the ability to conduct certain limited party transactions.

2.30 As such, the Review recommended that acquisitions and disposals of assets between related parties and SMSFs should be conducted through an underlying market, or, where an underlying market does not exist, be supported by a valuation from a suitably qualified independent valuer.

2.31 The amendments in the Bill implement the government's response to these recommendations. According to the Explanatory Memorandum, the new requirements given effect in the Bill are intended to 'ensure that these transactions are conducted with transparency and are not used to circumvent the requirements of the superannuation law.'[15]

Schedules 5 and 6: Loss carry-back tax offset

2.32 Schedules 5 and 6 amend the income tax law to allow corporate tax entities to carry back tax losses to previous income years. This is achieved by allowing corporate tax entities that have paid tax in the past, but are now in a tax loss position, to obtain a refund of some of the tax they have previously paid, in the form of a refundable tax offset.

2.33 The amendments would allow a corporate tax entity the choice of carrying back all or part of an unutilised tax loss from the current income year, or from the preceding income year, against an unutilised income tax liability for either of the two years before the current year.

2.34 The available tax offset would be the lowest of the following:

(a) the tax value of the amount of the loss the entity chooses to carry back;

(b) the entity's franking account balance at the end of the current year;

(c) $1 million multiplied by the corporate tax rate ($300,000 based on the current corporate tax rate of 30 per cent); and

(d) the entity's tax liability for the income year(s) it carries the loss back to.

2.35 Only tax losses – which generally occur when deductions exceed income over the income year – may be carried back. Capital losses cannot be carried back, as the capital gains tax regime operates on a realisation basis. As the Explanatory

14 Explanatory Memorandum, pp. 55–56.

15 Explanatory Memorandum, p. 55.

Memorandum points out, allowing capital losses to be carried back 'to produce a tax offset would mean that entities could choose to realise their capital losses to get an offset but defer their capital gains.'[16]

2.36 The loss carry-back measure applies to assessments from the 2012-13 income year onward. A transitional one year carry-back period would apply for 2012-13.

Background and context of amendments

2.37 The 2010 *Australia's Future Tax System Review* recommended that 'companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income, with the amount of any refund limited to the company's franking account balance.'

2.38 Following the Tax Forum in October 2011, the Government established the Business Tax Working Group (BTWG) to consider Australia's business tax system.

2.39 Following consultations with interested parties on loss carry-back (see 'consultation,' below), BTWG issued its *Final Report on the Tax Treatment of Losses*, which recommended a model of loss carry-back that would:

(a) be limited to companies;

(b) provide a two-year loss carry-back period on an ongoing basis; and

(c) place a $1 million cap on the amount of losses that could be carried back.

2.40 On 6 May 2012, the government announced that it would introduce loss carry-back for corporate tax entities.[17] The discussion paper released by the government shortly thereafter (see 'consultation,' below) indicated that the government's loss carry-back model would be based on the model recommended by BTWG, including the design features listed above.[18]

2.41 As the Assistant Treasurer, the Hon David Bradbury MP, and the then Minister for Small Business, the Hon Brendan O'Connor MP, noted in their joint media release announcing the loss carry-back measure, businesses are already able to carry forward their tax losses to offset future profits and reduce future tax liabilities. According to Mr Bradbury and Mr O'Connor's media release, allowing businesses to also carry back their losses to offset past profits will mean 'businesses can access their tax losses now – when they need to – rather than in the future when their businesses are performing better.'

16 Explanatory Memorandum, p. 84.

17 The Hon David Bradbury MP and the Hon Brendan O'Connor MP, 'Tax relief for businesses in our patchwork economy,' *Joint media release*, 6 May 2012.

18 Australian Government, *Improving access to company losses*, discussion paper, July 2012, pp

2.42 The Explanatory Memorandum draws this point out, suggesting loss carry-back will:

> …encourage companies to adapt to changing economic conditions and take advantage of new opportunities through investment. Firms will be able to utilise their tax losses sooner and reduce the extent to which they risk never being able to use those losses.[19]

2.43 The Explanatory Memorandum further suggests that the loss carry-back measures will help remove the tax system's current bias against sensible risk taking, increasing the quantity and the quality of corporate investment, and thereby improving the allocation of resources across the economy. This, according to the Explanatory Memorandum, will have a positive flow-on effect on productivity, and in turn on real wages growth and employment.[20]

2.44 The Explanatory Memorandum also notes that the measures are targeted at small and medium sized businesses. Whereas large companies and consolidated groups are often able to offset losses in one activity against profits from other activities, improving their ability to utilise current losses, this approach is often not available to small and medium sized businesses:

> [C]ompanies that undertake only one business activity do not have other sources of income against which to offset their losses. Companies that make a current year loss are therefore required to carry that loss forward.[21]

Consultation

2.45 BTWG undertook broad consultations on loss carry-back. This process included an invitation for written submissions from businesses and the wider community on issues and ideas discussed in an interim report on the subject, which resulted in the receipt of 24 submissions; meetings with stakeholders in Melbourne, Sydney, Brisbane and Perth; and consultations with the Australian Taxation Office on matters concerning the implementation of the measure.[22]

2.46 Following the government's announcement of its intention to introduce loss carry-back, in July 2012 the Assistant Treasurer released a discussion paper, *Improving access to company losses*, and invited written submissions in response.[23] In August 2012, the Treasurer released an exposure draft package, including the draft

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19 Explanatory Memorandum, p. 76.

20 Explanatory Memorandum, pp. 76-79.

21 Explanatory Memorandum, p. 127.

22 For details on the BTWG's consultations, see the Regulation Impact Statement in the Explanatory Memorandum, pp. 147-49.

23 The discussion paper and submissions received in response are available at http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/company-losses-access.

legislation and explanatory memorandum for loss carry-back, for public consultation.[24]

Schedule 7: Miscellaneous Amendments

2.47 Schedule 7 makes a number of miscellaneous amendments to various taxation laws to correct minor technical and drafting defects, and remove anomalies and legislative uncertainties.

24 The exposure draft package is available at http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/company-losses-access-Exp-Draft.

Chapter 3

Views on the Bill

3.1 The committee received seven submissions on the Bill.

3.2 To the extent that submissions commented on Schedules 1 (taxation of interest on unclaimed money) and 2 (reform of airline transport fringe benefits), this comment was supportive of the measures.

3.3 Only one submission addressed the loss carry-back measures at Schedules 5 and 6, with Virgin Australia supporting the loss carry-back concept, but arguing against the inclusion of a quantitative cap on the losses that could be carried back.

3.4 Five submissions discussed the measures relating to transactions of assets between SMSFs and related parties at Schedule 4.

3.5 None of the submissions received discussed Schedule 3, which relates to the SRWUIP, or Schedule 7, which gives effect to a range of miscellaneous changes to the tax and superannuation law.

Schedule 1: Taxation of interest on unclaimed money

3.6 The Australian Institute of Superannuation Trustees (AIST) expressed support for the measures contained in the Bill, suggesting the tax-free status of interest paid on unclaimed superannuation moneys would help preserve the value of unclaimed moneys in the period it remained out of the market.[1]

Committee view

3.7 The committee notes that while it only received two submissions addressing Schedule 1, the unclaimed money reforms (including the government's intention to exempt payments of interest on unclaimed moneys from income tax), have been subject to earlier consultative processes. These processes included an inquiry by the Senate Economics Legislation Committee on the *Treasury Legislation Amendment (Unclaimed Money and Other Measures) Bill 2012*, where the government made clear its intent to make interest paid on unclaimed money tax-exempt.[2]

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1 AIST, *Submission 3*, p. 1.

2 Senate Economics Legislation Committee, *Treasury Legislation Amendment (Unclaimed Money and Other Measures) Bill 2012*, report, November 2012, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=economics_ctte/completed_inquiries/2010-13/treasury_unclaimed_money_2012/index.htm.

Schedule 2: Fringe benefits tax – reform of airline transport fringe benefits

3.8 Virgin Australia expressed support for the reforms in its submission, arguing that the measures in the Bill would 'modernise and simplify the current legislation.' In particular, Virgin Australia suggested the Bill would reduce the:

> …current administrative burden associated with calculating taxable values of our existing staff travel arrangements, which represent an important benefit to our workforce. In our view, the valuation of these benefits will remain consistent with the previous law, but compliance has been simplified.[3]

3.9 In its submission, Qantas noted that it been consulted in relation to the proposed amendments, and that the Bill as currently drafted 'addresses concerns we had in relation to this initiative.'[4]

Schedule 4: Self-managed superannuation funds (SMSFs) – acquisitions and disposals of certain assets between related parties

The need for an equitable treatment of SMSFs

3.10 CPA Australia argued against the restrictions on the acquisition and disposal of assets between SMSFs and related parties, as given effect in this Bill. In particular, CPA Australia argued that it would be:

> …inequitable to restrict SMSFs from transacting effectively and efficiently off-market when there is no demonstrable evidence of abuse and this avenue remains available to all other investors, including APRA [the Australian Prudential Regulatory Authority] regulated funds and individuals.[5]

3.11 While supporting the measures, SPAA also expressed concern that the requirement to acquire or dispose of listed securities from a related party in a prescribed manner would be limited to transactions involving SMSFs. SPAA argues that, contrary to the observations of APRA, off-market transfers of listed securities where the buyer and seller of the securities is essentially the same entity also occur in the APRA regulated sector of the superannuation industry. As such, the potential for transaction date or asset value manipulation also exists in the APRA sector, and therefore the same regulations should apply. This, SPAA argued, would ensure that:

> …all superannuation funds are treated equitably, and one sector of the superannuation market is not treated favourable over another, ensuring an efficient level playing field for retirement income vehicles.[6]

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3 Virgin Australia, *Submission 1*, p. 1.

4 Qantas, *Submission 5*, p. 1.

5 CPA Australia, *Submission 6*, p. 1.

6 SPAA, *Submission 4*, pp. 3–4.

3.12 The Cooper Review distinguished between the characteristics of SMSFs and APRA-regulated superannuation funds. SMSFs are closely held entities where all members must also be trustees or directors of a corporate trustee. The Review noted that unless there is a countervailing public policy reason, trustees of SMSFs should be free, as much as possible, from government intervention. It also expressed some concern that part of the SMSF regulatory framework need to be improved, and that the ATO needs a greater range of flexible penalties if it is to achieve 'appropriate and proportionate regulatory outcomes'.[7] The EM to the bill observed that the SMSF structure 'may provide the opportunity for SMSF members to engage in behaviour that is inconsistent with the Government's retirement policy that superannuation savings should be invested for the sole purpose of providing an income in retirement'.[8]

Merger exception

3.13 The Bill provides an exception to the prohibition on a trustee or an investment manager of a SMSF acquiring an asset from a related party of the fund if the asset is acquired under a merger between regulated superannuation funds and at market value, as determined by a qualified independent valuer.

3.14 The Law Council suggested that along with the exception applying to the acquisition of an asset through a merger, a mirror exception should be added at paragraph 66B(3) so that the same arrangement applies regarding the disposal of an asset to a related party via the merger arrangement. The Law Council suggested this would be appropriate, given that 'if the transferee fund will be acquiring an asset from a related party (which is likely to be an SMSF) then the transferor fund will also be disposing of an asset to a related party via the merger arrangement.'[9]

3.15 The Law Council further argued that the requirement that an asset acquired through a merger must be acquired at market value is problematic, as it would imply that an:

> …amount would be paid or other consideration given to the transferor fund – however, this is most unlikely in a merger situation as the transfer will typically be made for nil consideration as the transferee fund takes on the liabilities with respect to benefits payable for the members of the transferor fund.[10]

3.16 As such, the Law Council recommended that instead of the Bill requiring that an asset be 'acquired' at market value, it require that an asset be 'recognised' by the transferee at market value, as determined by a qualified independent valuer.

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7 Super System Review, *Final Report: Part 1, Overview and recommendations*, 2010, p. 16.

8 Explanatory Memorandum, p. 55.

9 Law Council of Australia, *Submission 2*, pp. 2–3.

10 Law Council of Australia, *Submission 2*, p. 3.

3.17 The committee sought Treasury's response to the Law Council's argument that a mirror exception be added to apply to the disposal of an asset to a related party via the merger arrangement. Treasury noted that proposed paragraph 66B(3)(f) provides a general exception for assets that are disposed of to a related party for market value, as determined by a qualified, independent valuer. It argued that a specific mirror exception is not required as the disposal of an asset in a merger situation is covered by this general exception.[11]

Money exception

3.18 The Bill includes exceptions to the prohibition on a trustee or an investment manager of an SMSF acquiring or disposing of an asset from a related party of the fund if 'the asset is money' (at proposed new paragraph 66A(3)(f) of the SIS Act for acquisitions, and 66B(3)(c) for disposals).

3.19 The Law Council suggested that to ensure consistency with the current exclusion in the SIS Act of the acceptance of money from the definition of 'acquire an asset' (paragraph 66(5) of SIS Act) the exceptions in the proposed new paragraphs 66A(3)(c) and 66B(3)(f) should be replaced with new sections stating that the 'acquire an asset does not include acceptance of money' and 'dispose of an asset does not include payment of money.'[12]

3.20 The Explanatory Memorandum states that the money exception, as currently worded in the Bill:

> …is not intended to operate or apply in a different manner to SMSFs than the way that the current section 66 allows a regulated superannuation fund to accept the money from a related party, for example, in the form of contributions.[13]

3.21 Treasury informed the committee that it has consulted on the money exception with the ATO, and is confident that the Bill as currently drafted will operate in a manner that is consistent with section 66 of the SIS Act.

3.22 Treasury also told the committee that the transfer of assets under a merger of regulated superannuation funds may occur for no consideration however the market value requirement of the exception can still be satisfied. It noted that in Self Managed Superannuation Funds Ruling SMSFR2010/1, the Commissioner provided guidance to trustees of SMSFs as to how an asset may be acquired at market value in these circumstances.[14]

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11 Treasury, *Response to question on notice*, received 7 March 2013.

12 Law Council of Australia, *Submission 2*, p. 3.

13 Explanatory Memorandum, p. 65.

14 Treasury, *Response to question on notice*, received 7 March 2013.

Anti-avoidance

3.23 The Law Council notes that the new anti-avoidance measures in the Bill relating to acquisitions of disposals do not require any intention to enter into a scheme to circumvent the prohibitions under sections 66A (acquisitions) and 66B (disposals). The Law Council suggested there is potential scope for SMSF trustees to unknowingly contravene the prohibitions, and be subject to civil penalty under the anti-avoidance measures. Moreover, there is potential for an innocent contravention to cause an SMSF to be treated as a non-complying fund.[15]

3.24 In contrast, the anti-avoidance measures in paragraph 66(3) of the current SIS Act, which sets out anti-avoidance measures in relation to the acquisition of certain assets from members of regulated superannuation funds, operates so that a contravention would only occur if an intention to defeat or circumvent the prohibitions can be established. As such, the Law Council recommends that section 66C of the Bill be drafted to be consistent with the terms of the existing paragraph 66(3).[16]

3.25 Similarly, SPAA argues that the prohibition on asset certain acquisitions and disposals between SMSFs and related parties should only apply to transactions that knowingly and intentionally involved related parties:

> This is especially relevant due to the complexity of the definition of related party in the SIS Act which can result in entities being a related party of a fund, even where there is little evidence of a direct link between the fund and the entity.[17]

Treasury's response

3.26 The committee asked Treasury to comment on the Law Council's observation that section 66C could be innocently and unknowingly contravened. Treasury responded that a:

> contravention of the current subsection 66 is an offence and carries a maximum penalty of 1 year imprisonment, and therefore it is appropriate that the provision contains an element of intention. In contrast, the proposed section 66C is a civil penalty provision and the consequences of contravention are outlined in the general civil penalty regime contained in Part 21 of the Superannuation Industry (Supervision) Act 1993 (SIS Act). The result of a civil penalty order is a declaration of contravention and where appropriate, a monetary penalty as determined by a court (up to a

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Australian Taxation Office, *Self Managed Super Funds Ruling 2010/1*, http://law.ato.gov.au/atolaw/view.htm?docid=SFR/SMSFR20101/NAT/ATO/00001 (accessed 8 March 2013).

15 Law Council of Australia, *Submission 2*, pp. 3–4.

16 Law Council of Australia, *Submission 2*, p. 4.

17 SPAA, *Submission 4*, pp. 4–5.

> maximum 2,000 penalty units). Further, section 221 of the SIS Act provides for relief from liability for contravening a civil penalty provision where the court is satisfied that the person acted honestly and in the circumstances the person ought fairly to be excused from the contravention.[18]

3.27 Treasury also told the committee that for criminal sanctions to be imposed under the general civil penalty regime, the Director of Public Prosecutions is required to establish that a civil penalty provision was contravened dishonestly and intending to gain, whether directly or indirectly, an advantage for another person or intending to deceive or defraud someone.[19]

3.28 Treasury also responded to the Law Council's concern that there is potential for an innocent contravention to cause an SMSF to be treated as a non-complying fund. Treasury argued that contravention of a regulatory provision does not lead to a fund automatically becoming non-complying. Rather, the Commissioner of Taxation will only make that decision after considering a number of factors which are set out in ATO Practice Statement Law Administration PS LA 2006/19.[20]

Allowing valuations of transferred assets by trustees in certain situations

3.29 CPA Australia suggested that if the measure is introduced, section 66B(3) should be amended so that in instances where there is no underlying market and a trustee is unable to obtain an independent valuation, the trustee 'is able to use their own valuation provided they can demonstrate a reasonable basis for it and it is documented.'[21]

3.30 AIST, however, questioned the appropriateness of 'funds holding assets obtained from related parties where valuations are unable to be obtained, and so do not support such transfers'.[22]

3.31 The Association of Superannuation Funds of Australia (ASFA) recommended that proposed subsection 66B(3) be expanded to include an 'in-specie' transfer of the asset to a member in consideration for the payment of a benefit from the fund. However, the amount of the benefit paid must be equal to the market value of the asset transferred. In addition, ASFA argued that given the obligation to use a qualified independent valuer:

> …there could now be additional classes of assets where acquisitions from or disposals to related parties could be permitted without material systemic integrity risk. Those assets could include, amongst other things:

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18 Treasury, *Response to question on notice,* received 7 March 2013.

19 Treasury, *Response to question on notice,* received 7 March 2013.

20 Treasury, *Response to question on notice,* received 7 March 2013.

21 CPA Australia, *Submission 6,* p. 1.

22 AIST, Submission 3, p. 1.

- shares in unrelated unlisted public companies; and
- unlisted fixed interest type securities issued by listed public companies, unlisted public companies, governments and government authorities, such as debentures and bonds.[23]

Regulations governing off-market transactions

3.32 The Self Managed Superannuation Funds Professionals' Association of Australia (SPAA) was supportive of the measures in Schedule 4, but encouraged the government to expedite the release if the draft regulations prescribing how SMSF off-market transfers of listed securities are to operate.

3.33 SPAA suggests that 'the best approach to governing SMSF off-market regulations is via a Superannuation Industry (Supervision) Regulations 1994 (SISR) operating standard.'[24]

3.34 Treasury has informed the committee that it is currently consulting with the Australian Securities and Investment Committee to develop the regulations. Treasury anticipates a standard consultation process will follow the release of the draft regulations, allowing interested stakeholders to provide input on the regulations.[25]

Committee view

3.35 Given the different structure, investment choices and regulatory framework applying to SMSFs, the committee does not believe that the bill inequitably restricts SMSFs from transacting effectively and efficiently off-market. The Cooper Review was concerned with these off-market acquisitions and disposal of assets between related parties and SMSFs. The committee believes that the bill is a proportionate response to these concerns.

3.36 The committee is also satisfied that the general exception for assets disposed of to a related party in proposed paragraph 66B(3)(f) is well drafted. The general exception is adequate and a specific mirror exception is not required.

3.37 In terms of the Law Council's concerns with the wording of the money exception, the committee is presented with no evidence for it to believe that the Bill will operate in a manner inconsistent with the current section 66 of the SIS Act.

3.38 With regard to concerns raised by the Law Council and SPAA concerning the absence of a requirement for intention to be demonstrated in instances where civil penalty provisions are applied, the committee notes that section 221 of the SIS Act sets out circumstances in which a person can be wholly or partially of liability for

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23 Association of Superannuation Funds of Australia, *Submission 7*, p. 2.

24 SPAA, *Submission 4*, p. 1.

25 Treasury, *Response to question on notice*, received 7 March 2013.

contravention of the provisions. Specifically, if, in eligible proceedings against a person that has, or may have, contravened a civil penalty it appears to the court that a person has acted honestly, the court may relieve that person of liability for the contravention. The committee further notes that section 323 of the SIS Act provides further relief from civil penalties where the contravention was due to a reasonable mistake or reasonable reliance on information supplied by another person.

3.39 The committee notes the points made by SPAA regarding the yet-to-be-released regulations governing off-market transactions. The committee further notes that Treasury intends to conduct a consultation process after the draft regulations are released.

Schedules 5 and 6:

3.40 Virgin Australia argued that the quantitative cap on the tax loss a company could carry back would limit the benefits to small-to-medium sized enterprises:

> In Virgin Australia's view, the advantages of these measures, such as greater certainty for profitable companies to be able to utilise a loss from an investment and the associated cash flow benefits, should be available to all corporate taxpayers, including companies with large capital requirements such as airlines. The removal of the quantitative cap would extend the benefits of the measures of the measures to large businesses, driving greater investment and innovation in the Australian economy. Importantly, it would not impact on Government tax revenue in the long-term, as tax losses which are carried back will not be available to be carried forward.[26]

3.41 Virgin Australia argued that given the ability to carry back losses will be limited in terms of time (to the two previous tax years) and franking account balance, the further quantitative cap of $300,000 (that is, the corporate tax paid on $1,000,000) is not appropriate. According to Virgin Australia, the use of the franking credit regime as a capping mechanism already ensures that tax credits from previous years have not already been distributed to shareholders.[27]

3.42 Virgin Australia also noted that Australia's Future Tax System Review did not suggest a quantitative cap be placed on losses that could be carried back.[28]

3.43 Finally, Virgin Australia challenged the idea, as contained in the Explanatory Memorandum, that small and medium businesses are not able to take advantage of the consolidation regime's loss utilisation rules, wherein the losses of one member of a corporate group can be offset against income earned by other members. Virgin Australia notes that there are, in fact, 'no restrictions on applying the consolidation

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26 Virgin Australia, *Submission 1*, p. 2.

27 Virgin Australia, *Submission 1*, p. 3.

28 Virgin Australia, *Submission 1*, p. 3.

rules for small and medium business that have more than one entity in their corporate structure.

3.44 The Regulation Impact Statement (RIS) prepared by Treasury (and included in Explanatory Memorandum), explained that the quantitative cap has two purposes:

(a) reducing integrity concerns by reducing the value of the deduction that is available, and thereby reducing the incentive to tax planning; and

(b) targeting the option to carry back losses to small and medium businesses.

3.45 Explaining further how the cap helps target the measure to small and medium businesses, the RIS argued that these businesses 'don't have the same access to losses as diversified business and corporate groups,' which can use profits from other activities to absorb losses.[29]

3.46 The RIS also argued the cap would 'reduce the exposure of the Government to very large losses incurred by individual businesses.'[30]

Committee view

3.47 The committee is satisfied the quantitative cap on the losses that can be carried back is an effective and appropriate means to target the measure at small and medium businesses, and recognises that these businesses generally do not have access to losses as large companies and consolidated groups with diversified activities.

3.48 While the committee only received one submission that addressed the loss carry-back measures (from Virgin Australia), the committee is aware that the changes have already been subject to extensive consultative processes. These consultative processes were covered in more detail in the previous chapter.

Recommendation 1

3.49 The committee recommends that the Bill be passed.

Ms Deborah O'Neill MP
Chair

29 Explanatory Memorandum, p. 138.

30 Explanatory Memorandum, p. 138.

Coalition Members' Dissenting Report

Tax and Superannuation Laws Amendment

(2013 Measures No 1) Bill 2013

Schedule 4

Schedule 4 to this Bill amends the *Superannuation Industry (Supervision) Act* 1993 (SIS Act) to prescribe requirements for the acquisition and disposal of certain assets between SMSFs and related parties.

The proposed changes require that where an underlying market exists, the transaction should be conducted through that market. Where such a market does not exist, a valuation must be sought from an independent qualified valuer.

This measure yet again targets those Australians doing the right thing by saving to achieve a self-funded retirement with additional unnecessary and costly red tape.

It is also clear that the drafting of the measure creates further unnecessary uncertainty.

SPAA, for example, is concerned that the drafting is not clear regarding the valuation of hard-to-value assets such as frozen assets, or assets which do not have a readily available market.

If these assets can't be disposed of to a related party (i.e. the SMSF member) then it is likely many SMSFs won't be able to be wound up:

> …there are many types of assets held by SMSFs (many types of collectables for example), where no individual has the specific knowledge, experience and judgement necessary to be considered a qualified valuer. In these scenarios, the absences of a qualified independent valuer may result in the SMSF being unable to dispose of the asset which may then prevent the SMSF from being wound up even if it is clearly in the member's best interest to do so. [1]

This would result in the ATO being required to still administer numerous "legacy SMSFs" that have no functional purpose.

These changes are yet another example of the Gillard government's constant undermining, through badly drafted regulation, of the flexibility and effectiveness of SMSFs.

For example in their submission SPAA stated:

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1 SPAA, *Submission 4*, p. 5.

> SPAA is concerned that the requirement to acquire listed securities from a related party (or to dispose listed securities to a related party) in a prescribed manner is limited to transactions involving SMSFs. Off-market transfers of listed securities also occur in the Australian Prudential Regulatory Authority (APRA) regulated sector of the superannuation industry, where the buyer and seller of the securities is essentially the same entity. This would suggest that similar integrity concerns regarding off-market transfers and the manipulation of transfer prices of listed securities would similarly arise in the APRA sector.[2]

These changes as drafted are an unnecessary regulatory burden. The Government has not made the case about the evil they are supposedly trying to prevent.

Coalition members of the Committee recommend that this schedule be removed from the Bill.

MRRT Related Schedules

Two of this Bill's seven schedules implement the Government's announced loss carry-back measure – a measure linked to, and supposedly funded by, the government's failed Minerals Resource Rent Tax (MRRT). This is the mining tax which raises no meaningful revenue when the Labor government recklessly already spent all of the money they thought it would raise and more.

Another schedule in this Bill makes a number of amendments attempting to fix 'technical' problems with the MRRT itself.

The Coalition opposes the MRRT because it is a complex and distorting tax which is bad for investment, bad for jobs, bad for our economy and, as is now apparent, bad for the federal budget as well.

The Coalition in government will scrap Labor's failed MRRT and as such remains opposed to all the measures the government has irresponsibly attached to its revenue. The only exception to that principle is the increase in compulsory superannuation from 9 to 12 per cent which a future Coalition government will not rescind.

The federal government cannot afford to implement costly measures which were supposedly to be paid for by an MRRT which has proven to be highly inefficient, costly to administer while not raising any meaningful revenue.

Indeed, the MRRT has raised just $126 million in gross revenue in its first two (out of three) instalments this financial year, when Treasurer Swan estimated $2 billion in net revenue in his most recent formal budget update.

Out of that $126 million in gross revenue, about $38 million would have been raised in company tax anyway which means the comparable net revenue figure comparable

2 SPAA, *Submission 4*, p. 3.

with the budget forecast is about $88 million instead of the $2 billion estimate in MYEFO.

We also know that the ATO alone has spent $53 million so far administering the MRRT which takes revenue down to $35 million.

Bearing in mind that the government allocated $38.5 million to advertising the supposed merits of the mining tax, taxpayers are $3.5 million in the red in relation to the MRRT so far.

The Coalition has asserted for years that Labor's MRRT was a fiscal train wreck in the making and has been proven right.

The Treasurer incompetently overestimated the revenue from the MRRT and underestimated the cost of the various concessions he and the Prime Minister made in their MRRT Heads of Agreement.

The government has spent all of the money they thought the MRRT would raise and more by linking various measures – including the Loss Carry Back – to the MRRT.

The government has already delivered four out of four deficit budgets with deficits totalling $172 billion so far. Despite promising on more than 500 occasions that 2012/13 would be a surplus budget year, we now know that we're on track for yet another deficit this financial year.

Further, the way the government has structured its loss carry-back ignores the 1/3 of small and medium sized enterprises that are not incorporated and so cannot benefit from this measure. Only businesses with franking accounts can avail themselves of this measure so unincorporated businesses that must compete with those using carry-back will be at a competitive disadvantage.

For these reasons, the Coalition members of the Committee recommend that schedules 5 and 6 be removed from this Bill.

Schedule 7

Coalition Members of the Committee note that 38 pages of amendments in this schedule are designed to correct "technical errors" in the drafting of the MRRT.

This demonstrates yet again how poorly thought out, how poorly designed and how poorly implemented Labor's failed MRRT has been right from the outset.

Concluding Remarks

Coalition Members and Senators of this Committee recommend that the Parliament not support this Bill in its current form.

Coalition members of the Committee make the following specific recommendation:

Recommendation 1

That the Bill not be passed unless:

- **Schedule 4 dealing with transfer of assets with Self-Managed Superannuation Funds;**
- **Schedule 5 and 6 dealing with the loss carry-back changes (measures linked to the failed MRRT);**

are excised from the Bill.

Senator Sue Boyce **Senator Mathias Cormann**

Mr Paul Fletcher MP **The Hon Tony Smith MP**

Appendix 1

Submissions

1 Virgin Australia

2 Law Council of Australia

3 Australian Institute of Superannuation Trustees (AIST)

4 SMSF Professionals' Association of Australia Limited (SPAA)

5 Qantas Airways Limited

6 CPA Australia

7 Association of Superannuation Funds of Australia

Correspondence

- Responses from Treasury to questions asked by the secretariat, received on 7 March 2013