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REPORT ON THE
TAXATION LAWS AMENDMENT
(SUPERANNUATION CONTRIBUTIONS)
BILL 2000

SENATE SELECT COMMITTEE ON
SUPERANNUATION AND FINANCIAL SERVICES

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SUPERANNUATION AND FINANCIAL SERVICES

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TERMS OF REFERENCE

On 1 November the Senate referred the Taxation Laws Amendment (Superannuation Contributions) Bill 2000 to the Select Committee on Superannuation and Financial Services for examination and report by 4 December 2000.

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CHAPTER 1

INTRODUCTION

Origin and conduct of the inquiry

1.1 On 1 November 2000, the Senate agreed to refer the Taxation Laws Amendment (Superannuation Contributions) Bill 2000 (the Bill) to the Senate Select Committee on Superannuation and Financial Services for inquiry and report by 4 December 2000.

1.2 In referring the Bill to the Committee for inquiry, the Selection of Bills Committee determined that the principal issue for consideration was the use of off-shore superannuation schemes for tax evasion.

1.3 The Committee invited a range of individuals and organisations to make submissions and/or give evidence at public hearings. These included taxation and financial planning organisations and institutions, taxation specialists, the former Commonwealth Taxation Ombudsman, employer groups, companies and academics. The Committee also invited a number of representatives from the Australian Taxation Office (ATO).

1.4 Due to the short timeframe for the inquiry, the importance of the Bill in addressing the continued aggressive marketing of employee benefit arrangements, and the Government's legislative framework, a number of groups and individuals, including some possible promoters of the schemes, advised that they were unable to prepare a submission or attend the hearing. Not all of the ATO representatives requested were able to attend. However, the Committee appreciated the attendance of Second Commissioner of Taxation, Mr Michael D'Ascenzo, who attended much of the last hearing. The Committee would have appreciated more time to have conducted the inquiry in order to be able to have taken evidence from a wider range of witnesses.

1.5 A total of eight (8) submissions were received as part of this inquiry. A list of submissions received is at **Appendix 1**. The Committee held a public hearing in Canberra on 27 November 2000 to consider the Bill. Two additional hearings were held on 29 and 30 November 2000 where further evidence was taken from representatives from the ATO. A list of witnesses who gave evidence at all of the public hearings is at **Appendix 2**.

1.6 The Committee wishes to express its appreciation to those organisations and individuals that assisted the Committee in its inquiry.

Background to the Bill

Announcement of the measures

1.7 On 30 June 2000, the Assistant Treasurer, Senator the Hon. Rod Kemp, announced legislative changes relating to superannuation and Fringe Benefits Tax (FBT). This was designed to stop tax planners exploiting existing tax structures to maximise their clients' tax deductions through aggressively marketed employee benefit arrangements.

1.8 When announcing the amendments contained in the Bill, the Assistant Treasurer explained the reasons for the Government's action:

This move is necessary following Tax Office advice that these [aggressively marketed employee benefit] arrangements are still being actively promoted. The arrangements have continued despite the Taxation Commissioner's clear advice that the schemes are ineffective under existing law.

The Commissioner will continue to amend the assessments of taxpayers that have entered into these arrangements. Taxpayers who disagree with the Commissioner's view have the right to pursue the matter in the courts.

The Government remains committed to ensuring that tax avoidance arrangements do not succeed and that all Australians pay their fair share of tax. The arrangements as promoted seek to achieve far more concessional treatment than was ever intended by Parliament.

Specifically, the Government is acting to remove deductibility for contributions to non-complying superannuation funds (including off-shore arrangements) as these funds are not used for retirement income purposes and are not subject to prudential regulation.

The Government is also clarifying the law to make clear that for the purpose of obtaining a deduction for superannuation contributions, an employer and an employee cannot be the same person. This is consistent with the Commissioner's view of how the law currently operates. The Commissioner's view is supported by Senior Counsel.

These amendments, which will be introduced into Parliament as soon as possible, will remove any doubt about the application of the law and will apply from 4pm today.¹

1.9 In addition, Senator Kemp advised that he has asked the Taxation Office to review the interaction of the income tax and fringe benefits tax laws to ensure that employee benefit trusts and employee share plans are taxed appropriately. The ATO has advised the Government that some variations of earlier arrangements are being marketed. If legislative change is necessary to combat the ongoing marketing of these schemes, the Government has advised that further amendments will be introduced.²

Introduction of the Bill

1.10 The Taxation Laws Amendment (Superannuation Contributions) Bill 2000 was introduced into the House of Representatives on 7 September 2000 by the Parliamentary Secretary to the Minister for Finance and Administration, the Hon Peter Slipper MP.

1 Assistant Treasurer, 'Legislative Changes to Address Aggressive Tax Planning', *Press Release No. 035*, the *Treasurer* internet site: <http://www.treasurer.gov.au/AssistantTreasurer/pressreleases/2000/035.asp> (accessed 24 November 2000).

2 Assistant Treasurer, 'Legislative Changes to Address Aggressive Tax Planning', *Press Release No. 035*, the *Treasurer* internet site.

1.11 As outlined in the Explanatory Memorandum to the Bill and the Second Reading Speech, the intention of the Bill is to achieve three main objectives:

- a) to defeat the abuse of controlling interest superannuation schemes by clarifying the definition of ‘*eligible employee*’;
- b) to defeat the abuse of off-shore superannuation schemes by removing deductions for employer *contributions knowingly made to non-complying superannuation funds*, including non-resident superannuation funds; and
- c) to ensure that only superannuation contributions made on behalf of an employee, not an associate of an employee, are *excluded from Fringe Benefits Tax*.

1.12 The Bill’s amendments therefore both clarify one aspect of the existing law (point ‘a’ above) and introduce two new legislative changes (points ‘b’ and ‘c’ above). These changes were proposed as part of the Government’s ongoing commitment to address aggressively marketed employee benefit arrangements.

Clarifying the definition of ‘eligible employee’

1.13 Schedule 1 (item 3) of the Bill amends Section 82AAA of the *Income Tax Assessment Act 1936* to clarify the definition of ‘eligible employee’. Under the current legislation, ‘eligible employee’ includes an individual who is an employee of a company in which the taxpayer, including an individual taxpayer, holds a controlling interest.³

1.14 Currently, a taxpayer who holds a controlling interest in a company can claim a deduction for a contribution to a superannuation fund for an employee of the company, subject to certain limits, which have varied over time.

1.15 The intention of the amendment was to put beyond doubt that a taxpayer and an ‘eligible employee’ cannot be the same person. This would ensure that no deduction is allowable under section 82AAC for contributions made by a taxpayer to a complying superannuation fund for the purpose of making provision for superannuation benefits for himself or herself.

1.16 This amendment would not change the intention or the application of existing legislation. It was never intended that an individual could be treated as an employee of himself or herself. Instead, the amendments clarify and confirm the effect of the current law. The well-established general principle under common law (that an individual cannot enter into a contract with himself or herself) is not overturned by anything specific in this section.

1.17 This amendment would not affect the ability of an individual taxpayer to claim a deduction for contributions made in respect of employees of a company other than themselves in which the individual taxpayer has a controlling interest.

3 Subsection 82AAA(1) of the *Income Tax Assessment Act 1936*, as cited in Explanatory Memorandum to the Taxation Laws Amendment (Superannuation Contributions) Bill 2000, p. 5.

Contributions to non-complying superannuation funds

1.18 Schedule 1 (items 1, 2 and 4 to 7) of the Bill amends the *Income Tax Assessment Act 1936* and *Income Tax Assessment Act 1997* to deny deductions for employer superannuation contributions knowingly made to non-complying superannuation funds. This includes funds that do not meet the Government's criteria for concessional taxation treatment, and non-resident superannuation funds.

1.19 To qualify as a complying superannuation fund, current legislation directs that the central management and control of the fund must be in Australia. The fund must also have at least one active member, and resident active members must hold 50 per cent of its accumulated entitlements.⁴

1.20 Under the current law, contributions to a non-complying superannuation fund, both resident and non-resident, are deductible to employers and subject to FBT. The intention of this law was to ensure that these funds were not attractive in comparison to complying funds, which is the Government's preferred vehicle for retirement savings. Some evidence suggests that some of the non-complying funds domiciled overseas escaped a number of tax obligations, including the contributions tax and surcharge, and when these funds were returned to Australia, they gained considerable attractive tax advantages.

1.21 To date, however, some tax planners have been marketing schemes as a complete tax wipe-out using existing tax planning structures to maximise deductions while claiming that FBT does not apply.

1.22 The amendment aims to ensure that superannuation contributions would only be deductible if made to a complying superannuation fund from 30 June 2000. This is because non-complying funds have been judged as not having been used for retirement income purposes, and are not subject to prudential regulation.

1.23 Under this Bill, Section 82AAE of the *Income Tax Assessment Act 1936* would be repealed to remove the major provision through which deductions have previously been available for a contribution to a non-complying superannuation fund (Schedule 1, item 4). Subsection 26-75 would be inserted in the *Income Tax Assessment Act 1997* to ensure that no deduction is available under any other section of either Act for contributions made to a non-complying fund, and a definition of non-complying superannuation fund would be inserted into section 995-1 of the *Income Tax Assessment Act 1997* (Schedule 1, item 7).

1.24 An intended consequence of this amendment is that superannuation benefits that are made to a non-complying superannuation fund, on behalf of resident employees who are not 'exempt visitors', would not be deductible. Instead, these benefits would be subject to FBT. 'Exempt visitors' include Australian residents employed by an Australian company to work outside of Australia.

1.25 The Government's preferred approach is to endeavour to enter into bilateral negotiations with other countries to facilitate reciprocal agreements for the transfer of

4 Australian Taxation Office, 'Overseas Employment and the Residency Status of Self Managed Superannuation Funds', *Australian Taxation Office* internet site: http://www.ato.gov.au/content.asp?doc=/content/Professionals/super/smsf_pr49.htm (accessed 23 November 2000), and as defined in Part IX of the *Income Tax Assessment Act 1936*.

superannuation benefits by non-residents on permanent departure from Australia. (Resident employees overseas receive concessional treatment for contributions only if they are made to a complying fund because they may intend to return to Australia.)

Fringe benefits exemptions for employees

1.26 Part 3 of Schedule 1 of the Bill amends the *Fringe Benefits Tax Assessment Act 1986* to ensure that the exclusion of payments to superannuation funds and retirement savings accounts from the term ‘fringe benefit’ would apply only to payments made for the employee, not associates of the employee.

1.27 Currently, the definition of a ‘fringe benefit’ includes benefits provided to an employee, or an associate of an employee, by the employer, an associate of the employer, or a third party in respect of the employee’s employment.⁵ However, certain payments and benefits are specifically excluded from the definition and are, therefore, exempt from fringe benefits.

1.28 Superannuation contributions are currently among the payments that are excluded from the definition of fringe benefits, even if they are paid for the benefit of an associate. While this has enabled employees of tax exempt bodies to salary package in a more tax effective manner than that available to other employees, it has also provided a loophole for tax planning arrangements that seek to gain greater tax concessions than were intended to be available.

1.29 The amendment was designed to address this loophole by ensuring that associates would no longer be excluded from the definition of a ‘fringe benefit’.

1.30 It is an intended consequence of this amendment that superannuation contributions made for the benefit of associates of employees would now be subject to FBT, even though such contributions are generally not deductible. Superannuation contributions paid to non-complying funds would continue to be subject to FBT in all cases except where made for an employee who is also an exempt visitor.

Impact of the Bill

1.31 As outlined in the Explanatory Memorandum to the Bill, the Government considers that the financial impact of the Bill on Government expenditure would be negligible. The Bill acts to protect Government revenue; no additional revenue would be expected and no economic impact has been identified. Irrespective of the passage of some of the amendments in the Bill, the ATO is continuing to recover Government monies lost on account of these aggressive tax-planning schemes.⁶

1.32 The Government also claims that business should slightly benefit from the measures by some reduction in ongoing compliance costs by virtue of the greater simplicity and clarity. Taxpayers, who are not involved in aggressive tax planning schemes, and employers, should not be significantly affected.

5 Section 136 of the *Fringe Benefits Tax Assessment Act 1986*, as cited in Explanatory Memorandum to the Taxation Laws Amendment (Superannuation Contributions) Bill 2000, p. 13.

6 Committee Hansard, p. 73.

1.33 According to the Government, the superannuation industry has reacted positively to the announcement of these measures to date.⁷

Rationale for the Bill

1.34 As mentioned above, this Bill is introduced in an attempt to address aggressive marketing of employee benefit arrangements. On 30 June 2000, when announcing the amendments contained in the Bill, the Assistant Treasurer explained the reasons for the Government's action in relation to the aggressively marketed employee benefit arrangements, stating that:

This move is necessary following Tax Office advice that these arrangements are still being actively promoted. The arrangements have continued despite the Taxation Commissioner's clear advice that the schemes are ineffective under existing law.⁸ⁱ

1.35 On 15 November 2000, in his speech to the Taxation Institute of Australia in Melbourne, the Commissioner of Taxation, Mr Michael Carmody, stated:

Variations of employee benefit arrangements continue to be developed and promoted, despite the fact we made it abundantly clear that we would tackle this sort of activity, including by using the general anti-avoidance provisions.⁹

Employee benefit arrangements

1.36 Employee benefit arrangements describe a number of schemes that may allow deductions and the exemption of certain activities from FBT, so increasing remuneration for people able to establish such arrangements through their control, or association with control, of various corporate entities. They generally fall within four categories, two of which involve superannuation and the other two, employee share schemes and employee benefit trusts.

1.37 In October 1998 in a Draft Ruling, the ATO published its position on the definition of the term 'associate' within the legislation. The effect of this was that the trustee would be an associate of an employee for purposes of the FBT and so the employer would be liable for FBT on the value of the benefit provided. In a Media Release associated with the Draft Ruling, the ATO stated:

The public ruling today makes clear the Tax Office view that the structures used in these employee benefit arrangements do not avoid the concept of associate. They are therefore subject to FBT under the clearly intended operation of the law.

The ruling identifies a range of vehicles used for this purpose, including non-complying superannuation funds and unit trusts. Both off-shore and on-shore arrangements are involved.¹⁰

7 Explanatory Memorandum to the Taxation Laws Amendment (Superannuation Contributions) Bill 2000, p. 20.

8 Assistant Treasurer, 'Overseas Employment Residency of Self-Managed Superannuation Funds (SMSF)', Press Release No. 049, 30 June 2000.

9 The Integrity of the Private Binding Rulings System', Speech by Michael Carmody, Commissioner of Taxation to the Taxation Institute of Australia, Melbourne 15 November 2000, *Australian Taxation Office* internet site: <http://www.ato.gov.au/content.asp?doc=/content/Corporate/sp200007.htm>

1.38 The final public ruling was issued in May 1999. It appears to be consistent with the ATO's position as stated in its draft October 1998 ruling. In addition, the May 1999 ruling covers mass marketing of aggressive tax planning schemes. It also provides for exemptions for tax payers who have received a private ruling. The draft ruling and the final ruling are included at **Appendices 3 and 4** respectively.

1.39 The Taxation Office has consistently taken the view that the means of containing the abusive schemes is to pursue litigation against the participants under general anti-avoidance provisions and, in particular, Part IVA of the *Income Tax Assessment Act 1936*.¹¹

1.40 Clarifying the ATO's stance on the Bill to the Taxation Institute of Australia, referred to above, Commissioner Carmody stated:

There is no excuse in my mind for promoters or advisors using these private binding rulings to give assurance to thousands of investors that the claimed tax benefits would be available. That is not the position at law and it is hard to escape the conclusion that they knew that. After all, these activities were undertaken by people who presumable present themselves as having some knowledge of the law.¹²

1.41 In the same statement, Commissioner Carmody asserted:

Our advice to Government to confirm the law relating to controlling interest superannuation arrangements was at least in part motivated by our desire to protect people to whom these arrangements continued to be aggressively marketed, not withstanding our clear cut position on them. The resulting proposed legislation is not a new anti-avoidance measure. It is a confirmation of our view of the existing law, supported by counsel, that an employer and an employee cannot be the same person for the purposes of obtaining a deduction for superannuation purposes.¹³

1.42 The Bill aims to limit the negative effects on unwary investors who continue to receive ill-informed or unscrupulous advice from aggressive marketers. The Committee believes that aggressive marketing of exploitative tax schemes by tax avoidance promoters, who are in a position to know the law, is a practice that needs to be curtailed. Participants, some of whom may have been misled by tax avoidance promoters who should have known the law, may have cause to consider seeking legal redress.

1.43 The Committee notes that the wider issue of mass marketed tax effective schemes is currently the subject of an inquiry by the Senate Economics References Committee. That Committee's inquiry is continuing.

1.44 Given this, the Bill's concentration on the superannuation aspects of abuse under employee benefit arrangements might be taken to suggest that the ATO has perceived that tax planners have, in particular, targeted the area for exploitation. This is irrespective of the

10 Australian Taxation Office, *Media Release*, 28 October 1998.

11 'The Integrity of the Private Binding Rulings System', Speech by Michael Carmody, Commissioner of Taxation to the Taxation Institute of Australia, Melbourne, p. 15.

12 'The Integrity of the Private Binding Rulings System', Speech by Michael Carmody, Commissioner of Taxation to the Taxation Institute of Australia, Melbourne, p. 12.

13 'The Integrity of the Private Binding Rulings System', Speech by Michael Carmody, Commissioner of Taxation to the Taxation Institute of Australia, Melbourne, p. 14.

potential implications for their clients and despite the ATO's ongoing rejection of such interpretations of current legalisation and its commitment to litigate.¹⁴

1.45 The Selection of Bills Committee has referred the Bill to the Senate Select Superannuation and Financial Services Committee so that it might examine the appropriateness of the amendments to subvert the use of off-shore superannuation schemes for tax evasion; and to uncover any unintended implications of the amendments for those involved in the industry.

Superannuation aspects of the Bill

1.46 Australia has experienced enormous growth in both the volume and value of Australia's superannuation industry in recent years. As a consequence, fund managers are increasingly looking overseas to foreign markets for investment opportunities.¹⁵ The majority of these funds are legitimately seeking higher returns because of the limited size of the market in Australia.

1.47 The intention of the amendments, as stated, is to enhance the effectiveness of current legislation. The measures reflect the intention of all parties within the Parliament to ensure that these superannuation funds are not used to evade tax. At the same time, a core issue and object is to stop those knowingly investing in non-complying funds from gaining deductions for contributions made to these funds and from claiming exemption from FBT on that basis. It is argued that those contributing to non-complying funds do so against the expressed intention of the law and of the Government which intends to direct contributions to complying and therefore regulated funds.¹⁶

1.48 As indicated above (paragraph 1.19), Part IX of the *Income Tax Assessment Act 1936* dictates that to be a complying fund, the central management and control of the fund must be in Australia. The fund must also have at least one active member, and resident active members must hold 50 percent of its accumulated entitlements. The Australian Taxation Office reported that for a period following the implementation of the Superannuation Industry (Supervision) Act (SIS Act) in 1993, which articulated Government's rules for complying fund investment, a number of firms no longer entitled under the Act continued to receive deductibility on contributions. This was because they had well established superannuation arrangements, which could not be wound down.¹⁷

1.49 However, the ATO believes that, eight years on, any such arrangements should now be wound down and therefore, to counteract arrangements deliberately in breach of the SIS requirements, a reinforcement of the rulings for complying fund investment is necessary:

The most appropriate legislative change to ensure that these abusive arrangements do not continue to be promoted, and to protect potential participants from such arrangements, is to reinforce the position of complying superannuation funds as the

14 Chris Field, 'Taxation Laws Amendment Superannuation Contributions Bill 2000', *Bills Digest No. 2000-01*, Information and Research Services, Department of the Parliamentary Library, p. 5.

15 Australian Transaction Reports and Analysis Centre (AUSTRAC), Submission No. 2, p. 7.

16 Field, 'Taxation Laws Amendment Superannuation Contributions Bill 2000', *Bills Digest No. 2000-01*, p. 5.

17 Committee Hansard, p. 66.

Government's preferred vehicle for retirement savings by removing the deductions to non-complying superannuation funds.¹⁸

1.50 The Bill is introduced at a time when the Government has also announced that the residency status provisions of superannuation funds in the *Income Tax Assessment Act 1936* will be amended to make it easier for self-managed superannuation fund trustees to retain complying status. In a press release on 4 October 2000, the Assistant Treasurer, Senator the Hon. Rod Kemp, explained that the Government wants to ensure that a fund does not become non-complying, and suffer tax consequences, where a member/trustee is temporarily overseas.¹⁹

1.51 The amendments determine that central management and control of a fund will not be deemed to cease in Australia, provided the member or trustees stay overseas does not exceed two years, or a later period allowed by regulations.²⁰ The Assistant Treasurer's press release and ATO announcements on these amendments are at **Appendices 5 and 6**.

18 Committee Hansard, pp. 65–66.

19 Assistant Treasurer, 'Overseas Employment and the Residency Status of Self-Managed Superannuation Funds (SMSF)', Press Release no. 049, the *Treasurer* internet site: [http://www.treasurer.gov.au/Assistant Treasurer/ press releases/ 2000/049.asp](http://www.treasurer.gov.au/Assistant%20Treasurer/press%20releases/2000/049.asp) (accessed 23 November 2000)

20 Australian Taxation Office, 'Overseas Employment and the Residency Status of Self-Managed Superannuation Funds', *Australian Taxation Office* internet site.

CHAPTER 2

Overview

2.1 The Bill aims to clarify existing legislation and reinforce rulings on investment in complying, and therefore regulated, superannuation funds as the Government's preferred vehicle for retirement savings. The concept of controlling interest and the marketing abuse of off-shore schemes has evolved at a time of unprecedented growth in the superannuation industry—in an environment when fund managers are looking for the best remuneration domestically and overseas. At the same time, Australian industries are seeking to gain a steadier foothold in the international market place.

2.2 The Bill was strongly supported in the evidence received by the Committee, in order to stop tax avoidance. There was, however, some concern that Bill might exceed its target, having limited unintended consequences.

2.3 Two potentially affected groups were identified:

- those firms with expatriate employees overseas; and,
- those with foreign staff employed in Australia.

2.4 Concerns hinged on the definition of 'non-complying' fund. These groups may be obligated to contribute to non-resident, and by definition, non-complying funds. The unintended consequences of the Bill, then, were identified as:

- loss of previously allowed deductions; and,
- the imposition of Fringe Benefits Tax.

2.5 Witnesses saw that this would damage the global competitiveness for these firms and potentially discourage foreign expertise from entering our industries. Other issues of concern related to:

- international portability of funds;
- residency issues; and,
- the progressing of bilateral reciprocal arrangements for superannuation with other countries.

2.6 The evidence suggested a number of alternative approaches which might avoid these unintended consequences and broached matters such as whether the Bill should be retrospectively applied. These and other issues are described below. Industry also advocated more consultation on the Bill.

2.7 In conclusion, the Australian Taxation Office responded to suggestions made by industry in the evidence received by the Committee, and clarified its perspective of the intent and potential of the legislation. The ATO response is covered at paragraphs 2.47–2.66.

Views on the Bill

2.8 At hearings the ATO told the Committee that total contributions by clients to promoters of employee benefits arrangements was around \$1.5 billion, with about \$500 million claimed in relation to superannuation arrangements. Of these, \$100 million were related to off-shore funds.¹ These are amounts identified to date with some auditing still to be completed.

2.9 The Australian Transaction Reports and Analysis Centre (AUSTRAC), which provides a data analysis platform to the ATO, confirmed that the number of international funds transactions increases every year. Its submission records that the number and value of International Funds Transfer Instructions reported to AUSTRAC has increased by more than 30 per cent over the last five years.² There would appear to be potential for a continued and growing incidence of revenue loss by deliberate abuse of the system if the law is not clarified.

2.10 Evidence received by the Committee strongly supported the need to prevent tax avoidance, such as by using the ‘round robin’ method of shifting money to overseas superannuation funds and quickly moving the funds back onshore.³ CPA Australia, the Association of Superannuation Funds Australia (ASFA), the Small Independent Superannuation Funds Association (SISFA), the Institute of Chartered Accountants of Australia (ICAA), among others, all supported the sentiment expressed by the Corporate Super Association at hearings that ‘any legislation that seeks to address apparent areas of tax evasion’ should be supported as ‘a matter of decency and ethics’.⁴

2.11 Investment and Financial Services Association (IFSA) was more particular in its commendation of the Bill’s intention to safeguard the integrity of the superannuation system. In particular, IFSA remarked on the importance of the Bill in clarifying the interpretation of ‘eligible employee’ which, in IFSA’s view, had allowed schemes to pursue distortions affording individual tax relief, rather than promoting long term retirement savings.⁵

2.12 Nevertheless, the present proposal was criticised by a few for being heavy handed, with witnesses, such as Corporate Super Association, questioning the necessity of the Bill on the basis that existing tax avoidance legislation is sufficient to deal with aggressive tax planners.⁶ On this score, Arthur Andersen noted that a quicker clearer process was required. The firm advised: ‘you need to make sure that this type of legislation, whilst achieving what it is meant to achieve, does not also have unintended commercial consequences for bona fide retirement funds’.⁷

1 Committee Hansard, pp. 71 and 73 .

2 AUSTRAC Submission No. 2, p. 7.

3 As described by the Australian Taxation Office, and by CPA Australia, Committee Hansard, p. 5. ‘Round robin’ is a term used to describe a mechanism to obtain a tax advantage by returning the funds onshore with minimal or no tax payable on their return to Australia.

4 Committee Hansard, p. 33.

5 IFSA Submission No. 8, p. 1.

6 Committee Hansard, p. 33. See also SISFA Committee Hansard, p. 36.

7 Committee Hansard, p. 44.

Unintended consequences

2.13 The Committee heard that this Bill, while acting to end marketing abuse of the current system, may have unintended consequences for some Australian firms which are obliged to contribute to overseas superannuation or other compulsory funds, that are by definition non-complying. At a time when Australia is moving to enhance its profile in the international market place, many industry witnesses thought that the amendments could work against the global competitiveness of Australian businesses.⁸

Implications for employers of expatriates overseas and foreign employees in Australia

2.14 The Committee received evidence from a number of organisations reporting that they have clients who would be negatively affected if the Bill is passed in its present form. The Corporate Super Association represents the major corporate super funds in Australia, equivalent to 75 per cent of the total assets in the corporate super sector. The Association reported that several of its members' corporate sponsors are large employers with international or global business links which provide non-resident superannuation as part of their employees' employment benefits.⁹

2.15 The Corporate Super Association advised that, in its view, the amendments as presently proposed will penalise two main business categories:

- Australian businesses with foreign subsidiaries; and,
- global Australian businesses.

2.16 In the first category, Australian tax-paying corporate bodies are often obliged to employ expatriates in Australia, but are required to make contributions to the expatriate's non-resident superannuation fund. In the latter category, Australian taxpayers are required to meet statutory obligations of other countries when employing local staff: these obligations often include compulsory contribution to a 'non-resident' superannuation fund.¹⁰

2.17 The Institute of Chartered Accountants in Australia (ICAA) agreed that the proposed amendments would unfairly affect employers contributing to genuine off-shore retirement funds on behalf of expatriate employees. As these funds would be considered as non-complying funds for Australia tax purposes, these employers would be denied deductions on this basis. Also, as the individual for whom contributions is made remains an 'employee' for the purposes of Fringe Benefits Tax under Australian law, employers would also have to pay the FBT charge in relation to these contributions, causing such employers to be doubly disadvantaged by higher costs.¹¹

2.18 Firms in the alternate position of having foreign employees working in Australia suffer similarly, in contributing to home country-based retirement plans on behalf of these employees. Unless the employees are 'exempt visitors' (under Section 23(r) or

8 See for example, Corporate Super Association, Committee Hansard, p. 333; ASFA Submission No. 1, p. 1, and Arthur Andersen Submission No. 6, p. 3.

9 Corporate Super Association Submission No. 3, p. 2.

10 Corporate Super Association Submission No. 3, p. 2.

11 ICAA Submission No. 4, p. 2.

Section 23AG), not only will a deduction be denied for contributions, but a FBT charge will also be applicable to the contributions made. The ICAA saw that the amendments will therefore erect unintended impediments to Australian companies trying to participate in international markets, by internationalising their businesses geographically and demographically.¹² IFSA, which represents Australia's leading investment managers and life insurance companies, also expressed these same concerns.¹³

2.19 Arthur Andersen, being another firm with international clients employing expatriates off-shore and foreign nationals within Australia, supported these views, judging that a 'double whammy' would be delivered to longer term foreign executives in Australia. It judged that being denied deductions on payments to overseas funds and being subjected to an FBT charge could drive foreign expertise back overseas prematurely.¹⁴

2.20 At the hearing, Arthur Andersen also pinpointed specific limitations in the legislation in relation to foreign employees in Australia. Noting the statement in the Bill's Explanatory Memorandum that people are free to contribute to Australian funds if they want to, it was observed that such a suggestion focussed on short term solutions, 'whereas retirement planning requires a very long term view'.¹⁵

2.21 In particular, the firm identified problems for employees from the UK and US who would wish to avoid risk by having funds in their own currency, and, in any case are subject to punitive taxation if they transfer into an Australian fund after a six month period. Difficulties arising from an inability to remove funds was also major stumbling block, as Australia attempts to establish reciprocal agreements with other countries, according to Government policy, was limited by a lack of bargaining power.¹⁶

Portability, bilateral agreement and residency issues

2.22 Portability of funds was also raised by the Small Independent Superannuation Funds Association (SISFA), which remarked that regulated superannuation funds in Australia are permitted to accept transfers of benefits from foreign pension schemes or similar vehicles, but not vice versa.¹⁷ This issue grows out of the Government's expressed commitment to establish bilateral agreements with other countries for reciprocal treatment and transfer of superannuation benefits. However, a number of witnesses remarked that the establishment of such agreements had been, as described by IFSA, 'somewhat glacial'.¹⁸

2.23 While residency status was not an issue raised in the Bill under consideration, the Committee heard that there are implications, particularly in the case of global businesses and for Australian taxpayers who have foreign subsidiaries. The Corporate Super Association told the Committee:

12 ICAA Submission No. 4, pp. 1–2.

13 IFSA Submission No. 8, pp. 1–2.

14 Arthur Andersen Submission No. 6, p. 3.

15 Committee Hansard, p. 42.

16 Committee Hansard, pp. 42–43.

17 SIFSA Submission No. 7, pp. 6–7.

18 IFSA Submission No. 8, p. 2.

we have positions there where, for either the local employee or the expat who is brought in here, the corporate is obliged to contribute to the local superannuation fund of that employee. Local is non-resident. Non-resident means non-complying fund according to the definition here. The non-complying fund would say that there would be no tax deduction for the contribution, and there may or may not be FBT on the contribution. So that is our worry.¹⁹

2.24 There were also specific concerns about the status of self-managed funds. Currently the central management and control of a superannuation fund is exercised by the trustee of the fund (eg an individual trustee, a board of individual trustees or a company). Accordingly, whether the central management and control test has been satisfied will depend on whether the trustee has been in Australia at all times during the year of income. Thus, in the case of a self-managed fund (where a married couple are members and trustees of a fund), the mere temporary absence from Australia of the trustees, or majority of trustees, will cause the fund to lose its residency status for the year of income. The fund, therefore, becomes a non-complying fund, causing it to lose its concessional tax treatment for the year of income.²⁰

2.25 As referred to in Chapter 1, in October 2000 the Assistant Treasurer Rod Kemp announced amendments to the *Income Tax Assessment Act 1936* to make it easier for trustees of these funds to retain complying status when overseas temporarily. The amendments intend to permit funds to remain as resident and complying, even when its trustee/member remains overseas, for up to 2 years, or a later period allowed by regulations.²¹

2.26 The Committee heard that this provision needs further consideration before the legislation is made law. Industry recommendations, which relate to the processing of the present Bill, are outlined below.

Other issues

2.27 Industry evidence also touched on matters such as whether the Bill should be retrospectively applied and on the degree of consultation that had taken place or would be advisable to finalise amendments to the Bill.

Commencement date/retrospectivity

2.28 The issue was raised regarding the commencement date of the Bill and whether the legislation should be retrospectively applied.

2.29 The Bill was due to take effect from the announcement of these measures by the Assistant Treasurer on 30 June 2000, that is, amendments to the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* were to apply to any superannuation contributions made after 4.00pm, by legal time in the Australian Capital Territory, on 30 June

19 Committee Hansard, p. 33.

20 'Overseas Employment and the Residency Status of Self-Managed Superannuation Funds', *Australian Taxation Office* internet site: <http://www.ato.gov.au/content.asp?doc=/content/Professionals/super/smsf-pr49.htm> (accessed 23 November 2000)

21 Assistant Treasurer, 'Overseas Employment and the Residency Status of Self-Managed Superannuation Funds (SMSF)', Press Release no. 049, the *Treasurer* internet site: [http://www.treasurer.gov.au/Assistant Treasurer/ press releases/ 2000/049.asp](http://www.treasurer.gov.au/Assistant%20Treasurer/press%20releases/2000/049.asp) (accessed 23 November 2000)

2000. Changes to the *Fringe Benefits Tax Assessment Act 1986* were to apply to contributions made after the introduction of this Bill.

2.30 Considering the time period over which various tax abuses have occurred, and the intention of the original Bill, the question was raised as to whether retrospective application of the legislation beyond the time of the Assistant Treasurer's media release would be more appropriate. CPA Australia expressed some concern about this proposal:

I think the general position of our organisation has been that retrospective legislation must be entered into with a considerable amount of thought going through about the ramifications, particularly if people have been making what they thought at the time were very legitimate decisions. Generally, our view has been that tax legislation should generally try to go forward.²²

2.31 ISFA stated that it would not support retrospective application without public and industry consultation on any specific measure proposed. The Association noted that it had not seen any detailed proposal for retrospectivity in relation to this Bill to date.²³

2.32 Similarly, Arthur Andersen agreed that retrospective legislation would be a less appropriate option in this case, provided that there have been sufficient announcements regarding the change to the legislation, and provided that the legislation will be passed within a 'reasonable period of time'.²⁴

2.33 ATO views on the retrospective application of the Bill are outlined at paragraph 2.55.

Consultation

2.34 Some concern was raised regarding consultation around this Bill, and whether this had been extensive enough on behalf of the ATO. The ATO stated that it had consulted widely with industry associations and accounting bodies in an attempt to quantify the concerns raised relating to the unintended effects of the Bill.²⁵

2.35 CPA Australia said that it had raised its concerns with the ATO, particularly regarding the deductibility of employer contributions to overseas funds. The CPA had advised the ATO that it did not consider the proposed changes to be insurmountable but that they would involve some costs and inconvenience to put into effect.²⁶

2.36 CPA advised that other bodies such as the Taxation Institute of Australia, and the Corporate Super Association have also raised their concerns regarding this Bill with the

22 Committee Hansard, p. 9.

23 ISFA, Submission No. 8, p. 2.

24 Committee Hansard, p. 44.

25 Committee Hansard, p. 66.

26 Committee Hansard, p. 3.

ATO.²⁷ The Corporate Super Association told the Committee that it had in fact held three meetings with the ATO but did not receive a positive response on this particular legislation.²⁸

2.37 According to the ATO, no party has been able to provide them with any details about the number of employees involved in these arrangements or the level of contributions that they would have been making. Hence, while the ATO recognised that some unintended impact is likely as a result of the Bill, it believed that the effect of this was not quantifiable.²⁹ This point is discussed further below.

Alternative approaches

2.38 Submitters and witnesses to the inquiry made recommendations to the Committee about how these negative effects, or unintended consequences, could be averted, or minimised. They identified a number of alternative approaches that might allow the legislation to be ‘carved out’, to avoid capturing legitimate arrangements involving employers with overseas employees or foreign Australian based employees.

Reinstating deductions to approved overseas funds

2.39 The Institute of Chartered Accountants in Australia (ICAA) recommended that identified firms should be allowed deductions, providing they can demonstrate their obligations to comply with overseas funds or that employees are in fact residents of another country for taxation purposes. The ICAA suggested that the obligation should be enshrined in specified legislation, in the companies’ employment policies or funds deed trust.³⁰ CPA Australia supported this view, in addition stating that the establishment requirements could be equivalent to those for the superannuation guarantee charge.³¹

2.40 The Corporate Super Association saw, in both expatriate and foreign employee cases, that taxation deductions should be allowed provided that the contribution is within the aged-based limits to avert impairment of Australian business competitiveness in the global business environment. It recommended, therefore, that bona fide Australian businesses should be exempted from the effect of the proposed Bill, and that there should be express exception for deductions within the age-based limits.³²

2.41 Arthur Andersen, supported the ICAA’s proposal that affected companies should be exempted from the new legislation providing they can prove obligations to pay into non-complying funds for foreign onshore or off-shore expatriate employees.³³ The firm also saw that, for clarification, the existing anti-avoidance law needs testing in the court system. Only

27 Committee Hansard, p. 2.

28 Committee Hansard, p. 34.

29 Committee Hansard, p. 67.

30 ICAA, Submission No. 3, p.1.

31 Committee Hansard, p. 4.

32 Corporate Super Association, Submission No. 3, p. 2.

33 Arthur Andersen Submission No. 6, p. 2.

in this way, it was argued, could appropriate boundaries be established for business, which could then work within them.³⁴

Addressing portability, bilateral agreements and residency issues

2.42 In relation to portability of funds, SISFA saw a need to make consistent rulings on the portability of benefits between Australian superannuation funds and their overseas counterparts³⁵ SISFA noted the Government's expressed commitment to establish bilateral agreements with other countries for reciprocal treatment and transfer of superannuation benefits, but argued for further commitment by Government to pursue the issue of portability in this context.³⁶

2.43 In its submission, ASFA also judged that the Government's emphasis on establishing reciprocal arrangements may delay timely introduction of measures to ensure Australian employers can compete in the global environment. It therefore recommended that the Government seek to establish workable interim arrangements.³⁷

2.44 Arthur Andersen agreed with SISFA that a positive approach to the portability issue would be to allow organisations to make contributions to bona fide funds in the country of origin of the individual. This would provide the necessary control through the legislation, without opening up the field for exploitation.³⁸

2.45 On matter of residency arrangements, Arthur Andersen saw the amendments announced by the Assistant Treasurer in October 2000 to be a step in the right direction but pointed out that the proposals do not resolve the implications for members resident overseas for longer than two years. The firm recommended that the period of compliance should be extended to a five year maximum period.³⁹ This was also supported by SISFA, which noted that the Assistant Treasurer had agreed to consult further on this matter before the amendments are finalised.⁴⁰

2.46 Taking matters further, SISFA recommended that the two-year extension applying to self-managed superannuation funds was 'a reasonable starting point' but that the ruling should apply to *all* superannuation funds.⁴¹ This dovetails with recommendations from ASFA, which believes that the possible negative outcomes outlined in this report highlight the need for a major review of superannuation arrangements for visiting employees and Australians working overseas.⁴²

34 Committee Hansard, p. 44.

35 SISFA Submission No. 7, pp. 1–2.

36 SISFA, Submission No. 7 and see Committee Hansard, p. 37.

37 ASFA, Submission No. 1, p. 1.

38 Committee Hansard, p. 43.

39 Arthur Andersen Submission No. 6, p. 3.

40 Committee Hansard, p. 37.

41 Committee Hansard, p. 38; and SISFA, Submission No. 7, p. 1.

42 ASFA, Submission No. 1, p. 1.

Response from the Australian Taxation Office (ATO)

2.47 During the hearings, a number of issues were explored with the ATO officials. These largely related to obtaining from the ATO its views in relation to addressing the unintended consequences of the proposed legislation. A number of other matters were also discussed. These are outlined below.

2.48 In its evidence to the Committee, the ATO maintained that a major sticking point in identifying the potential unintended consequences of the Bill was the lack of ability to quantify those effects. As mentioned above, the ATO stated that it had consulted widely with industry associations and accounting bodies in an attempt to quantify these concerns but had not been able to obtain any details about the number of employees involved or the level of contributions they would have been making.⁴³

2.49 The ATO judged that, depending on the mix of factors involved, there may be some impact, but reiterated industry advice that this would be small and likely to affect only a limited numbers of employers and employees.⁴⁴

2.50 The ATO explained that to properly assess the effect of the Bill on identified firms a large number of factors would need to be taken into account including:

- whether any income is assessed under the control foreign company regime or the foreign branch profits provisions;
- whether provisions are in a broadly exemption-listed country, a limited exemption-listed country or an unlisted country;
- the percentage of active income against tainted income;
- whether the entity makes a profit or loss in that country in that revenue period;
- whether a tax deduction is available in that country for any contributions that need to be made;
- whether the remuneration package can be restructured to eliminate or minimise the contribution to a non-complying superannuation fund; and,
- whether the contribution is actually made to a non-complying superannuation fund or some other type of entity, for example, consolidated revenue.⁴⁵

2.51 In relation to the matter of inbound employees, the ATO emphasised that the Bill would only come into effect for long term stayers, that is over four years, and there would be no change for shorter term employees. The ATO explained the intention of the Bill was to ensure that the longer term stayers would be treated as Australian residents, and so should be encouraged to invest their superannuation with complying funds regulated by Australian law.⁴⁶

43 Committee Hansard, p. 66.

44 Committee Hansard, p. 67.

45 Committee Hansard, pp. 66–67.

46 Committee Hansard, p. 67.

2.52 For this reason, the Bill would remove deductibility for non-complying funds and ensure FBT was applied. To conclude, the ATO again emphasised that industry had told it that there would be a small effect on a minimal number of firms:

We have been informed that in many cases employers will need to restructure remuneration packages for such employees. We have also been advised that this repackaging will be an irritant but in the vast majority of cases will not present any major difficulties.⁴⁷

2.53 At the hearing on 29 November 2000, the ATO further clarified the status of the amendments in relation to existing law. The amendments to 82 AAA of the *Income Tax Assessment Act 1936* were clarifications of the definition of ‘eligible employee’, the remaining two elements were new and were introduced to reinforce existing law by removing deductions from non-complying funds, under the *Income Tax Assessment Act 1997*, and applying FBT under the *Fringe Benefits Assessment Act 1986*.⁴⁸

2.54 The ATO explained that these changes were needed to further discourage aggressive marketing of exploitative tax schemes. The ATO also emphasised that such clarification and reinforcement was a part of the process of administering taxation effectively. The ATO reminded the Committee that legislation has been reviewed, and new legislation introduced, in the past to address evident weaknesses in existing legislation.⁴⁹

2.55 In regard to a hypothetical suggestion to apply the amended law retrospectively, the ATO saw that, if retrospectivity only applied to part of the Bill, this would cause a great deal of confusion for industry advisers and taxpayers.⁵⁰ It could also potentially introduce some inequities between those cases that have been settled on the basis of existing law, and others to which a retrospective measure could apply.

2.56 In acknowledging the potential for some innocent expatriate players to be caught out by the legislation, the ATO reported that since changes in July 1998 (when permanent departure from Australia ceased to be a condition for release of superannuation benefits held in Australia) the Government has indicated that it is prepared to enter bilateral reciprocal agreements with other countries to assist affected firms. These agreements would facilitate portability of funds between countries. The ATO stated that to date, however, Australia had not been approached by any country in order to establish bilateral agreements.⁵¹

2.57 The ATO agreed that there was room for additional measures which might act to assist those negatively affected by the amendments introduced by the Bill. However, the ATO was of the view that two of the possible measures suggested by industry—the recognition of overseas funds and the exception for deductions within the age-based limits—were not feasible.⁵²

47 Committee Hansard, p. 67.

48 Committee Hansard, p. 83.

49 Committee Hansard, pp. 83–84; p. 96.

50 Committee Hansard, p. 98.

51 Committee Hansard, p. 20.

52 Committee Hansard, p. 68; p. 112.

2.58 The Committee noted that residents of the United Kingdom and United States had been identified as a group who were reluctant to invest in Australian superannuation funds because of associated currency risks.

2.59 Questioned about the potential for an Australian domiciled master fund to be established to allow US and UK employees in Australia to invest in their own currencies off-shore, the ATO responded that, within its knowledge, no Australian fund had established a fund which would accept foreign currency. The ATO was not aware of a market for such a service. Given the development of such a market, however, the ATO judged that this was potentially ‘a way round’ the ‘irritant’ aspects arising from the Bill.⁵³

2.60 During the course of the hearings, the Committee explored with the ATO the quantum of money involved in employee benefit arrangements. The ATO reported that there was \$1.5 billion in outstanding contributions pertaining to four different types of employee benefit arrangements.⁵⁴ The Committee was advised that the ATO has currently recovered \$100 million of outstanding taxes and was seeking to recover a further \$140 million.⁵⁵ However, there is still some further auditing to be carried out.

2.61 The ATO advised the Committee that most of the activity occurred in the period 1997-99 and the Office agreed that it seemed to peak in 1998. The ATO further advised that the income level of participants in the schemes was at the higher end of the income scale, which is generally defined as being above \$100,000 per year.⁵⁶

2.62 The ATO advised that, in relation to employee benefit arrangements, 54 cases have been settled ‘generally by way of penalty tax amounts, but not primary tax other than that issue about multiple taxing points’. The ATO also advised that it would be taking action in respect of those cases in accordance with its normal policy of recovery of tax.⁵⁷

2.63 The ATO also advised that, in relation to appeals concerning various employee benefit arrangements, five cases are currently being contested through the Administrative Appeals Tribunal, and one case is currently before the Federal Court.⁵⁸ It is unknown whether these relate specifically to superannuation arrangements. In relation to the listing of particular cases, the timing of court hearings is beyond the control of the ATO.

2.64 The ATO reported that it had around 130 people pursuing matters associated with employee benefit arrangements, of which 50 are focussing on matters arising from controlling interest superannuation and off-shore superannuation schemes. The ATO advised that it has increased its resource allocation to this area since 1998, and it is intending to further increase these resources.⁵⁹

53 Committee Hansard, pp. 82–83.

54 Committee Hansard, pp. 71, 72 and 135.

55 Committee Hansard, p. 122.

56 Committee Hansard, p. 141.

57 Committee Hansard, p. 124 and answers to questions taken on notice.

58 Committee Hansard, p. 125.

59 Committee Hansard, p. 136.

2.65 As stated above, the ATO confirmed that the current law is sufficient to defeat the abuse of controlling interest superannuation schemes and is taking appropriate recovery action. One of the proposals in the legislation is intended to clarify the current law, while the other two proposals are new measures.

2.66 The Committee notes that at the time of reporting, a number of significant matters were still outstanding. The Committee will be pursuing these with the ATO.

CHAPTER 3

CONCLUSIONS AND RECOMMENDATIONS

3.1 The Committee notes that there was strong support for the thrust of the Bill in acting to address tax avoidance. However, there were some concerns about some aspects of the Bill, in particular whether the proposed amendments could have some limited possible unintended consequences for expatriate staff and whether they could have a possible detrimental effect on Australia's global competitiveness.

3.2 One of the difficulties faced by the Committee during the inquiry was that there was little evidence to quantify the extent of the unintended consequences. Hence, while the ATO recognised that some unintended impacts were possible as a result of the Bill, it considered that these were not quantifiable and that they were only likely to apply in a few cases.

3.3 Although it may not be possible to quantify the extent of the problem, the Committee urges the ATO to actively consider the claims made in evidence to the Committee about possible unintended consequences with a view to alleviating the concerns expressed.

3.4 The Committee also notes that, while not making specific drafting suggestions, a number of alternative approaches and possible amendments were put to the Committee during the course of the inquiry by organisations like ASFA, SISFA, the Institute of Chartered Accountants, Arthur Andersen and the Corporate Super Association. These suggestions were aimed at minimizing the unintended consequences of the proposed legislation and restoring Australia's global competitiveness. The Committee regards these as areas requiring more consideration by the ATO. The Committee urges the ATO to consult with parties that have international staff in Australia and Australian staff overseas to consider the issues.

3.5 The Committee recognises that addressing the concerns raised in this report will not be easy. However, in the view of the Committee, good tax law should cover all issues, people and circumstances, regardless of the quantum of dollars involved. Despite the fact that it does not appear to be possible to quantify the impact of the Bill, the Committee considers that it is in Australia's interests to ensure that Australia has a good tax system that is both robust and internationally competitive.

3.6 The Committee also recognises that taxpayers might be concerned if any or all of the proposed legislation were to be retrospective, as this may introduce an element of confusion. It may also possibly lead to some inequities between those cases that have been settled on the basis of existing law, and others to which a retrospective measure could apply.

3.7 The Committee believes that aggressive marketing of exploitative tax schemes by tax avoidance promoters, who are in a position to know the law, is a practice that needs to be curtailed. Participants, some of whom may have been misled by tax avoidance promoters who should have known the law, may have cause to consider seeking legal redress.

3.8 The Committee considers that there is some more work needed to ensure that the Bill achieves the effect that is desired, and that the impact of the unintended consequences is

minimised. Naturally the Committee would expect that where there can be some recognition of arrangements with other countries, that this will be reflected in further amendments to the proposed legislation.

3.9 The Committee therefore recommends that the Australian Taxation Office continue to consult with appropriate parties to overcome any unintended consequences.

3.10 In the meantime, notwithstanding that there may be some further amendments to the proposed legislation, the Committee regards it as essential for the Bill to proceed in its present form in order to address the continued aggressive marketing of tax avoidance schemes.

3.11 The Committee recommends that the Bill be agreed to.

Senator John Watson

Committee Chair

LABOR SENATORS' MINORITY REPORT

Labor Senators support passage of the legislation, however, we have serious concerns about:

- the policy process leading up to the introduction of the bill;
- the explanation and evidence provided by the Government and the ATO concerning aspects of the bill;
- the lack of co-operation with the Committee by promoters of these schemes;
- the claimed financial impact of the legislation;
- the prospective operation of the legislation; and
- the lack of legislative action by the Government against other employee benefit arrangements which involve tax avoidance.

Despite an unrealistic reporting date forced on the Committee by the Government, the limited opportunities to examine witnesses on the issues covered by the bill have raised serious questions regarding widespread tax avoidance practices, and the inactivity of the Government in curbing these practices.

In addition, we are concerned that the ATO consistently did not make available the witnesses specifically requested by Labor. This resulted in Labor Senators questions being unable to be answered by ATO personnel.

In addition, material in the possession of the Opposition appears to be in conflict with some of the evidence provided by some witnesses. Accordingly, Labor Senators request that the Committee hold a further hearing to examine and explain these and other matters relating to the evidence provided to the Committee.

The obfuscatory behaviour practiced before the Committee is consistent with the recent practice of the Government and the ATO regarding tax avoidance – which is to always seek to deny or minimise the extent of revenue at risk (including claiming that the bill had a negligible financial impact) and pretend that resources and strategies are adequate to deal with the issues when this is obviously not the case.

One example of this is the extraordinary and disturbing claim by Second Commissioner D'Ascenzo¹ that the ATO has still not raised assessments for around half of the revenue from participants in employee benefit arrangements identified so far by the ATO. Indeed of the approximately half of the identified revenue that have had assessments issued, less than one half of that money has been raised. That is less than one quarter of the outstanding revenue identified has been collected!

Many of these arrangements relate to schemes dating back several years. Labor Senators find this practice of not collecting tax, which the ATO claims is clearly payable at law, very disturbing.

This is an obvious indication of the Government's total lack of commitment to providing the ATO with the necessary resources to collect monies which should be collected on behalf of the Australian community.

The position of the Government contains fundamental contradictions. It claims that the two major tax avoidance schemes covered by the bill - namely, controller superannuation schemes and non-complying superannuation schemes, are not effective at law. Despite this claim, the bill amends the law to make it consistent with the intention of Parliament. Claiming that there is no revenue flowing from this bill is simply not credible and is rejected by Labor.

It is alarming that the ATO has given numerous rulings, including to tax scheme promoters, that clearly indicate an ATO policy on matters covered in the Bill that are a direct contradiction of the ATO's current claims. For example Mr Thomas told the Committee,

"Looking at the marketing of off-shore superannuation arrangements, when the Government announced these changes, it indicated that it is amending the law because of the continued marketing of the arrangements by some promoters despite clear, public advice from the ATO that they fail both at law and in their implementation."

*"In our view, these off-shore superannuation arrangements are a blatant abuse of tax laws and an attack on the integrity of the tax system and the retirement incomes system."*²

¹ Evidence: 30 November 2000 page 135

² Evidence Mr T Thomas 27 November 2000 p 65.

Yet evidence to the Committee was that private binding ruling on precisely these schemes were provided to taxpayers and promoters, in which the ATO conceded the legality of these arrangements.

Mr Fitzpatrick sought to explain these inconsistencies as follows, “...*we have certainly issued what we believe to be some incorrect advices, particularly over 1998 and 1999, in relation to controlling industry regulation arrangements.*”³

Labor agrees that these schemes are blatant tax avoidance schemes and are therefore at odds with the intention of the Parliament. However, the new provisions in the bill only operate from 1 July 2000. In addition, Labor Senators are very concerned that evidence to the Committee suggests that the Government will not be tightening the law regarding other types of employee benefit arrangements tax avoidance.

This action of amendment clearly indicates that the law prior to 1 July 2000 was deficient in respect of both types of schemes. This interpretation is backed by the fact that legal opinions, including opinions provided to the ATO, and private rulings issued by the ATO, confirm the effectiveness of the schemes. Indeed evidence provided to the Committee from accounting and other bodies confirms the industry view that the schemes will enable tax to be avoided prior to 1 July 2000.

Accordingly, in order to ensure that Parliament’s intention is achieved Labor Senators recommend that the Senate amend the bill so that the provisions for these two types of schemes contained in the bill operate retrospectively.

In making this recommendation, Labor Senators are mindful of the fact that as a general principal legislation should be prospective in operation.

However, outweighing this general concern is that fact that these types of tax avoidance arrangements are not available to the vast majority of taxpayers who earn low or middle incomes. These are only available to relatively few very high income earners.

Indeed, the number of participants revealed by the ATO was relatively small:

- 2,400 participants in controlling interest superannuation schemes; and
- 220 participants in offshore non-complying funds.⁴

³ Evidence Mr K Fitzpatrick 29 November 2000 p 89.

⁴ Evidence: ATO officers Thomas & Fitzpatrick Hansard 30 November 2000 pages 112-113

Despite these small number of participants, the ATO has discovered around \$1.5 billion has been claimed in deductions for these and other types of employee benefit arrangements (EBAs). Labor Senators believe this to be a significant understatement of the scope of these schemes.

This small number of scheme participants claimed by the ATO is contrary to evidence by a former senior ATO official who has had experience in this area both representing taxpayers and the ATO. The official stated that he believed there were around 10,000 controlling interest superannuation schemes. In addition, he stated:

*“Offshore funds became increasingly popular in 1999-2000, largely because of the awareness created by the Commissioner. One individual firm is known to have put about \$2 billion into offshore, New Zealand, super.”*⁵

These alternative views were apparently based on experience gained outside the ATO:

*“The 10,000 controlling super type funds that I think are out there are based on evidence I discovered after going into private practice where information is a lot more forthcoming that it would be to the Australian Taxation Office.”*⁶

Labor Senators are not in a position to assess the veracity of these claims. However, we note that the ATO has not followed up these claims, nor were officers aware of the firm that was claimed to have been involved in \$2 billion worth of transactions. We are very concerned that it does not appear as though the ATO or the Government has any intention of pursuing this claim about the alleged promoters.

It is an outrage that some high income earners have avoided paying tax on contributions, fund earnings, (including the surcharge tax) in respect of non-complying superannuation funds both off-shore and on-shore. In some instances of off-shore funds this “laundered” money is then returned to Australia via round robin transactions, with no income tax being payable.

Accordingly, retrospective legislation to properly enforce the will of the Parliament against a small number of taxpayers who seek to take advantage of illegitimate loopholes to avoid their proper tax liabilities is the duty of legislators.

⁵ Evidence Mr N Petroulias 27 November 2000 page 18

⁶ Evidence Mr N Petroulias 27 November 2000 page 20

Labor Senators also note that one of the key drivers of the increasing popularity of these schemes is the fact that they allow exemption from the taxes that apply to legitimate superannuation arrangements.

Evidence from the ATO confirmed that these illegitimate schemes grew in popularity from 1997 onwards. We note that this is the time when the superannuation surcharge was introduced which punished legitimate superannuation members with a new tax liability of up to 15% of their contributions. No surcharge liability was imposed on these tax avoidance superannuation schemes.

The shortfall of \$130 million in initial collections of the surcharge, can clearly be directly linked to the increase in participation in superannuation tax avoidance schemes.

Labor Senators are also concerned about the apparent anomaly in the law which prevents Tax Office personnel from publicly disclosing the identity of the promoters of these tax avoidance products. Whilst proper secrecy provisions must obviously apply to taxpayer details, these provisions should not be available to shield the identity from the public of those who seek to profit by abuse of the taxation law.

Senator The Hon Nick Sherry (Deputy Chair)

On behalf of Labor Senators

