



27 October 2023

Mr Alan Raine
Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Mr Raine,

SMSF ASSOCIATION SUBMISSION – TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL 2023: NON-ARM'S LENGTH EXPENSE RULES FOR SUPERANNUATION FUNDS

The SMSF Association welcomes the opportunity to provide this submission in response to *Treasury Laws Amendment (Measures for Consultation) Bill 2023, Schedule 7: Non-arm's length expense of superannuation funds*. Successive amendments to the non-arm's length income rules in relation to non-arm's length expenses has created significant complexity, uncertainty, and unintended consequences.

The amendments contained in this schedule only address part of the problem, addressing only general fund expenses. There are many issues with the way the 2019 non-arm's length expenditure (NALE) provisions apply to specific fund investments, which are not addressed by these amendments. Significant issues also remain with the operation of the non-arm's length rules with respect to capital assets and associated capital gains.

All these issues could be addressed by repealing the 2019 NALE amendments to *Income Tax Assessment Act 1997 (Cth) (ITAA97) Subdivision 295-H*.

Excessive Regulation

Well established and effective compliance levers are present within the taxation and superannuation compliance frameworks. These are further supported through rulings and guidance published by the Commissioner of Taxation and associated compliance activities. The amendments contained in the Bill will create distortions and an unlevel playing field between different segments of the superannuation industry. They will add to complexity, increase cost and create unnecessary red tape particularly for the SMSF sector. We also note that if this Bill were to pass in its current form, yet further changes will be needed to address the outstanding operative issues and concerns.

The stated policy rationale for introduction of the 2019 amendments was to address concerns regarding certain related party limited recourse borrowings arrangements (LRBAs). This was despite the Australian Taxation Office (ATO), as regulator for the SMSF sector, having already addressed that concern.

The publication of the ATO's Practical Compliance Guidelines PCG 2016/5 *Income tax - arm's length terms for Limited Recourse Borrowing Arrangements established by self-managed superannuation funds*, and the safe harbour terms for arm's length dealing, has achieved its objective in ensuring that related party LRBAs are conducted on arm's length terms. Arrangements outside the Commissioner's guidelines that do not sufficiently and appropriately substantiate an arm's length arrangement will result in the application of non-arm's length income (NALI). PCG 2016/5 has been very successful in achieving its objectives and the desired compliance outcomes.

Prior to the introduction of NALE, well established principles and Commissioner guidance required the non-arm's length element of an expense (revenue or capital) to be recognised as a contribution.¹ This ensured that the correct value was recorded in the fund's accounts and the contribution rules were applied and tested against the member's available contribution cap. It also acted as a contribution integrity measure, ensuring that the contribution caps could not be avoided. Contributions that exceed the applicable cap will trigger taxation consequences.

Strict contribution caps apply to both the concessional and non-concessional contributions. Noting, that a person's non-concessional contributions (NCC) cap is also subject to a total superannuation balance (TSB) test.

Members with a TSB equal to or exceeding the general transfer balance cap as at 30 June of the previous financial year will have a NCC cap of nil. Any resulting contribution will automatically be an excess contribution. An excess NCC not withdrawn from the fund, will be subject to tax at the rate of 47 per cent.²

The operation of the contribution caps ensures that any non-arm's length elements are accounted for and addressed. Including a penalty element where contributions exceed the member's contribution cap (which may be nil).

Taxation of Capital Gains as NALI

The Commissioner of Taxation's recent release of draft Tax Determination *TD 2023/D1 Income tax: how the non-arm's length income and capital gains tax provisions interact to determine the amount of statutory income that is non-arm's length income*, has highlighted a significant issue arising from the misalignment of the NALI/NALE provisions and the calculation, treatment, and classification of capital gains as statutory income.

The operation of the current law risks tainting arm's length capital gains received during an income year as NALI, if the fund has also received NALI in that same income year. . This is clearly an unintended consequence. An urgent legislative solution is required to remediate this outcome, and to allow for the apportionment of capital gains, separately recognising the proportion of the net assessable capital gains that are not arm's length income.

We look forward to continuing our dialogue with the ATO and Treasury in seeking an appropriate legislative solution. A solution is needed as a matter of urgency.

¹ Australian Taxation Office, *Income Tax: Superannuation Contributions* (TR 2010/1, 24 October 2012).

² *Superannuation (Excess Non-Concessional Contributions Tax) Act 2007* (Cth) s 5.



Specific Expenses

For SMSFs, the proposed amendments do not address the severity of the NALI rules in relation to specific investments. This remains a significant issue for the SMSF sector. With the proposed amendments an opportunity exists now to address a range of disproportionate outcomes that can arise under the current law.

For example, under the current law, a small capital expense (for instance an expense relating to the repair of a property) can taint the entire capital gain derived by the fund when the asset to which the specific NALE relates is eventually sold. This will have retrospective application when we consider the accrued capital gains over the life of the asset prior to the incurrence of the expense. Further, it risks tainting gains accrued prior to the introduction of the NALE provisions.

A practical and equitable solution is urgently needed. A method that allows for a proportionate approach to be taken is required.

Remediation

The NALI/NALE provisions fail to include the ability for a fund to remediate immaterial and/or inadvertent breaches. In appropriate circumstances, for expenses that related to a specific fund investment, Trustees should be given the opportunity to rectify the breach by “making good” the expense shortfall amount. Under this approach the income received from the asset to which the NALE relates could still be taxed as NALI up until the income year in which the NALE is rectified.

We support the inclusion of anti-avoidance measures that seek to address deliberate, and substantive schemes to avoid tax, the contribution caps, and the operation of other compliance measures. However, any attempts to address this must be targeted and proportionate.

Enabling trustees to remedy inadvertent or minor breaches is consistent with other tax integrity and superannuation compliance measures.

Lack of Neutrality

The proposed amendments seek to treat some participants of the sector with an uneven hand. The express exclusion of large APRA funds lacks equity and sector neutrality.

The lack of sector neutrality is inconsistent with existing measures and current Government policy proposals with regards to superannuation.

A workable, legislative solution is needed for the whole superannuation sector. It is poor policy design to provide a commercial advantage to one segment of the market and then apply significant, punitive measures to another, on what is tantamount to the same behaviour.

Urgent Need for Reform

The 2019 amendments have added significant complexity with far-reaching consequences well beyond the original policy intent. We understand the need for important anti-avoidance measures. However, the application of these measures extends well beyond those bounds.

The superannuation sector requires a legislative solution to address the broad, unintended impacts of the current provisions. Noting the Commissioner’s temporary non-compliance approach as set out in Practical Compliance Guideline *PCG 2020/5 Applying the non-arm’s length income provisions to ‘non*



arm's length expenditure' - ATO compliance approach for complying superannuation entities, ceased on 30 June 2023.

The proposed amendments are a vast improvement on the current law, and we thank the Government for a solution which breaks the nexus between general NALE, and income derived by the fund. However, it remains our view that all the 2019 NALE amendments should be repealed for all funds. Given the existing compliance frameworks present in the superannuation and taxation compliance legislation, the risks associated with NALE are insignificant and the likely outcomes innocuous.

Should the 2019 NALE amendments not be repealed for all funds, and the Bill proceeds with these proposed amendments, it will be critically important that the proposed amendments are broadened to address disproportionate outcomes arising from specific NALE, and inconsistencies in the way the CGT provisions interact with NALI. Failure to do this now, will ultimately require further amendments to the NALI provisions, and a further period of confusion, complexity, and uncertainty for both Industry and Regulators.

If you have any questions about our submission, please do not hesitate to contact us. We look forward to further discussing our submission with the Committee, and for the opportunity to continue our discussions with Treasury and Government.

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of 1.1 million SMSF members and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education resources for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners, and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF members and provides them access to independent education materials to assist them in the running of their SMSF.