3 September 2021

Senator the Hon Jane Hume
Minister for Superannuation, Financial Services and the Digital Economy
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: senator.hume@aph.gov.au

Cc The Hon J Frydenberg Treasurer
The Hon M Sukkar, Assistant Treasurer
Ms Lynn Kelly, Retirement Advice and Investment Division, Treasury

Dear Senator,

Joint Submission: Superannuation Non-Arm's Length Income Rules

Chartered Accountants Australia and New Zealand, CPA Australia, the Institute of Public Accountants, The Tax Institute, the SMSF Association, the National Tax and Accountants Association, the Australian Superannuation Funds Association, the Actuaries Institute, Self-Managed Independent Superannuation Funds Association, the Financial Planning Association of Australia, and Tax & Super Australia (together **the Joint Bodies**) write to you as the peak professional accounting, tax, actuarial and superannuation bodies in Australia representing both large APRA and small superannuation funds (e.g. SMSFs and small APRA Funds with no more than 6 members).

Issue to be addressed

The introduction of the non-arm's length expenditure (**NALE**) rules,[1] and the ATO's interpretation of these rules, as published in the recently finalised Law Companion Ruling LCR 2021/2, will have far reaching and, it is submitted, significant harmful consequences; it is difficult to imagine that such outcomes were intended. These rules apply with effect from 1 July 2018, including with respect to income derived as a result of an arrangement entered into prior to that date.[2]

We note that even the ATO's final ruling itself at [91] states:

---

[1] *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019*.

[2] Given the potentially severe consequences of the new law, the ATO has allowed a grace period in practical compliance guide PCG 2020/5. The ATO will not allocate compliance resources to determining whether the NALI general expenditure rule applies to the 2021-22 and earlier years.

Nevertheless, the Commissioner is alive to concerns that a finding that general fund expenses are non-arm's length is likely to have a very significant tax impact on the complying superannuation fund, even where the relevant expenses are immaterial.

While the Joint Bodies have a number of issues with the reach of these provisions, our overarching concern is that the ATO's interpretation of the law means that, rather than merely addressing the mischief at which the government policy was directed, the rules could result in unwarranted significant and long-term detriment to fund members and could operate in conflict with a range of trustee obligations such as the best financial interests duty (**BFID**) rule in the *Superannuation Industry (Supervision) Act 1993* (Cth).

For example, unallocated expenses (no matter how minor in nature), that are incurred on a non-arm's length basis, will generally trigger non-arm's length income (**NALI**) tax (currently 45%) on all of the income of the superannuation fund for that particular year. In an SMSF context, a non-allocated expense of $1,000 that is not charged for, or is undercharged, in a financial year the SMSF derives $100,000 in assessable income, will result in $45,000 of tax for the SMSF. That is, by not paying $1,000, the SMSF incurs additional tax of up to $45,000.[3] In the Joint Bodies' view, such an outcome is both unintended and disproportionate.

In a large APRA fund context, the application of the ATO's interpretation of the rules at least conceptually could give rise to extremely large increases in funds' tax liabilities. If a large APRA fund's usual tax liability (for contributions income and investment income combined) was $1 billion in a particular tax year, the incurrence of a $1,000,000 general expense to a related entity of the fund — where it was subsequently determined that an arm's length amount should have been $1,500,000 — could give rise to an increase in this tax liability from $1 billion (at the usual superannuation fund rate of 15%) to $3 billion (at the NALI tax rate of 45%). Again, in the Joint Bodies' collective view, such an outcome is disproportionate and significantly harmful to the retirement outcomes for members.

While the ATO notes in LCR 2021/2 that it would not expect the rules to apply to the ordinary operations of large APRA funds, the *mere existence* of these potentially catastrophic consequences is likely to add significant complexity and costs to funds' operations in seeking to avoid any possible risk that the rules could apply. Ultimately these costs will be borne by the members of the funds. The NALI consequences are also contrary to the fund trustee's BFID where trustees are broadly required to minimise expenses with a reverse onus on trustees to prove that each expense has been in beneficiaries' best financial interest.

A number of the Joint Bodies have been working for several years seeking an appropriate response from the ATO in relation to its ruling and guidance process, without success.

Request for legislative amendments

Given the significant impact these rules may have on retirement savings, the Joint Bodies ask that the Government make an announcement that they will review the NALI rules in section 295-550 of the *Income Tax Assessment Act 1997* (Cth) and encourage the ATO to provide further administrative relief until this review and relevant amendments to the legislation are enacted (retrospectively to the original starting date of 1 July 2018).

Such announcement would:

---

[3] The additional tax will range from $30,000 to $45,000 depending on whether the superannuation fund is in pension phase and/or whether the income includes discounted capital gains.

- exclude arrangements where the other party(ies) to the transaction with the fund do not include a fund member or an associated person of a fund member;
- ensure that the potential for general expenses to taint all the income of the fund at the NALI tax rate ceases to apply;
- ensure that the NALI rule operate in a manner which is more consistent with other anti-avoidance provisions, thus ensuring the application of the rule is proportionate to the problem to be addressed; and
- provide the trustee with an opportunity to correct unintended errors.

The Joint Bodies are currently working with the Retirement Income Division within the Department of Treasury on the issue.

We would welcome the opportunity to discuss this important issue further with you. If you are willing, please contact The Tax Institute's Director, Andrew Mills on (02) 8223 0005.

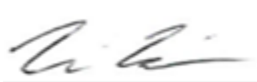
Yours faithfully,

Simon Grant
Group Executive – Advocacy & International
Chartered Accountants Australia and New Zealand

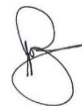
Dr Gary Pflugrath
Executive General Manager, Policy & Advocacy
CPA Australia

Tony Greco
General Manager Technical Policy
Institute of Public Accountants

Peter Godber
President
The Tax Institute



Julian Cabarrus
Director – Policy Operations, Member Engagement & External Relation



Peter Burgess
Deputy CEO
SMSF Association

Australian Superannuation Funds Association

Geoff Boxer CEO
National Tax and Accountants Association

Michael Lorimer
Managing Director
Self-managed Independent Superannuation Funds Association

Benjamin Marshan
Head of Policy
Financial Planning Association of Australia

Pippa McKee
Chief Executive Officer
Tax & Super Australia

Tim Jenkins, Convenor
Superannuation & Investments Practice Committee
Actuaries Institute