



7 July 2023

Retirement, Advice and Investment Division  
Treasury  
Langton Cres  
Parkes ACT 2600

Email: [superannuation@treasury.gov.au](mailto:superannuation@treasury.gov.au)

Dear Sir/Madam,

**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 the Government's exposure draft legislation on the non-arm's length expense rules for superannuation funds. Despite these proposed amendments, concerns on unintended consequences remain. The live issues surrounding general expenses of a capital nature, specific expenses and capital gains are not considered in this Bill.

As a matter of urgency, the entire superannuation sector needs a solution to remediate the far reaching, unintended consequences present in the existing non-arm's length expenditure (NALE) provisions. These would be best served with the repeal of 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. These amendments create further duplication in regulation, increasing complexity and red tape for all stakeholders. The desire to proceed with the 2019 amendments and continued amendments to these provisions mean unintended outcomes persist. Noting 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 (LRBAs). This was despite the Australian Taxation Office, as regulator for the SMSF sector, having already addressed that concern.

The publication in of 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.<sup>1</sup> This ensured that the correct value was recorded in the fund's accounts and the contribution rules were applied and tested against the members 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.

A person's non-concessional contributions (NCC) cap are 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 a 47% rate of tax.<sup>2</sup>

### General Expenses - Capital

The exposure draft does not address general expenses that are capital in nature. This exposes all of a fund's income to NALE.

Expenses such as a deed update may be either revenue or capital in nature. Broadly, what would be an immaterial and relatively small cost forgone to the fund, could result in all the fund income being taxed as NALI at 45%.

We refer to the Commissioners Taxation Ruling *TR 93/17 Income tax: income tax deductions available to superannuation funds* paragraph 5(e) states that *"the cost of amending trust deeds are allowable as a deduction provided the expenditure is not of a capital nature."*

Paragraph 23(e) further states *"The costs incurred by a trustee of a superannuation fund in amending the fund's trust deed are, as a general rule, not deductible because they are expenses of a capital nature."*

Other examples could include software acquired by the fund for its administration, share trading, or investment management.

Expenses of this nature fall outside the proposed amendments in this exposure draft. The risk that the whole of a fund's income may be classed as NALI therefore remains. This is an undesirable outcome.

### 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 serious 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 will risk tainting arm's length capital gains that occur in the same year as one that is not at arm's length. 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,

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

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



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 Treasury in seeking an appropriate legislative solution.

### 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 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 capital repair to property during the holding period or when preparing it for sale is an example of such an expense. This differs significantly to a circumstance where, under a scheme, an asset at first instance was not acquired at market value.

A practical and equitable solution is urgently needed. A method that allows for a proportionate approach to be taken must be considered where the non-arm's length element represents only a part of the overall value.

### 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 or the operation of other compliance measures. However, any attempts to address this must be targeted and proportionate.

### 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.

A workable, legislative solution is needed for the whole of the superannuation sector.

### 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 Commissioners 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 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 Government proceeds with the proposed amendments, it will be critically important that the proposed amendments are broadened to address disproportionate outcomes arising from specific NALE and general NALE which is capital in nature, 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 and uncertainty for Industry and Regulators.

If you have any questions about our submission, please do not hesitate to contact us. We look forward to 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 over 1.13 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.