The Tax Institute

6 February 2025

Ms Bonita Tsang
Director
Complex Technical Unit
Superannuation and Employer Obligations
Australian Taxation Office

By email: PAGSEO@ato.gov.au

Dear Ms Tsang,

ATO consultation on TR 2010/DC2 and LCR 2021/DC2

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to the draft Taxation Ruling TR 2010/DC2 *Income tax: superannuation contributions* (**draft TR**) and draft Law Companion Ruling LCR 2021/DC2 *Non-arm's length income - expenditure incurred under a non-arm's length arrangement* (**draft LCR**) (collectively, **the draft guidance**).

In the development of this submission, we have closely consulted with our National Superannuation Technical Committee to prepare a considered response that represents the views of the broader membership of The Tax Institute (**TTI**). Our committee members have considerable practical experience in dealing with and advising on taxation issues arising from non-arm's length income (**NALI**) and non-arm's length expenditure (**NALE**) matters.

We have also reviewed a copy of the submission by Chartered Accountants Australia and New Zealand, CPA Australia, and other professional bodies dated 24 January 2024 (**Joint Bodies' Submission**). We agree with and endorse the Joint Bodies' Submission.

The Tax Institute and its members remain committed to seeking changes and improvements to the law and ATO guidance materials on NALI/E and our submission should not be construed as endorsing the current state of affairs. The Tax Institute and numerous other professional and industry bodies have made many submissions in recent years expressing widespread concerns that the NALI/E provisions and current ATO views reflected in its guidance materials, among other things, can result in disproportionate tax outcomes, and should provide greater discretion to the ATO to deal with honest and inadvertent oversights. Our detailed response and recommendations to further improve the draft guidance are contained in **Appendix A**.

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The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact our Head of Tax & Legal, Julie Abdalla, at (02) 8223 0058.

Yours faithfully,

Julie Abdalla
Head of Tax & Legal

Tim Sandow
President

APPENDIX A

We have set out below our detailed comments and observations on the draft guidance for your consideration.

Preliminary comments

De minimis threshold

We recognise that the setting of a *de minimis* threshold for NALI is generally a policy decision. However, the Commissioner may exercise his remedial powers to establish such a threshold, and in our view, it is important to have such a safe harbour in place. Otherwise, even a $1 discount could trigger NALE and result in serious disproportionate consequences for a fund. We note that this does not only unfairly impact taxpayers. Without a safe harbour, the administrative costs of the ATO could rise significantly. This has broader implications for the system as a whole.

Clarifying the distinction between contributions and NALI/E

The draft guidance lacks a clear delineation between contributions and NALE. Historically, the ATO has regarded payments made on behalf of a fund, including a discount on an employee share ownership plan (**ESOP**), as contributions. In practice, expenses incurred on behalf of a fund often go unrecognised until a later financial year when they are reported in the financial statements as sundry creditors. Based on feedback received from our members, there is a genuine concern that self-managed superannuation fund (**SMSF**) auditors and the ATO may consider such amounts as invoking NALE. Accordingly, we are of the view that further guidance from the ATO is necessary to clarify the treatment of the expenses incurred on behalf of the fund and that guidance added to both the draft TR and draft LCR must be consistent.

TR 2010/1DC2 - Superannuation Contributions

Transferring an existing asset (*in specie* contribution)

Paragraphs 20 to 24 of the draft TR deal with the transfer of beneficial ownership of an existing asset. The lack of clarity on conditions surrounding the trigger for the transfer of beneficial ownership across various asset types creates ambiguity. For example, paragraph 22 indicates that legal ownership of publicly listed shares is transferred upon the superannuation provider's registration as the owner, while beneficial ownership may occur before this registration.

Conversely, paragraph 24 states that beneficial ownership of shares or units in an Australian Securities Exchange-listed entity is acquired by the superannuation provider only upon receiving a properly executed off-market share transfer in registrable form. Feedback from our members indicates that when a trustee decides to conduct an off-market transfer to acquire an asset, the date of beneficial ownership change should be documented in the trustee resolution. The requirement in paragraph 24 relates to the legal ownership transfer registration process, raising questions about how this prerequisite, which is simply a step before registration, can be considered a trigger for a change in beneficial ownership of the asset.

It is a well-accepted legal position that at the settlement of a transaction, the transferor must provide the transferee with all necessary documentation to facilitate the registration of legal title transfer. For example, in non-PEXA land transfers, the transferor would provide to the transferee at settlement, the title, a signed transfer of land document, and, if applicable, a discharge of mortgage. At that time, the transferee assumes beneficial ownership and possession of the land, notwithstanding that the legal title remains in the name of the transferor. That is, at the time of settlement, the beneficial interest in the asset transfer to the transferee notwithstanding that the transferor is still the registered proprietor of the legal title which will be subsequently transferred to the transferee.

It is noted that delays may occur in the transfer of legal title, depending on factors such as the time it takes for the particular register of the legal titles to effect that transfer, and/or for it to be reviewed by the relevant title registry or state revenue office.

Therefore, when a trustee resolves to execute an off-market transfer to acquire an asset, the date for the change in beneficial ownership change should be reflected in the trustee resolution. The filing of Registry paperwork is part of the implementation process and provides for the change in legal ownership.

To address this issue, a control mechanism could be inserted to ensure any time delay between the trustee resolution, the execution of the off-market transfer form, and the registration of the transfer of legal title should be effected in a reasonable time.

Increasing the value of, or shifting value to, an asset owned by the superannuation provider

Paragraphs 32 to 32B are limited and lack the detail needed to understand the topic. Taxpayers and advisers alike may be left with uncertainty about the specific points being addressed.

A reference to the draft LCR should be incorporated into the draft TR to enhance clarity and guide readers seeking additional information. In the alternative, we recommend amending the draft TR to include more detailed information.

LCR 2021/2DC - Non-arm's length income – expenditure incurred under a non-arm's length arrangement

Preliminary comments

We have concerns that there is an overall lack of clarity and detail in the draft LCR. There are limited examples of technical analysis or apparent references to legal principles, including case law or other authority to support the views taken.

Application of draft LCR

Paragraph 8B of the draft LCR states that:

> 8B. The non-arm's length expenditure provisions do not apply to expenditure incurred or expected to have been incurred before 1 July 2018.

This necessitates clarification regarding the draft LCR's applicability to that prior period. It should explicitly address the circumstances of non-arm's length acquisitions that occurred before 1 July 2018 but were subsequently sold on an arm's length basis after this date. For example, if an asset valued at $20,000 is acquired for $10,000 (50% of its market value) before 1 July 2018, it is important to clarify whether the non-arm's length expenditure provisions would apply to the subsequent sale of that asset, provided that all related transactions were conducted at arm's length.

In addition, it would be beneficial to many SMSFs for the ATO to provide guidance through an example where an SMSF has invested in a unit trust that continually issued units at a fixed price of $1 prior to 1 July 2018, despite the net tangible asset (**NTA**) value behind the unit trust increasing in value. In certain cases, where the unit trust is 100% owned by the SMSF, the issue of units at $1 rather than the NTA may have been due to an oversight. Guidance on the applicability of the NALE provisions in these circumstances would be beneficial.

Further, the draft LCR should address whether non-arm's length transactions can be rectified, specifically if subsequent payments or reimbursements of expenses can effectively 'untaint' the income. If such rectification is not permissible, an explanation should be provided. Although we recognise that delayed payments may contravene other provisions of the *Superannuation Industry (Supervision) Act 1993* (Cth), such as those related to arm's length dealings or separation of assets, it is our view that rectification could resolve issues pertaining to NALI and NALE.

The terms 'arm's length' and 'market value'

The draft LCR references concepts such as 'arm's length' and 'market value'; however, neither term is defined or fixed. Rather, these terms encompass a variety of ranges and factors.

For example, when an asset valuation is undertaken, there will be differences in the amounts, and potentially the supporting reasons or analysis undertaken to arrive at a particular valuation or range of values. Paragraph 3.49 of the Explanatory Memorandum to the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2019 recognises the challenges in determining a 'non-arm's length' price.

> 3.49 It can be difficult to determine an exact price that is 'non-arm's length'. An 'arm's length' price may be accepted to fall within a range of commercial prices. For example, loans may be available at different interest rates based on a range of factors. Accordingly, an SMSF may be able to apply an acceptable commercial rate of interest to a loan within a band of rates available to it on an arm's length basis.

Valuers typically provide a range of values; for example, a property's value may be determined to be between $1 million and $1.4 million, rather than being assigned a specific value. Further, arm's length transactions can vary significantly with different terms and conditions, sometimes lacking clear, formal documentation. It would be beneficial for the ATO to provide guidance on these matters. This would have the additional benefit of providing direction for ATO officers who may not necessarily have sufficient practical experience in commercial or private industry contexts.

Additionally, substantiating transactions with adequate evidence can be challenging. It would be helpful for the draft LCR to clarify whether the ATO considers there is any difference between the documentation requirements for related party and arm's length transactions, and if so, what such requirements are.

Fundamental framework of NALI/E

Understanding the fundamental framework for applying the NALI/E provisions requires clarity on several factors, including the difference between:

- general and specific expenses;
- capital and revenue expenses;
- pre-acquisition and post-acquisition expenses relating to an asset; and
- general expenses and those tax-deductible under section 25-5 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**).

Given the potential for various combinations of these expenses, guidance and additional examples from the ATO would be beneficial in navigating these complexities.

Paragraph 69 in Example 9 of the draft LCR indicates that renovations to Trang's SMSF rental property categorised as a post-acquisition expense on a capital account, taint the capital gain on disposal. However, such a clarification is absent in Paragraph 75 of Example 11 in the draft LCR. It would be beneficial to expressly confirm that a post-acquisition expense on revenue account does not taint the capital gain on disposal.

We note that paragraph 19 of the draft LCR includes the following as examples of general expenses:

- actuarial costs – except those incurred in complying with, or managing, the fund's income tax affairs and obligations (for example, Subdivision 295-F) which are ordinarily deductible under section 25-5; and
- accountancy fees – except those incurred in complying with, or managing, the fund's income tax affairs and obligations (for example, Subdivision 295-F) which are ordinarily deductible under section 25-5.

Based on feedback received from our members, we understand that prior communications from the ATO indicated that tax-related expenses do not result in tainting in the same way that general expenses would generally result in tainting (assuming the 2024 amendments were not enacted). In this regard, clarifying the ATO's views on the different treatment of a tax-related expense of a general nature compared to other general expenses would be beneficial.

Purchase of an asset under a non-arm's length arrangement

When a trustee of an SMSF acquires an asset using both cash and *in specie* member contributions, several commercial issues arise. As specified in paragraph 29 of the draft LCR, an *in specie* contribution can occur simultaneously with an SMSF purchasing a portion of an asset, as long as the contract specifies that the SMSF is acquiring only a portion of the asset. This clarifies that the SMSF possesses only a partial interest in the asset, which raises stamp duty and other considerations.

For stamp duty assessments, the entire market value of the property is considered, leading to questions about stamp duty liability when the SMSF is only a partial legal owner. To minimise potential complications under various legal frameworks, two separate contracts should be created, one for the cash transaction and another for the *in specie* contribution, instead of relying on a single contract between the seller and the SMSF trustee.

Services provided by the Trustee in other capacities

We recommend that additional examples are included in the draft LCR to clarify the distinction between actions taken in an individual capacity versus those undertaken as a trustee, particularly in scenarios where a trustee/director/member of an SMSF is also involved in an entity in which the SMSF invests, such as a private company or unit trust.

Also, we suggest that additional examples providing clarity as to understand whether a minor utilisation of a professional qualification or license could lead to NALE are included in the draft LCR. For example, if an accountant prepares accounts during their personal time with minimal use of business resources and the SMSF does not incur any fee, it would be helpful to confirm that if the lodgement made through their firm’s tax agent registration, it would not give rise to NALE.

Example 7 of the draft LCR at paragraph 56 illustrates Levi's situation, where he performs bookkeeping and occasionally executes online investments for his SMSF using business-provided resources. We understand that financial planning firms have valuable software resources and licences to make investments. Example 7 appears to understate the potential value Levi contributes through his business resources, as even infrequent investments could involve substantial sums. We consider that there is no material distinction between an accountant lodging a tax return via a tax agent's software and Levi's investment activities. This merely highlights one example of the complexities that arise when seeking to consider the services provided. Therefore, to address the uncertainty in Example 6 of the draft LCR, further explanation should be provided about Leonie's involvement in preparing the accounts and annual return for the SMSF even if she lodges via the tax agent’s portal.

Example 9 of the draft LCR illustrates a scenario in which Trang, a plumber, undertakes renovations on the kitchen and bathroom of a rental property held as a rental property in her SMSF. This taints the net rental income from the property, and any future capital gain that may only be realised several decades later will be subject to a penal 45% tax rate. In reality, many individuals like Trang may undertake renovations without any knowledge of these complex provisions, while seeking to provide for their retirement without seeking to exploit the system.

The creation of an SMSF to accumulate superannuation is often motivated by individual investment strategies shaped by personal experiences and professional backgrounds. In this context, we are of the view that Example 9 is impractical. If Levi, as illustrated in Example 7, is allowed to make occasional contributions to his SMSF portfolio as a trustee without the application of NALI provisions, it raises a question regarding why Trang, in Example 9, is restricted from conducting a bathroom renovation on a fund asset in her capacity as a trustee. Given that Trang is unlikely to engage in such renovations regularly, the associated costs would be incorporated into the asset's cost base. If her labour is to be considered, the market value of the service provided should be treated as a cost base adjustment.

Discount policy

Paragraph 51 of the draft LCR currently provides:

> A small complying superannuation fund might enter into arrangements that result in it receiving discounted prices. Such arrangements will still be on arm's length terms where they are consistent with normal commercial practices, such as an individual acting in their capacity as trustee (or a director of a corporate trustee) being entitled to a discount under a discount policy where the same discounts are provided to *all* employees, partners, shareholders or office holders.

Requiring 'all' members of a specific group, such as employees, officers or partners, does not reflect typical arm's length commercial practices, is not supported by law, and sets an unrealistic standard. For example, many ESOPs only mandate a certain participation level, like an offer to at least 75% of permanent employees as per Division 83A of the ITAA 1997.

Further, we consider that the sentence regarding the trustee's influence on the discount policy should be removed from paragraph 51 and Example 8. Small businesses, particularly those where an SMSF trustee/director is a sole director of the business may find it challenging to demonstrate that they cannot influence a discount policy. In any case, there is no context to the influence, i.e., it is not a material or significant influence, but seemingly any influence, which may be insignificant or minor. While directors typically have some influence, that does not necessarily mean that they can implement or effect a discount policy. This addition is unnecessary and is not supported by law or arm's length commercial practices.

We consider that if the discount policy is consistent with standard commercial practices and is appropriately benchmarked, the trustee's influence should not be a concern or relevant factor to take into consideration. If the sentence should remain, we recommend the ATO clarifies whether the mere decision to implement a discount policy is sufficient to demonstrate influence, noting that this would effectively preclude any trustee from implementing a discount policy where they own and operate a small business as a sole proprietor.

Further, referring to an ESOP arrangement where a member obtains a discount, it would be helpful if the ATO could clarify whether this discount would trigger NALE, or if there are grounds where that discount would not give rise to NALE. In particular, it appears that an SMSF that purchases an asset like a share at a discount will result in all future dividends and net capital gain on disposal being NALI and broadly taxed at 45%.

Additionally, it would be helpful if the ATO could clarify whether an interest in an ESOP, such as shares or securities that is only offered to an employee (including a director), would constitute NALE, given that an arm's length party cannot acquire such shares. We consider that the better view is that the ESOP arrangement is at arm's length as the discount is offered to a relatively significant spread of employees on an arm's length basis, and this is consistent with ESOPs offered by other employers.

Cost recovery

The elaboration on cost recovery in paragraph 53 is, in our view, is very broad and should be removed. Cost recovery is used in various industries, including architecture, building and construction, and various trades. We consider that the inclusion of this paragraph is inappropriate, and it is unnecessary to connect it explicitly to paragraph 51, which can apply without express reference.

Practical Compliance Guideline

We consider a Practical Compliance Guideline (**PCG**) would provide helpful guidance on how ATO compliance resources will be allocated to address the above and other related issues. We would be pleased to work with the ATO on suitable matters to be addressed in any such PCG.

Without practical administration of NALI/E matters, we expect the administrative costs for all funds will rise. This is likely to lead to increased ATO resources being required to deal with potentially minor and trivial issues, as auditors may be compelled to qualify more annual reports. In such cases, the administrative costs associated with managing NALE will likely surpass the tax revenue generated.

We commend the ATO on its earlier guidance contained in Practical Compliance Guideline PCG 2016/5: *Income Tax: arm's length terms for Limited Recourse Borrowing Arrangements established by self-managed superannuation funds* (**PCG 2016/5**), in relation to limited recourse borrowing arrangements (**LRBAs**). PCG 2016/5 has provided clear guidance in relation to related party LRBAs and has assisted the SMSF sector and its advisers to understand the interaction between arm's length and non-arm's length LRBAs.

Resolving minor or insignificant errors

The draft LCR or alternatively, a new PCG, should address scenarios in which the ATO may offer administrative leniency to allow taxpayers to rectify minor or immaterial errors or oversights that might otherwise give rise to NALI/E issues. For example, where an asset is purchased at less than its market value, recording an *in specie* contribution for the balance would be a practical and efficient solution to resolve such issues.

Further examples

We are of the view that there is significant value in including additional examples addressing the topics and scenarios considered above. In addition, it would be helpful to provide examples dealing with cases where:

- SMSFs experience reduced income and whether it is classified as NALE. For example, when income derived from a related party lease is not indexed; and
- an expense is paid on behalf of a fund. For example, whether fees paid by a member relating to documents setting up an SMSF and the corporate trustee constitute NALE.