

Chapter 1

Introduction

1.1 Pursuant to a resolution of the Senate on 9 May 2018,¹ the Senate on 24 May 2018 referred the provisions of the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018 (the bill) to the Economics Legislation Committee for inquiry and report by 18 June 2018.

Conduct of the inquiry

1.2 The committee advertised the inquiry on its website. It also wrote to relevant stakeholders and interested parties inviting submissions by 6 June 2018. The committee received 11 submissions, which are listed at Appendix 1.

1.3 The committee held a public hearing in Canberra on 12 June 2018. The names of witnesses who appeared at the hearing are at Appendix 2.

1.4 Hansard references throughout this document relate to the Proof Hansard. Please note that page numbering may differ between the proof and final Hansard.

1.5 The committee thanks all individuals and organisations that contributed to the inquiry.

Overview of the bill

1.6 Schedule 1 of the bill provides for a year-long amnesty for employers who voluntarily report past shortfalls in payments of the superannuation guarantee (SG) to their employees.

1.7 Schedule 2 allows individuals to avoid unintentionally breaching their concessional contributions cap when they receive superannuation contributions from multiple employers by allowing them to apply to the Commissioner for an 'employer shortfall exemption certificate', which prevents their employer from having a superannuation guarantee shortfall if they do not make superannuation contributions for that individual for a period.

1.8 Schedule 2 allows individuals to avoid unintentionally breaching their concessional contributions cap when they receive superannuation contributions from multiple employers by allowing them to apply to the Commissioner for an 'employer shortfall exemption certificate', which prevents their employer from having a superannuation guarantee shortfall if they do not make superannuation contributions for that individual for a period.

1.9 Schedule 3 provides that the non-arm's length income rules for superannuation entities apply in situations where a superannuation entity incurs non-arm's length expenses in gaining or producing the income.

1 *Journals of the Senate No. 96, 24 May 2018, p. 3069.*

1.10 Schedule 4 amends the total superannuation balance rules to ensure that, in certain circumstances involving limited recourse borrowing arrangements, the total value of a superannuation fund's assets is taken into account in working out individual members' total superannuation balances.

Financial impact

1.11 According to the Explanatory Memorandum, the measure in Schedule 1 is expected to result in a gain to revenue of \$101 million.

1.12 Treasury estimates that the amnesty will result in the collection of a further \$230 million of employee's superannuation entitlements, over and above what would have been collected without the amnesty through usual compliance activities.²

1.13 The treatment of non-arm's length transactions is expected to result in a gain to revenue of \$30 million over the forward estimates. The other measures have small positive impacts.

Background and content of the bill

Schedule 1: Superannuation Guarantee amnesty

1.14 Compulsory superannuation is provided for in the Superannuation Guarantee (Administration) Act 1992 (the SGAA). Under the SGAA, an employer who does not pay the prescribed minimum superannuation contribution into the employee's superannuation fund is liable to a tax (the SG charge) equal to the amount of the superannuation shortfall, plus interest, plus an administration charge. The Australian Taxation Office (ATO), which administers the SG, can impose additional penalties of up to 200 per cent of the super guarantee charge.

1.15 The superannuation shortfall amount and interest are paid by the ATO into the employee's superannuation account³

1.16 Interest is calculated at a simple rate of 10 per cent a year. This is a higher rate than the average returns on funds, but it does not compound.

1.17 The administration charge and any additional penalties are retained by the ATO and paid into consolidated revenue.

1.18 Unlike the payment of employee SG within prescribed timeframes, SG charge and penalties are not tax deductible.

1.19 The ATO estimates a gross shortfall in superannuation payments of \$3.26 billion in 2014–15 or about 5 per cent of contributions payable. This is reduced to \$2.85 billion by the \$414 million retrieved through ATO's compliance activities.⁴

2 Mr Robert Jeremenko, Division Head, Retirement Income Policy Division, Treasury, *Committee Hansard*, 12 June 2018, p. 30.

3 Explanatory Memorandum, p. 18.

4 Australian Taxation Office (ATO), *Super Guarantee System: Superannuation guarantee gap*, <https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/tax-gap/superannuation-guarantee-gap/?page=2> (accessed 5 June 2018).

1.20 There are current arrangements to encourage employers to report SG shortfalls, including reductions in penalties.

1.21 The ATO makes the following observations about reports of non-compliance:

- About 20,000 reports of unpaid super guarantee are made (by employees and former employees) to the ATO each year.
- Reports of unpaid super guarantee are received mostly from employees and former employees of small businesses.
- Non-compliance is reported more often about employers in accommodation and food services, construction, manufacturing and retail trade industries.
- Drivers of non-compliance include poor cash flow management by employers, poor record keeping and low levels of business experience.
- Insolvency amongst employers means that debts are sometimes difficult to collect on behalf of employees. Around 50% of collectable super guarantee charge debt is subject to insolvency.⁵

1.22 The Treasury Laws Amendment (2018 Measures No. 4) Bill 2018, which is before the Parliament, includes changes which are intended to improve compliance with the SGAA. Increased penalties including prison terms and improved collection tools, programs such as Single Touch Payroll being extended by the bill and more frequent reporting by superannuation funds being implemented by the ATO will make earlier detection of non-compliance possible.⁶

What the bill does

1.23 The bill provides a 12-month amnesty, dating from the introduction of the bill (24 May 2018), during which employers can rectify outstanding shortfalls for employees. On repaying the shortfall and interest owing, employers can then claim the tax deduction for payments made during the amnesty and have penalties and charges for non-payment reduced to zero.⁷

1.24 The amnesty is available only in respect of quarters up to and including the January 2018 to March 2018 quarter, and only to employers who voluntarily disclose the shortfall. It is not available to an employer who has already been informed that their compliance is being examined. It is available to any disclosure which results in an increased shortfall.⁸

1.25 The amnesty is available only to employers who voluntarily disclose the shortfall. It is not available to an employer who has already been informed that their

5 ATO, *Super Guarantee System, Superannuation guarantee gap*.

6 The Hon Kelly O'Dwyer, Minister for Revenue and Financial Services, *House of Representatives Hansard*, 28 March 2018, p. 3042.

7 Explanatory Memorandum, p. 10.

8 Explanatory Memorandum, pp. 10, 13.

compliance is being examined. It is available to any disclosure which results in an increased shortfall, for example relating to a different earnings quarter from the one being examined.⁹

1.26 The bill also provides that, where the ATO pays contributions recovered under the amnesty into the employee's account, the Commissioner can disregard the contributions cap, without the employee having to apply. If shortfall amounts are paid directly by the employer into the employee's fund, the employee can apply for the cap to be disregarded.¹⁰

1.27 There is also a provision to ensure that employees receiving shortfall payments are not disadvantaged with regard to their total taxable income.¹¹

1.28 The Explanatory Memorandum foreshadows that employers who are found to be in shortfall after the amnesty has expired will attract higher penalties if they could have taken advantage of the amnesty and did not.¹²

1.29 The amnesty provided for in this bill is a complement to the improved SG visibility, collection and enforcement measures contained in Treasury Laws Amendment (2018 Measures No. 4) Bill 2018. It is intended both to collect outstanding superannuation on behalf of employees and create a basis for improved compliance in the future.¹³

Schedule 2: Multiple employers and the concessional contributions cap

1.30 There is a cap on the amount of concessional superannuation contributions (that is, contributions taxed at 15 per cent rather than the individual's marginal rate) an individual make in any one year. From 1 July 2017 the cap is \$25 000.

1.31 Any concessional contributions above the cap are taxed at the individual's marginal rate, less a 15 per cent offset (representing the tax paid in the superannuation fund) and plus an interest charge to reflect the fact that the tax is collected later than it would normally be. At present the interest charge is around 4.75 per cent of the excess contributions a year.¹⁴ Individuals who breach their cap can choose to keep their excess contributions in their superannuation as a non-concessional contribution, or remove 85 per cent of the excess contributions.

1.32 Compulsory contributions paid by an individual employer to an employee under the SG regime are included in the employee's concessional contributions cap. The amount of compulsory contributions paid by an employer in respect of a single

9 Explanatory Memorandum, pp. 10, 13.

10 Explanatory Memorandum, p. 18.

11 Explanatory Memorandum, p. 19.

12 Explanatory Memorandum, p. 10.

13 Mr Robert Jeremenko, *Committee Hansard*, 12 June 2018, p. 30.

14 ATO, *Excess concessional contribution charge*, https://www.ato.gov.au/rates/key-superannuation-rates-and-thresholds/?page=4#Excess_concessional_contribution_charge (accessed 6 June 2018).

employee is capped so that the employee does not breach their concessional contributions cap.

1.33 However, this only operates in respect of individual employers. There is no mechanism to prevent a breach of an individual's concessional contributions cap as a result of multiple employers making compulsory contributions.

1.34 By way of example, an individual with two employers, each paying her \$150 000 a year, would receive compulsory superannuation contributions of \$14 250 a year from each. Taken alone these contributions are below the individual's concessional contributions cap, but together they total \$28 500. This amount would breach the individual's concessional contributions cap. However, each employer must make these contributions, as if they did not make the contribution, they would be in breach of their SG obligations under the SGAA.

What the bill does

1.35 The measure in Schedule 2 enables an employee to apply to the Commissioner of Taxation for a certificate for one or more of their employers, exempting that employers from having to pay the SG for that employee for a specified quarter. The assumption is that the employee will negotiate an alternative remuneration package, but there is no requirement that this must have happened.¹⁵ The existence of a shortfall exemption certificate does not prevent an employer from making contributions on behalf of that employee.¹⁶

1.36 It is up to the Commissioner to be sure that the individual is receiving superannuation contributions from at least one employer, but there is no specification as to the level of these contributions.¹⁷

1.37 An employee can make an application covering more than one employer and more than one quarter.¹⁸ However, the employee must have at least one employer making SG contributions on their behalf.

Schedule 3: Non-arm's length income rules

1.38 Because the favourable taxation treatment of superannuation creates an incentive to put as much money as possible into superannuation, transactions of superannuation funds are required to be at arm's length.

1.39 An arm's length transaction is where the buyers and sellers of a product act independently and do not have any relationship to each other. Each party would be acting in their own best interest.¹⁹

15 Explanatory Memorandum, p. 26.

16 Explanatory Memorandum, pp. 24–5.

17 Explanatory Memorandum, p. 27.

18 Explanatory Memorandum, p. 28.

19 Investopedia, *Arm's Length Transaction*, <https://www.investopedia.com/terms/a/armslength.asp> (accessed 6 June 2018).

1.40 The ATO says that income is non-arm's length income if the parties were not dealing with each other at arm's length, and the fund gains more than it would have if the parties had been dealing with each other at arm's length. Income derived by a fund as a beneficiary of a discretionary trust is non-arm's length income, as are dividends from a private company (unless the dividend is consistent with arm's length dealing).²⁰

1.41 The taxable income of a superannuation fund is generally taxed at 15 per cent. However, if the income is derived from a non-arm's length transaction, it is taxed at the top marginal rate.²¹

1.42 A fund's taxable income is affected by the amount of expenses (for example, interest payments) incurred in earning the income. These expenses also need to be at arm's length. This is provided for in Subdivision 295-H of the *Income Tax Assessment Act 1997*, but there is a concern that there is some ambiguity.

What the bill does

1.43 Schedule 3 of the bill amends subsection 295-550 of the *Income Tax Assessment Act 1997* to make clear that superannuation funds cannot circumvent the non-arm's length income rules by entering into schemes involving non-arm's length expenditure (including where expenses are not incurred).

1.44 Schedule 3 does so by inserting in the definitions of non-arm's length income more explicit references to 'loss, outgoing or expenditure' that is less than the entity might have been expected to incur, or 'loss, outgoing or expenditure' that is not incurred that the entity might have been expected to incur. These apply to income earned directly by a fund or received as beneficiary of a trust.

1.45 The new definitions apply to capital expenditure that results in revenue or capital gains.

1.46 The amendments apply to income for 2018–19 and future years, regardless of when the arrangement was entered into.

1.47 The amendments are aimed at ensuring that superannuation funds cannot circumvent the contribution caps by using non-arm's-length expenditure to inflate their overall income, for example, by borrowing money from a member at a reduced interest rate.²²

Schedule 4: Limited recourse borrowing arrangements

1.48 SMSFs are allowed to borrow, but only in very restricted circumstances. One form of borrowing that is allowed is through limited recourse borrowing arrangements. A limited recourse loan is a loan that is secured against a specific asset

20 ATO, *Non-arm's length income*, <https://www.ato.gov.au/super/self-managed-super-funds/investing/tax-on-income/non-arm-s-length-income/> (accessed 6 June 2018).

21 Explanatory Memorandum, p. 32.

22 The Hon Kelly O'Dwyer, Minister for Revenue and Financial Services, House of Representatives Hansard, 24 May 2018, p. 6.

only. In case of default, the lender would have a claim only on the specific asset, and not the other assets of the fund.²³

1.49 Reforms to the taxation of superannuation in 2016 introduced the concept of 'total superannuation balance', which is used to establish an individual's concessional and non-concessional contributions caps and eligibility for other measures such as the unused concessional cap carry forward and the spouse tax offset.²⁴

1.50 This has led to some SMSFs to attempt to utilise limited recourse loans to manipulate their total superannuation balance in order to retain contribution cap space and eligibility for certain measures.

What the bill does

1.51 Schedule 4 of the bill provides that, in a limited number of cases, for SMSFs or funds with fewer than five members, the value of the balance of a limited recourse loan that is attributable to an individual member of a fund will be included in the member's total superannuation balance. In effect, this means the total value of the asset will be counted, even though there is a loan outstanding against it. Without the amendment, the value of the asset would have been reduced by the loan outstanding against it, so the total superannuation balance would be lower.

1.52 The cases where the amendment applies are:

- where the limited recourse borrowing arrangement is between the fund and one of its associates; or
- where the member has satisfied a condition of release with a nil cashing restriction (that is, they are retired or have reached the age where they are able to withdraw their funds).

1.53 The application of the amendment is targeted to these situations only, as these are the preconditions which have been identified as giving rise to the potential for the gaming behaviour which the amendments are designed to prevent.

1.54 The amendment also only applies to borrowings arising under contracts entered into on or after 1 July 2018. It does not apply to refinancing of contracts entered into prior to 1 July 2018, or to borrowings arising under a contract that was entered into prior 1 July 2018.

23 ATO, *Limited recourse borrowing arrangements—questions and answers*, <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Limited-recourse-borrowing-arrangements---questions-and-answers/> (accessed 7 June 2018).

24 ATO, *Total superannuation balance*, <https://www.ato.gov.au/individuals/super/super-changes/total-superannuation-balance/> (accessed 13 June 2018).

