

SUBMISSION

Submission to Treasury —
Non-arm's length
expense rules for
superannuation funds
Response to Treasury
Consultation Paper

21 February 2023

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Retirement, Advice and Investment Division
The Treasury
Langton Crescent
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Via email: superannuation@treasury.gov.au

21 February 2023

Dear Sir / Madam

**Non-arm's length expense rules for superannuation funds
ASFA response to Treasury Consultation Paper**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's Consultation Paper *Non-arm's length expense rules for superannuation funds*, released on 24 January.

The submission has been prepared with the support of ASFA's Tax Specialist Advisory Committee, which consists of superannuation tax professionals from the 'Big 4' accounting firms, as well as the heads of tax from many large superannuation funds. Accordingly, this submission carries the weight of the large fund industry and its advisors.

About ASFA

ASFA is a non-profit, non-partisan national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$3.3 trillion in retirement savings.

Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 17 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact Julia Stannard, Senior Policy Advisor, on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Glen McCrea
Chief Policy Officer and Deputy Chief Executive Officer

1. Executive summary

ASFA welcomes Treasury's consultation on proposed changes to the non-arm's length income (NALI) and non-arm's length expense (NALE) rules.

Comments in relation to 'general expenses'

ASFA strongly supports the proposed carve-out from the NALI provisions in relation to 'general expenses' incurred by large APRA-regulated funds.

ASFA wishes to acknowledge the benefit of industry consultation that helped achieve this positive policy outcome on general expenses.

When the final legislation to give effect to this measure is drafted, we recommend that it includes a definition of what constitutes a 'general expense' for these purposes. This will help to avoid unnecessary compliance costs in the future and provide a further level of clarity to taxpayers.

Comments in relation to 'specific expenses'

ASFA understands that Treasury has made a distinction, from a tax policy perspective, between the treatment of general and specific expenses incurred by large APRA-regulated funds for the purposes of the NALI provisions. Under this distinction, the NALE provisions would continue to apply to 'specific expenses'.

ASFA's preferred view would be for the NALI provisions to return to their form prior to the amendments made in 2018, such that the NALE provisions did not apply to any expenses incurred by large APRA-regulated funds. The basis for this view is that ASFA is not aware of any circumstance with respect to specific expenses incurred by large funds that may give rise to the types of integrity concerns the NALI provisions were designed to address.

In the event the decision is made to still include 'specific expenses' within the scope of the NALE provisions, ASFA's view is that a factor-based approach – similar to the one proposed for general expenses of self-managed superannuation funds (SMSFs) and small APRA-regulated funds (SAFs) should apply, albeit with a factor of 2 rather than 5. ASFA considers this would be a more appropriate policy position, and a more proportionate approach, than tainting all of the income to which the specific expense relates.

We further recommend that the final legislation to give effect to this measure includes a definition of what constitutes a 'specific expense' for these purposes.

Additional comments

Not all public sector superannuation funds are technically APRA regulated. Accordingly, when the final legislation is drafted, it should be clear that the above treatments for large APRA-regulated funds is extended to large public sector funds that are not, technically, APRA-regulated.

ASFA does not understand the references made in Example Four of the Consultation Paper with respect to wholly owned vehicles of superannuation funds. In ASFA's view, the NALE rules should have no application to wholly-owned vehicles of large APRA-regulated superannuation funds.

2. Comments in relation to ‘general expenses’

ASFA strongly supports the approach proposed in the Consultation Paper in relation to general expenses incurred by large funds. Under this approach, large APRA-regulated funds would be exempted from the NALI provisions for ‘general expenses’.

In ASFA’s view, the proposed policy approach addresses concerns held by large funds regarding the disproportionate impact these rules may have had with respect to general expenses if the current ATO interpretive and compliance approach had been adopted.

Under the current rules and the compliance approach outlined by the ATO¹, where an amount determined to be a non-arm’s length general expense is incurred by a superannuation fund, this could cause all the ordinary and statutory income of the fund to be subject to tax at the highest marginal tax rate, currently 45%. ASFA is of the view this would be a disproportionate outcome and inconsistent with the original policy intent of the NALI/NALE provisions.

Further, this compliance approach would have caused large superannuation funds to incur significant compliance costs in relation to documenting justification for the expenditure. This additional cost – which would ultimately be borne by fund members – would be incurred in scenarios where, we would submit, the mischief intended to be addressed by the NALI/NALE provisions was not present.

As acknowledged in the Consultation Paper:

“To the extent that non-arm’s length arrangements providing general services to large APRA-regulated funds are in place, these are generally entered into with the primary intention of reducing cost and passing savings on to members, rather than for the dominant purpose of obtaining a tax benefit.”

Accordingly, ASFA welcomes the proposed exemption in relation to general expenses as this will both address the disproportionate tax outcome that could arise under the current rules and save considerable compliance costs, to the benefit of fund members.

Request for further measures in relation to ‘general expenses’

Clarification of what constitutes a ‘general expense’

ASFA considers that clarity should be provided as to what constitutes a ‘general expense’. Some examples that Treasury may wish to consider include platform fees, account administration fees, investment management fees and service fees for advice.

Recommendation

General expenses – large APRA-regulated funds

ASFA recommends that the proposed exemption from the NALI provisions for large APRA-regulated funds in relation to ‘general expenses’ is adopted, with clarity provided as to what constitutes a ‘general expense’.

¹ As outlined in LCR 2021/2 *Non-arm’s length income – expenditure incurred under a non-arm’s length arrangement* and PCG 2020/5 *Applying the non-arm’s length income provisions to ‘no-arm’s length expenditure*

3. Comments in relation to ‘specific expenses’

ASFA has concerns in relation to the continued application of the NALI provisions in relation to ‘specific expenses’ incurred by large APRA-regulated funds.

The NALI provisions set out in section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997) were amended to include rules in relation to NALE (the NALE amendments) in 2018. The Explanatory Memorandum to the NALE amendments makes clear that a primary objective was to prevent the circumvention of the contribution caps and the threshold for additional tax under Division 293 of the ITAA 1997 in a manner that would benefit one or more members of the fund.

The contribution cap rules and Division 293 already operate effectively for large funds, and an individual member does not have the capacity to influence the incurring of expenses by such funds. Trustees of large funds are already under significant regulation, including requirements under the *Superannuation Industry (Supervision) Act 1993* to act at arm’s length.

Further, it is ASFA’s view that there are no other circumstances in which the NALE amendments are necessary for large funds.

Additionally, application of the NALE rules to ‘specific expenses’ will likely involve considerable compliance cost given the extent of documentation likely to be necessary to justify that ‘specific expenses’ are incurred at arm’s length.

Request for further measures in relation to ‘specific expenses’

Application of a factor-based approach to ‘specific expenses’ that are NALE

If the current proposal in relation to ‘specific expenses’ is adopted, ASFA considers a more proportionate outcome would result from application of a ‘factor-based approach’ in relation to any shortfall of the expense that is deemed to be non-arm’s length. Such an approach should, we submit, be similar to the approach proposed in relation to general expenses of SMSFs and SAFs, albeit with a factor of 2 rather than 5.

Clarification of what constitutes a ‘specific expense’

In the event that Treasury’s current proposal is adopted in relation to specific expenses, it would be beneficial for the amending legislation to provide clarity as to what constitutes a ‘specific expense’. We recommend that this is achieved through the use of a principles-based definition.

Recommendation

Specific expenses – large APRA-regulated funds

ASFA considers that large APRA-regulated funds should be provided with an exemption from the NALE rules for ‘specific expenses’.

However, if no exemption is provided, ASFA recommends that a ‘factor-based approach’ should be applied in relation to any shortfall of the expense that is deemed to be non-arm’s length.

Clarity should also be provided as to what constitutes a ‘specific expense’.

4. Additional comments

Exclusion for large APRA-regulated funds in relation to wholly owned entities and investments

As the size of large funds has increased, many trustees have reached the decision that more of their activities should be brought in-house. As part of this decision-making process, regard is had to where these activities should arise – either within the fund or in a wholly owned subsidiary (which could be either a company or a trust).

For commercial reasons, trustees will often wish to place certain services – such as member administration services or investment management services – in a separate vehicle (such as a wholly owned unit trust or company) to quarantine the risks associated with these activities from the other investment assets held in the fund for the benefit of members.

These vehicles will require capital at certain stages and funds are concerned about the impact on franked dividends and/or trust distributions that ultimately flow up to the fund if, in the future, these capital contributions were to be considered to be conducted on a non-arm's length basis.

An interpretation by either Treasury and/or the ATO in relation to when capital contributions (for either shares and/or units) are considered non-arm's length may distort structuring in the industry resulting in these activities being performed by the superannuation fund, thereby unnecessarily exposing members to these commercial risks that would otherwise have been quarantined in a separate vehicle.

In particular, ASFA is concerned about some aspects of Example Four outlined in the Consultation Paper. That example relates to a service company that is a related party of a large fund. ASFA submits that Example Four does not set out a circumstance in which the integrity risk addressed by the NALE amendments arises for large funds.

ASFA submits that there are no circumstances where this integrity risk arises in a large fund context, and thus it is not appropriate that the NALE amendments apply to large funds and accordingly, the carve-out should apply for large APRA-regulated funds in relation to wholly owned entities and investments.

ASFA would welcome the opportunity to address these concerns in a separate consultation with both Treasury and the ATO.

Application to large public sector superannuation funds

Whilst the Consultation Paper refers to large APRA-regulated funds, Treasury should be mindful that there are some large public sector superannuation funds that, while not strictly APRA-regulated, should also enjoy the benefit of carve-outs made for large APRA-regulated funds.

We recommend that this is addressed in the drafting of the legislation.

Recommendation

Wholly owned entities and investments of large APRA-regulated funds

ASFA recommends that any amendments to the NALI/NALE rules made in relation to large APRA-regulated funds should also be extended to wholly owned entities and investments of those funds.

Public sector funds that are not APRA-regulated

ASFA recommends that any amendments to the NALI/NALE rules made in relation to large APRA-regulated funds should also be extended to large public sector funds that are not, strictly, APRA-regulated.

5. Response to the consultation questions

Consultation Question One

Are there any potential unintended adverse consequences for superannuation funds, their members and other stakeholders from adopting a sector-specific approach to the NALI provisions related to general expenses which applies different treatment to large APRA-regulated funds and SMSFs and SAFs?

ASFA does not see any potential unintended adverse consequences arising from the proposed sector-specific approach and is of the view that it is open to Treasury to distinguish these separate groups in its policy response if this is appropriate to the mischief that is trying to be addressed.

Specifically, the purpose of the NALE rules is to capture arrangements where a trustee may acquire assets and/or services for expenditure less than arm's length (or for no expenditure), increasing the capital of the fund **for that member** and thereby circumventing the integrity of the contribution caps.

An individual member of a large superannuation fund does not have the capacity to influence the incurring of expenses by the fund. As a result, ASFA's view is that strategies to circumvent the contribution cap rules are simply not possible for a member of a large fund to implement with respect to expenses of a large fund. On this basis, we consider it is appropriate for the integrity measure to distinguish large funds.

Whilst ASFA does not seek to comment specifically on the detail of the proposed changes for SMSFs and SAFs, we note that there are existing examples within the ITAA 1997 (and associated regulations) where different tax treatment apply as between large APRA-regulated funds and SMSFs and SAFs.

Consultation Question Four

Would carving out large APRA-regulated funds from the NALI provisions for general expenses appreciably lower the compliance burden for large APRA-regulated funds?

Carving out large APRA-regulated funds from the NALI provisions for 'general expenses' will appreciably lower the compliance burden for large APRA-regulated funds *provided* there is clarity as to what constitutes a 'general expense'.

ASFA notes however that a compliance burden would remain with respect to 'specific expenses' absent a further carve-out and clarity in relation to 'specific expenses' as outlined in section 3 of this submission.

Consultation Question Five

Are there any unintended adverse consequences for large APRA-regulated funds, their members and other stakeholders from carving out large APRA-regulated funds from the NALI provisions for general expenses?

ASFA does not consider that any unintended adverse consequences would arise.