

COMMENTS

Submission to Australian
Taxation Office — Interaction
of non-arm's length income
and capital gains tax
provisions: Draft Taxation
Determination TD 2023/D1

28 July 2023

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Mr Kendrick Yim

Australian Taxation Office

Via email: kendrick.yim@ato.gov.au

28 July 2023

Dear Mr Yim

Draft Taxation 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

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide comments to the Australian Taxation Office (ATO) in response to Draft Taxation 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* ("the Draft Determination") released on 28 June 2023.

This submission has been prepared with the support of ASFA's Tax Specialist Advisory Committee, which consists of the heads of tax from many large superannuation funds, as well as superannuation tax professionals from the 'Big 4' accounting firms. Accordingly, these comments carry 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 \$3.5 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 our comments, please contact Julia Stannard, Senior Policy Advisor, on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Julian Cabarrus

Director – Policy Operations, Member Engagement & External Relations

For a non-arm's length capital gain which is a discount capital gain, the part of the superannuation fund's net capital gain which is NALI should never be more than the discounted gain amount

ASFA acknowledges that the non-arm's length income (NALI) rule under section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997) is capable of applying to capital gains, and we broadly agree with the ATO statement at paragraph 8 of the Draft Determination that:

"The amount of NALI is determined by reference to the amount of the non-arm's length capital gain, being the capital proceeds less the cost base arising from the scheme in which the parties were not dealing at arm's length, that gives rise to the application of subsection 295-550(1). This non-arm's length capital gain is subject to the relevant CGT market value substitution rules (if any) and is reduced by any attributable deductions to calculate the non-arm's length component under subsection 295-545(2)."

Our agreement with the above statement is premised on the ATO's use of the words "by reference to".

In this context, it is submitted that the ATO does not have proper regard to the operation of subsection 102-5(1) of the ITAA 1997 insofar as the application of the Capital Gains Tax (CGT) discount is concerned. As Example 1 of the Draft Determination demonstrates, the capital gain which could have potentially been treated as NALI is \$1,300,000 (paragraph 20) which, based on the ATO's view, is not reduced by the one-third CGT discount for superannuation funds under section 115-100, notwithstanding that the asset in question was acquired at least 12 months before the CGT event.

The ATO's rationale for not having regard to the CGT discount is outlined in paragraph 62 as follows:

"... The calculation of the net capital gain under subsection 102-5(1) takes into account all capital gains (both arm's length and non-arm's length) as determined by the relevant CGT event, being capital proceeds less the relevant cost base. The collective capital gains are then subject to any of the reductions in subsection 102-5(1) and comprises the fund's net capital gain as its statutory income. However, the amount of statutory income that is NALI must also satisfy the requirements of subsection 295-550(1). Accordingly, it is only those capital gains arising from a scheme to which the parties were not dealing with each other at arm's length which are NALI."

ASFA respectfully disagrees that the CGT discount is applied on a 'collective' basis under subsection 102-5(1) as suggested by the ATO.

Step 3 of the method statement is as follows (with emphasis added):

*"Reduce by the discount percentage each amount of a *discount capital gain remaining after step 2 (if any)."*

'Discount capital gain' has the meaning given by Subdivision 115-A of the ITAA 1997, based on meeting various requirements (including the minimum 12 month holding rule). Only a specific capital gain can be a discount capital gain.

Accordingly, in the context of applying Step 3 of the method statement, it is necessary to identify specific capital gains which are remaining after Step 2. Then under Step 5, it is necessary to 'add up' the amounts of capital gains remaining after Step 4. Again, this clearly requires specific capital gains to be identified.

ASFA further contends that there might be similar arguments with respect to the application of capital losses against capital gains under Steps 1 and 2 of the method statement. However, we acknowledge that there is one key difference in that these steps allow a taxpayer to choose how current and prior year capital losses are applied. By comparison, Step 3 does not provide for a choice, but rather the reduction of the capital gain by the CGT discount (where eligible) is automatic.

Accordingly, in the context of determining the amount of NALI as part of a net capital gain and by reference to a non-arm's length capital gain, it is clear that where the non-arm's length capital gain is a discount capital gain (within the meaning of Subdivision 115-A), the amount of that non-arm's length capital gain which forms part of the superannuation fund's net capital gain will never exceed the discounted amount (that is, two-thirds of the capital gain).

Conversely, as the reduction for capital losses depends on the order chosen by the taxpayer, it is not necessarily the case that a non-arm's length capital gain shall be reduced by capital losses (although such an ordering approach would appear to be most optimal).

ASFA considers that under the ATO's view as currently expressed in the Draft Determination, non-arm's length capital gains are effectively being treated as not being discount capital gains, which is clearly not in accordance with Subdivision 115-A (within which there are certain types of gains specified as not being discount capital gains in sections 115-40, 115-45, 115-50 and 115-55). Furthermore, in doing so, arm's length capital gains can be treated as NALI which is an entirely inappropriate outcome and against the policy intention of the NALI rules.

ASFA requests that the final version of the Draft Determination is updated to reflect that for a non-arm's length capital gain which is a discount capital gain, the part of the superannuation fund's net capital gain which is NALI can never be more than the discounted gain amount, as a 'lesser of' alternative to the superannuation fund's overall net capital gain.

Application of attributable deductions against the non-arm's length capital gain to calculate the non-arm's length component

ASFA considers that the Draft Determination would be well served by including one or more examples showing an allocation of deductions attributable to NALI arising from a non-arm's length capital gain, including guidance as to apportionment.