

24 January 2025

Bonita Tsang
Director- Complex Technical Unit
Superannuation & Employer Obligations
Australian Taxation Office

Delivered via email PAGSEO@ato.gov.au

Dear Bonita

Re – LCR 2021/2DC and TR 2010/1DC2

Chartered Accountants Australia and New Zealand, CPA Australia, the Financial Advice Association Australia, the Institute of Financial Professionals Australia, the Institute of Public Accountants, the National Tax and Accountants' Association and the SMSF Association (together **the Joint Bodies**) write to you as the peak professional accounting, tax and superannuation bodies in Australia representing both large APRA and small superannuation funds with six or less members. The Joint Bodies welcome the opportunity to provide this submission about the above draft rulings.

Law Companion Ruling 2021/2DC (“draft NALI/E LCR”)

A draft Law Companion Ruling (LCR) involving superannuation fund non-arm's length income and expenditure (NALI/E) provisions was first published in December 2018.

Commercial price or value

The LCR needs to provide solid guidance on how a superannuation fund can establish an appropriate commercial price especially for income and expense items.

The explanatory memorandum for the Treasury Law Amendment (2018 Superannuation Measures No. 1) Bill 2019 – “2019 Bill” – that contained the initial amendments to the superannuation non-arm's length said the following at par 2.49:

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.

This sentence was also stated in the exposure draft legislation when it was released¹ and was also in the original legislative Bill that sought to enact the NALI changes²

¹ <https://treasury.gov.au/consultation/t243169>

² Treasury Law Amendment (2018 Superannuation Measures No. 1) Bill 2018

These words do not appear in the explanatory memorandum for the Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023 – “2023 Bill” – that contained the most recent amendments.

However, the difficulty with determining a precise arm’s length price has been expressed in the BPFN case in which the Administrative Appeals Tribunal accepted the taxpayers expert witness’ view that the transactions in question were “within the reasonable bounds within the commercial market” – see par 75³.

We are concerned that the ATO remains silent on the fact that it is ubiquitously difficult to definitively determine what an arm’s length price or value might be and that a range will be appropriate.

The LCR would be improved if this point was acknowledged. The LCR should also contain guidance on how small super funds may acceptably determine the lower and upper bounds of appropriate commercial prices and how they may then decide on an appropriate price or value to apply in a particular circumstance.

For asset values, we acknowledge the ATO guidance for determining a market value⁴ as well as the related guidance for SMSFs⁵.

It is our understanding that many valuers avoid providing a pinpoint value (e.g. fear of being sued and increased professional indemnity insurance premiums).

We would therefore like to have confirmation that the ATO do accept that there can be considerable range in market values and that this is especially the case where there is no mandatory requirement for a registered valuer to be engaged (refer, for example, to the SMSF guidance document referred to above). It is unreasonable to expect taxpayers to engage a professional valuer who only reports a range of market values – between a lower and higher value range – and then expect a taxpayer to gather evidence to establish and support their pinpoint value within that range, e.g. do they go the mid, the lowest, the highest or somewhere in between?

Record-keeping requirements for asset acquisitions

We acknowledge that taxpayers are required to retain adequate records to accurately determine their tax liabilities. For example, Sec 121-35 of the *Income Tax Assessment Act 1997* (ITAA97) allows superannuation fund trustees (like other taxpayers) to satisfy their Capital Gains Tax (CGT) record keeping obligations by keeping a CGT register.

In addition superannuation funds may be required to complete a CGT schedule or Losses schedule as part of their regulatory return obligations each year.

³ <http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2023/2330.html>

⁴ https://www.ato.gov.au/law/view/document?docid=SGM/market_val

⁵ <https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/in-detail/smsf-resources/valuation-guidelines-for-self-managed-super-funds>

Most superannuation fund trustees will be required, often via their fund's trust deed, to keep records of all relevant transactions, such as all asset purchases and disposals.

It is clear that trustees can satisfy the statutory CGT record keeping requirements yet still have insufficient information for Sec 295-550 of the ITAA97 purposes.

For example, suppose a SMSF had acquired business real property from a related party in July 2015 via part purchase and part in-specie contribution. Since the property was acquired the SMSF has moved to a new tax agent on two separate occasions. The trustee and the previous tax agents all say that the transaction was completed at market value and recorded as such by the SMSF in its asset and CGT registers. The initial tax agent also says that the in specie contribution was completed in accordance with the requirements of the applicable TR 2010/1.

The current tax agent has sought to find corroborating documentation confirming that the property was acquired at market value however given the time lapse and record keeping requirements neither of the previous tax agents has retained relevant information. The trustee had taken advice from its tax agents that as the acquisition had been recorded in the fund's CGT and asset registers no other documentation had to be retained longer than required by the superannuation and tax laws.

What evidence would prove that the transaction had been completed on arm's length terms?

Internal SMSF arrangements and associated issues

Internal fund arrangements are arrangements in which services are provided to an SMSF by an individual trustee or a director of a corporate trustee of the fund in their capacity as trustee or director (referred to as 'trustees' for simplicity). Paragraphs 40 to 48 of the LCR say that Sec 295-550 does not apply to these internal arrangements.

Secs 17A and 17B of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) prohibits a SMSF from remunerating a trustee for internally provided services.

If a trustee or provides services to an SMSF in a non-trustee capacity, the arrangement may be subject to Sec 295-550 unless, broadly, the SMSF provides arm's length remuneration for the services provided.

Overall, we consider that the ATO has provided insufficient guidance to enable SMSFs to identify whether services provided to it by a trustee constitutes an internal fund arrangement or the provision of services in another capacity.

This is of significant concern to our members, especially those in public practice, because an inadvertent misclassification can create significant exposure for SMSFs.

Incorrectly classifying services provided by a trustee as internal arrangements may see Sec 295-550 apply as Sec 17A of the SIS Act prohibits such services being remunerated.

The reverse also applies – that is, incorrectly classifying services as those provided in a non-trustee capacity which may be a breach of Secs 17A and 17B of the SIS Act where arm's length remuneration has been provided by the fund to the trustee.

The ATO provided some guidance on this issue in LCR 2021/2, with limited updates being provided in LCR 2021/2DC. However, the guidance in LCR 2021/2DC still fails to address even the more commonplace scenarios that SMSF trustees encounter.

Paragraph 47 of LCR 2021/2DC lists various factors that are to be considered in assessing the capacity in which services may be provided to an SMSF. However, as it is necessary to weigh up all the relevant circumstances and factors when making this assessment (paragraph 48), SMSFs will be reliant on practical ATO examples to guide them.

It would be valuable for the finalised LCR to provide guidance as well as examples of services that could be provided by trustees who work in a trade occupation – for example builders, joiners, carpenters etc – and indicating if certain services are provided in their capacity as trustee. For example, a carpenter who installs or repairs timber windows on a rental property, a plumber who unblocks drains, a builder who provides labour to build a deck. Such people may be employees and may be registered but not individually licensed.

Application of Sec 17B of the SIS Act

If Sec 17B of the SIS Act can be applied then an SMSF can avoid the application of Sec 295-550 by ensuring that a trustee receives arm's length remuneration for services provided.

The converse also applies. That is, if the exception in Sec 17B of the SIS Act is unavailable in a particular situation, then the trustee cannot be remunerated for the services provided (in their individual capacity), which would, therefore, create potential exposure to Sec 295-550. In these circumstances, the trustee would be unable to provide the services without exposing the SMSF to adverse consequences.

SMSF trustees need confidence about how the ATO will administer this provision and whether any administrative relief will be provided.

In Private Binding Ruling ('PBR') 1052155666298⁶, an individual (referred to as the 'Trustee') was a director of the corporate trustee of an SMSF, and a retired employee accountant. The Trustee prepared the annual accounts and lodged the annual return for his SMSF. The return was lodged on electronic software using his personal tax agent registration (which was retained post-retirement). Of relevance to this issue, the PBR concludes by stating:

"In this case, the Trustee of the Fund is appropriately qualified to be remunerated for accounting services he could provide to the Fund. Section 17B of the SISA would be satisfied if you made the decision to contract these services to the Trustee in his individual capacity."

⁶ <https://www.ato.gov.au/law/view/document?docid=EV/1052155666298>

We note that the Trustee was not, and had never, carried on a business in his own right (involving the provision of these services to the public), which is a requirement under paragraph 17B(2)(c) of the SIS Act.

Although a non-binding document, this PBR suggests that the ATO may take a broad approach to the administration of Sec 17B of the SIS Act.

We request that the ATO provides sufficient further guidance in relation to the requirements of Sec 17B of the SIS Act so that SMSFs are able to identify and manage this issue.

In the context of the LCR 2021/2, a 'safe harbour' compliance approach could be considered to not apply ATO compliance resources to determine whether Sec 295-550 applies in scenarios where a trustee is prohibited by Sec 17A from being remunerated by an SMSF for services that are general in nature (e.g., when the trustee does not carry on business in their own right, such as where the trustee is an employee).

Trustees of fixed unit trusts

Industry has previously asked that the draft NALI/E LCR include commentary that the trustee of a fixed unit trust also has statutory and fiduciary duties and obligations which the fixed trust's deed and governing rules may empower the trustee to perform these actions and that the trustee's skills, knowledge and experience can assist the trustee to complete these tasks.

We again request clear guidance in the finalised NALI/E LCR in relation to this matter.

Greater clarity is required to determine whether trustees of fixed unit trusts can apply their professional skills in fulfilling their duties without breaching their trustee capacity and tainting distributions to SMSF unit holders.

Inclusion of an example applying LCR principles at the unit trust level will provide certainty for SMSF trustees and ensure alignment of the ATO's view across different trust structures.

Furthermore, paragraph 23 of LCR 2021/2EC states that:

We [ATO] consider the Ruling provides sufficient guidance on the key principles to assist trustees to determine how the provisions apply.

Reliance on private rulings to address these matters should be minimised to reduce administrative burdens on both the ATO and taxpayers.

Discount policies

Paragraph 51 of the LCR states that an arrangement involving discounted prices will be considered to be on an arm's length basis for the purpose of the NALI rules where an individual acting in their capacity as trustee is entitled to a discount which is the same as that provided to all employees, partners, shareholders or office holders.

Updated paragraph 51 of LCR 2021/2DC now also requires that the trustee should not be able to influence the discount policy in order for it to be at arm's length.

There are a number of aspects of paragraph 51 that would benefit from further explanation:

1. Why is 'same discounts' in paragraph 51 plural?

Does this mean the same discount has to be provided to employees and partners but the discount provided to each can be different?

Or are employees, partners, shareholders or office holders (i.e., 'staff') considered together as one group, and the same discount policy must apply to all (but within that policy, there may be different discount rates applied, say a more significant discount for longer-serving employees)?

2. Could the ATO confirm in the updated LCR its view on discount policies that do not strictly apply to all employees? It may be, for example, that an employee must satisfy a qualifying period to become eligible for the discount policy. The overarching principle in this regard appears to be that the policy be "consistent with normal commercial practices". On that basis, it seems that a policy that did not apply to all employees may be considered arm's length, provided it can be demonstrated that the policy was formulated on a commercial basis.

3. The inclusion of the requirement that the trustee must not be able to influence the discount policy creates uncertainty, especially given that the word 'influence' is not defined.

In general terms, influence basically refers to the power to change something or to cause change without directly forcing it. So, it would be clear that a sole director and shareholder of a small business company or a sole trustee (or sole director of a corporate trustee) of a trust would influence any discount policy of the respective entity.

It is far less clear that the same influence would be present in situations where, for example, there are two or more equal 'controllers' of a business. In these cases, the controllers may have some capacity to influence staff policies but generally to a lesser degree, and there is generally no ability to control an outcome without the support of a majority.

Over and above the issue of the meaning of 'influence', however, the Joint Bodies consider it inappropriate for there to be a blanket exclusion of an SMSF to obtain an arm's length discount merely because the fund's trustee is in the position to influence the discount policy.

If a trustee inappropriately influences a discount policy, such as where the benefit of a discount will be wholly or predominantly enjoyed by the trustee's SMSF, that would often strike at the commerciality and arm's length nature of the arrangement. In this regard, the focus of paragraph 51 should be on whether a discount provided to an SMSF is consistent with normal commercial practices and whether the policy is legitimately implemented rather than a trustee's ability to influence the discount policy.

Paragraph 18 and footnote 17

Paragraph 18 of the draft NALI/E LCR says that

"Non-arm's length expenditure incurred to acquire an asset (including associated financing costs) will be specific expenditure and will have a sufficient nexus to all ordinary or statutory income derived by the small complying superannuation fund in respect of that particular asset. This

includes any capital gain derived on the disposal of the asset (see Example 1 of this Ruling). There **will** still be a sufficient nexus between the initial non-arm's length expenditure incurred to acquire an asset (including associated financing costs) and an amount of statutory income, determined by reference to any capital gain derived by the fund on the disposal of that particular the asset ..." (our emphasis)

Paragraph 18 refers readers to footnote 17 which says,

"Paragraphs 7.1, 7.2 and 7.40 of the EM to the TLA Bill 2024 refer back to the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2019 (TLA Bill 2019). As such, see Example 2.1 and paragraph 2.39 of the Explanatory Memorandum to the TLA Bill 2019 ...".

However, paragraph 2.41 of the 2019 Bill's explanatory memorandum states,

"In some circumstances, non-arm's length capital expenditure can result in a superannuation entity earning non-arm's length income. Where a fund acquires an asset for less than market value through non-arm's length dealings, the revenue generated by that asset **may be** non-arm's length income, as well as any statutory income (that is, net capital gains) resulting from the disposal of that asset." (our emphasis)

Clearly, "will" is a significantly stronger word than "may". Consequently, we are concerned about the use of the word "will" in paragraph 18 as there will be circumstances where an asset purchased for less than market value may not lead to any resultant capital gains being taxed as NALI/E as acknowledged in the 2019 Bill's explanatory memorandum.

Employee Share Schemes

Industry has previously asked the ATO for guidance on how the NALI/E provisions could potentially apply to Employee Share Schemes.

We are aware of the published private binding advice document 1052314103521⁷ which was published on the ATO's website on 16 December 2024.

The end result of the private advice is that the acquisition of the options offered via an employer share scheme and the resultant shares (which were acquired for less than market value) did not result in Sec 295-550 applying to the superannuation fund in question.

In our view the result may be fact dependent. The following are key factors in NALI/E not applying in this particular case:

- The employer offered its share scheme to all permanent staff members on equivalent terms – that is, the employee did not influence the employer's decision to make the offer, the quantity of options offered or the price at which the options were exercised

⁷ <https://www.ato.gov.au/law/view/document?docid=EV/1052314103521>

- The employee participated in the share scheme and at the same time nominated their SMSF to participate in the scheme and acquire the share options
- The employee made a contribution to their SMSF of the options and the SMSF recognised these options as a non-concessional member contribution – the value of these options was independently determined using the Black Scholes Model
- The SMSF then exercised all options it acquired resulting in those options converting into ordinary shares in the employer's company at the set price determined under the employee share scheme plan; as already noted the exercise price was for less than the prevailing market price

Our question is, if any of the above factors changed then would Sec 295-550 apply? For example, many employee share schemes are only offered to a particular class of employee, such as senior managers and executives only. Alternatively, participation in the employee share scheme may be offered to greater than say 75% of permanent employees who have completed at least 3 years of service (for example, as required by Sec 83A-105 of the ITAA97). Some employee share schemes may not be based on above model but the immediate purchase of employer ordinary shares.

We believe the LCR would be improved if our concerns were discussed including via a specific example that also addresses the application of the SIS Act, particularly restrictions under sec 66.

Provision of trustee guarantees

We would argue that personal guarantees provided by super fund trustees should not lead to the NALI/E provisions applying because third party arrangements by lenders or others (such as builders) would demand a super fund's trustees provide a personal guarantee.

We believe the draft NALI/E LCR should have a discussion and example about this issue.

The NALI/E LCR Examples

The December 2018 draft ruling contained 7 examples.

Another draft ruling about this subject was issued in October 2019 which contained 9 examples.

When the current LCR 2021/2 was initially finalised in 2021, it contained 13 examples.

The same number of examples appears in this current draft re-write.

Our point is that the 7 examples first seen in 2018 remain largely unchanged. Similarly, all additional examples added in 2019 and 2021 also remain mostly unchanged from when they were first published.

We do acknowledge that the examples have been updated to make them more contemporary with updated timeframes. Obviously, the timeframe updates will only have a short-term impact.

We welcome the additional text that has been added to many examples to provide greater clarity.

We provide the following comments about each example:

1. Non-arm's length expenditure was incurred to acquire an asset – NALI

This example is no longer necessary as the topic is discussed in greater detail in TD 2024/5. If the ATO wishes to retain Example 1, then it should discuss the market substitution rule and also refer to TD 2024/5

2. Non-arm's length expenditure incurred has a nexus to all income of the fund – NALI

We note that this example has been updated to take into account the changes made by the 2023 Bill. It should be further updated for the following reasons:

- To discuss the issue of establishing an appropriate arm's length value (as per the BFPN case as discussed above)
- To acknowledge that the explanatory memorandum for the 2023 Bill states,

“Provided that the amount charged for any such services **is not less than** that which would be expected to be charged between parties dealing at arm's length, the dealings are not subject to the non-arm's length income rules. In such cases, the trustee of an SMSF may also be prevented from charging any more than the arm's length price because of the regulatory requirements in the SIS Act (see section 17B of the SIS Act, which permits a trustee to charge up to an arm's length amount for duties or services performed other than in the capacity as trustee)” – refer par 7.32 of the 2023 Bill explanatory memorandum (our emphasis)

- Greater clarity is needed around the deductibility of expenses under Sec 25-5 of the *Income Tax Assessment Act 1997*.

The NALI/E LCR implies that non-arm's length expenditure (NALE) incurred in complying with, or managing, the fund's income tax affairs and obligations which are deductible under sec 25-5 do not result in the application of the NALI/E rules because these expenses lack the necessary nexus to all the ordinary and statutory income of the fund.

We are unsure how this applies in many cases, including for superannuation funds that have no accumulation assets (that is, only have pension assets) because, like all other superannuation funds, these funds still have ordinary or statutory income. The tax rate applying to pension assets is zero per cent.

3. Purchase less than market value and no in specie contribution – NALI

We believe the matters discussed in this example are covered in TD 2024/5 and TR 2010/1. If the ATO wishes to retain this Example 3, then it should be updated to discuss the market substitution rule in greater detail (and not include this subject as a separate subject and its own standalone example) and also refer to TD 2024/5 and TR 2010/1.

4. Purchase financed through a limited recourse borrowing arrangement (LRBA) on non-arm's length terms – NALI

We are disappointed this example does not discuss PCG 2016/5 as well as TD 2016/6. Reference should be made to LRBAs set on arm's length terms but then accidentally fall outside the rules but the mistake is promptly corrected. For example, an LRBA may be structured and maintained at arm's length but miss an interest and principal repayment in a particular year, which is rectified as soon as the issue is identified. In ordinary commercial lending arrangements, a catch-up payment would be permitted. In this scenario, due to the nature of the NALI we do not consider that there is sufficient nexus to the future capital gain derived by the fund on the disposal of the asset acquired under the LRBA.

Further guidance is necessary to assist trustees to determine market based lending terms when a third party lender is only able to provide indicative terms not binding contractual terms.

5. Part purchase/part in specie contribution at market value - not NALI

This case study should be updated to provide guidance on establishing an appropriate arm's length value as discussed above.

The explanatory memorandum to the 2019 Bill states that,

“Where a superannuation fund purchases an asset at less than market value or reports the in-specie contribution at less than market value, then the acquisition may form part of a non-arm's length scheme such that any ordinary or statutory income derived from the asset and the disposal of the asset will be treated as non-arm's length income” (refer to par 2.45).

6. Internal arrangement within an SMSF - trustee provides services to the SMSF

This example should be expanded to discuss the alternative that Leonie uses her employer's Tax Agent portal to lodge the SMSFs annual return as per PBR 1052155666298 (see above for further commentary on this PBR).

Example 6 should also clarify whether the ATO's conclusion in this example would be different if Leonie used the equipment or assets of her employer and/or lodged the SMSF's return under her employer's tax agent registration. We believe there is an argument that Leonie would still be providing her services in her trustee capacity in both those alternative circumstances, but further clarity in the LCR on a very common arrangement would be valuable.

Our discussion above under Example 2 about the treatment of expenses ordinarily deductible under Sec 25-5 is also applicable here.

7. SMSF trustee carrying out duties - trustee capacity

This example should be expanded to discuss the situation where Levi performed tasks at his business premises – or anywhere else that is not his principal place of residence – especially as based on the wording of this example he is likely to be an employee of the business for

common law, employment law and income tax law. If any part is deemed NALÉ then establishing an arm's length price should also be discussed as per BPFN.

8. Third party providing services - discounts

We do not consider that Sasha's employer would be a third party. We accept however that based on the facts she cannot influence the discount rate offered by her employer.

Taking into account our comments in relation to paragraph 51, this example should be expanded to include the additional situation where Sasha has a degree of influence on the discount rate and what process should be followed to establish an arm's length price should also be discussed as per BPFN. This remains the most difficult issue for professionals providing services to their SMSF and their commercial colleagues.

9. SMSF trustee carrying out duties - different capacities

It is industry's view that this example needs a lot of work. Issues that we have with it include:

- What would be the NALÉ outcome if Trang had the skills, knowledge and experience to complete all tasks in renovating the bathroom and kitchen in the second apartment such as tiling, waterproofing etc but did not hold formal trade qualifications for those tasks? We consider the correct interpretation in this case is that, in part, Trang has provided professional services (the specific plumbing work) and, in part, trustee services (those not requiring her plumbing trade skills, knowledge or experience).

Trang will need a reasonable and acceptable method of determining an arm's length price for her professional services.

- In relation to the above point, what if Trang completed all tasks during normal business hours (and only performed this work when third party clients had not asked her to complete work for them on a particular half or full day) and also used her employee's time and energy to complete these tasks as otherwise that person would not have been employed gainfully?
- It would be open to Trang to value her work on the apartment's bathroom and kitchen as an in specie contribution on the arm's length determined increase in market value of the apartment as per paragraph 29 to proposed paragraph 32B of TR 2010/1DC2. This point should be acknowledged in the finalised NALÉ LCR.

As per above, Trang will need a reasonable and acceptable method of determining an arm's length market value both before the renovations commence and once they are completed.

- The 2023 Bill's explanatory memorandum says (at par 7.40),

"Where a specific expense is incurred as a result of a scheme in which the parties are not dealing with each other at arm's length and the entity is a small APRA-regulated fund or SMSF, the amount of income that is

non-arm's length income is the same as the treatment prior to these amendments. All of the ordinary or statutory income that results from the scheme is non-arm's length income."

We would argue that further guidance is required to determine the ordinary and statutory income from the scheme in this case. Arguably the scheme between Trang and her SMSF was the provision of her plumbing skills, knowledge and experience and the services of her employee for nil consideration and/or that the increase in the market value of the apartment as a result of the provision of those services had not been reflected as an in-specie contribution.

That is, the ordinary income that results from the scheme is the increase in rent as a result of the plumbing work only. The statutory income that results from the scheme is the increase in market value of the apartment as a result of the plumbing work only.

In other words the scheme is the increase in rent or market value caused by the renovation of the bathroom and kitchen. The scheme is narrower than the conclusion this example assumes.

- It is well accepted that overtime kitchens and bathrooms in residential premises must be replaced due to normal wear and tear, improvements in equipment and changing consumer tastes. The ATO typically allows depreciation at 2.5 per cent per year over 40 years commencing when construction has been completed. The US internal revenue service typically allows residential property improvements to be depreciated over 27.5 years if the property is rented out.

The declining value of the work performed needs to be discussed in this example as this will feed into the SMSF's CGT calculations and will also feed into the capital gain made in relation to the "scheme".

If residential property bathrooms and kitchens are not maintained or improved then this can negatively impact on the market value of the property as prospective purchasers will mark down the property by the cost of completing these tasks after acquisition.

Maintenance and improvements of bathrooms and kitchens are essential in ensuring rental returns are not negatively impacted.

In any event, by renovating the bathroom and kitchen, Trang is merely acting like any prudent owner would by using her skills, knowledge and experience to keep the costs of completing these renovation tasks as low as possible. Acting prudently is a statutory prudential requirement and a common trustee obligation.

There appears to be an assumption in the LCR that by renovating the kitchen and bathroom of the second apartment, Trang has improved that property. As detailed in the ATO's SMSFR 2012/1, it may be that this is not the case – see pars 19 to 24.

We recognise the difficult communication balancing task the ATO has with ruling documents such as this LCR as they will be used by a very wide audience including those who are not superannuation taxation experts. There will also be a cohort who believe that such documents need to be kept as brief and succinct as possible even if this means removing important details and information. We agree that this LCR should not be unnecessarily complex or long. Nevertheless, we believe that it should also be able to be applied by those who have statutory and professional obligations to provide accurate and timely advice and assistance to their clients.

10. SMSF trustee carrying out duties – individual capacity

This example should be expanded to include the situation where Jean is a retired electrician however retains his license but is no longer providing services to the general public.

On the ATO's other reasoning it would seem to follow that because Jean is able to undertake the work without charging a fee and the work can only be done by a qualified person it must be NALE to the fund. However, that should not be the outcome as Jean is prevented from charging a fee by Sec 17A of SIS Act and the effort can be said to be in Jean's capacity as trustee (see our commentary above).

11. SMSF trustee carrying out duties - individual capacity

We have no comment about this example.

12. SMSF incurs non-arm's length expenditure in acquiring a fixed entitlement in a unit trust

We have no comment about this example.

13. Market value substitution rules (CGT consequences for the transferor and the fund)

Please see our comments for example 3.

TR 2010/1DC2 ("Draft Contribution Ruling")

General Comment

The Draft Contribution Ruling applies retrospectively, requiring updates to address the defunct maximum earnings test; however, the Draft Contribution Ruling should also modernise examples (e.g. Example 10 references 2012) and provide clarity on the current law regarding deductible contributions, particularly the interaction with the work test and work test exemption.

ATO Compliance Approach

The compliance approach previously outlined in Appendix 2 of TR 2010/1EC has been removed from the Ruling. This absence of clear guidance creates uncertainty about whether the ATO intends to apply both the NALI and contribution provisions simultaneously, raising concerns about the potential for double taxation.

Without a compliance framework, a non-arm's length arrangement could be subject to taxation as NALI under section 295-550, while also being treated as a contribution. This dual treatment could result in excessive tax liabilities and significantly diminish a member's retirement savings.

For instance, a specific non-arm's length capital expense could result in:

1. Taxation as NALI on all future income and capital gains from the affected asset at a 45% rate.
2. Simultaneous classification as a non-concessional contribution, triggering excess contributions tax and requiring withdrawal of excess amounts.

It is essential for the industry to have a well-defined framework to manage scenarios where both NALI and contribution provisions are triggered, thereby preventing double taxation and mitigating the negative financial effects on members' retirement savings.

We urge the Commissioner to adopt a pragmatic compliance approach that upholds fairness and proportionality. This approach should address the interaction of contribution rules and NALI provisions, considering both general and specific non-arm's length expenditure (see below for further commentary on this issue).

Date of Effect

When finalised, it is proposed that Part A of the Ruling, which deals with general superannuation contribution concepts, will apply both before and after its date of issue.

The retrospective application of NALF provisions (effective from 1 July 2018) could require years of contribution caps to be recalculated, exposing members to associated earnings penalties backdated to 1 July of the year the contribution was made.

This is a punitive outcome that is very disproportionate and unjust.

The retrospective application of the Ruling needs to be accompanied by appropriate administrative relief.

The Commissioner should consider exercising discretion under PS LA 2008/1⁸ which provides for disregarding or reallocating superannuation contributions in situations involving excess contributions. This approach ensures appropriate outcomes in special circumstances.

While the GYBW case offers useful guidance on the treatment of contributions, we recommend that its application be restricted to prospective arrangements. Such a limitation would promote fairness and prevent individuals from being penalised for actions taken before the release of clear guidance.

Additionally, with the removal of the Commissioner's compliance approach in Appendix 2, we urge that the Commissioner's discretionary powers are not confined to post 28 July 2021

⁸ <https://www.ato.gov.au/law/view/document?docid=PSR/PS20081/NAT/ATO/00001>

arrangements. Instead, these powers should extend to arrangements occurring between 1 July 2018 and the date this Ruling is issued.

To enhance clarity and minimise administrative burdens, PS LA 2008/1 should be revised to reflect the ATO's views as outlined in the Ruling and the accompanying LCR. Updating the practice statement would provide staff with clear, actionable guidelines for exercising discretion, reducing the reliance on trustees needing to request Commissioner intervention.

The Draft Contribution Ruling examples

1. Contribution made by paying a fund's expenses

We agree with the outcome of this example. However, if the contribution is not recorded then we assume that Sec 295-550 may apply. The NALI/E impact should be discussed here.

2. No contribution made by a free service

We agree with the outcome of this example. We consider that it should be noted that Jasmine preforms her tasks in her trustee capacity not her professional capacity. Reference should be made to relevant paragraphs of the NALI/E LCR.

3. Contribution made by forgiving liability

We agree with the outcome of this example. Similarly to example 1, if the contribution is not recorded then we assume that Sec 295-550 may apply. The NALI/E impact should be discussed here.

We have no further comments about examples 4 to 11.

Comments about specific sections of the Draft Contribution Ruling

1. Ordinary meaning of contribution

Paragraph 4 of TR 2010/1DC2 says, "In the superannuation context, a contribution is anything of value that increases the capital of a superannuation fund provided by a person whose purpose is to benefit one or more particular members of the fund or all of the members in general."

This comment is mostly repeated in paragraph 126 of the Draft Contribution Ruling.

This is a particularly important point. There are a range of transactions that have the net effect of benefiting particular members of a superannuation fund or all the members in general.

To illustrate, take example 2 of the Draft NALI/E LCR. This is deemed to be a scheme that would see Sec 295-550 apply. However arguably this transaction has the effect of benefiting particular members of Mikasa's SMSF because the fund has not incurred an ordinarily expected outgoing.

Is the ATO saying that specific transactions will not only attract the NALI/E provisions but also the arm's length price should be classified as a contribution as per the GYBW Administrative Appeals Tribunal case⁹?

2. Insurance benefit maybe treated as a contribution

The ATO have proposed amending Paragraph 138 to say, the following,

...where it is objectively determined that the purpose of the insurance payment is to benefit a member of the fund, the payment may be a treated as a contribution”.

Paragraph 138 of the Draft Contribution Ruling reaffirms that, by default, insurance proceeds are considered part of a super fund's investment returns. Additionally, in the context of superannuation death benefit income streams, regulation 307.125.02 of the *Income Tax Assessment (1997 Act) Regulations 2021* also confirms insurance proceeds are classified as "investment earnings".

The Compendium (TR 2010/1EC) for the original version of TR 2010/1 does not indicate any ambiguity regarding insurance proceeds being classified as income or profit – refer to item 10 in that document.

We find this proposed sentence of considerable concern especially in relation to various life insurances such as income protection (often referred to as salary continuance insurance) and permanent disability insurance. Such insurance claim proceeds are arguably for the benefit of a fund member.

Death insurance proceeds typically form part of a superannuation death benefit, which is then paid to the member's dependants or legal personal representative, subject to the superannuation fund's governing rules.

Superannuation related insurance arrangements have evolved over time, including:

- The phasing out of whole-of-life insurance in favour of term life insurance following the introduction of compulsory superannuation in 1992.
- Legislative changes from 1 July 2014 restricting the types of insurance that can be held within a superannuation fund.
- ATO guidance confirming that holding life cover as part of a buy/sell agreement within a superannuation fund would breach the sole purpose test and constitute financial assistance to a member or a related party.

To avoid unintended speculation as to the meaning of the changes, we seek clarification on the basis for this change in position within the draft ruling.

⁹ <https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2019/4262.html>

We would welcome the opportunity to discuss this submission with you. Please contact Tony Negline of Chartered Accountants Australia and New Zealand at tony.negline@charteredaccountantsanz.com.

Sincerely,

Tony Negline

Superannuation &
Financial Services
Leader

Chartered Accountants
Australia & New Zealand



Richard Webb

Superannuation
Lead Policy,
Standards and
External Affairs
CPA Australia



Phil Anderson

General Manager
Policy, Advocacy and
Standards

Financial Advice
Association Australia



Natasha Panagis

Head of Superannuation
& Financial Services
Institute of Financial
Professionals Australia



Tony Greco

Senior Tax Advisor
Institute of Public
Accountants



Geoff Boxer

CEO
National Tax and
Accountants'
Association



Mary Simmons

Head of Technical
SMSF Association

