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Pre-Budget Submission

2015/16 Federal Budget

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Topics: Superannuation, SMSFs

Key recommendations:

- Encourage the use of corporate trustees for SMSFs
- Create a safe harbour provision for low interest rate SMSF borrowings
- Extend the ability to save for retirement via superannuation

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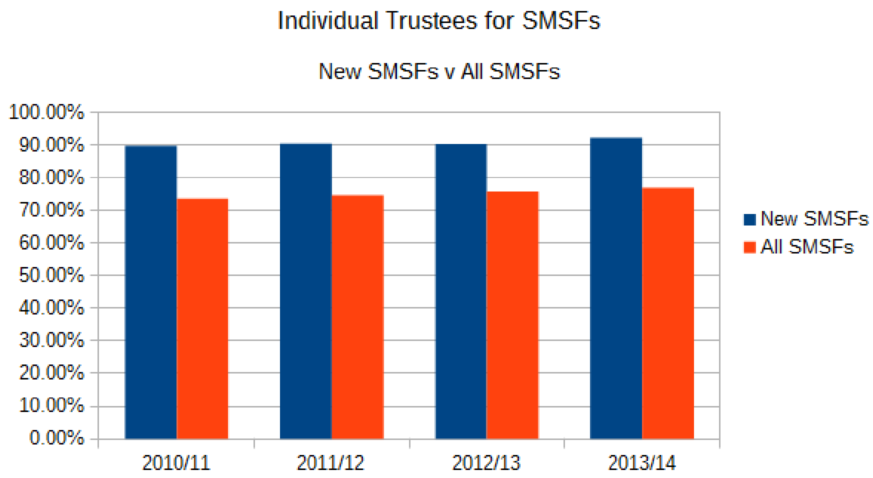
Thank you for the opportunity to make a submission prior to the 2015/16 Federal Budget. This submission will discuss issues relating to superannuation and SMSFs.

The key recommendations of this submission are:

- Encourage the use of corporate trustees for SMSFs
- Create a safe harbour provision for low interest rate SMSF borrowings
- Extend the ability to save for retirement via superannuation

1.0 Encouraging use of corporate trustees for SMSFs

92.35% of new SMSFs are set up with individual trustees, according to the most recent ATO statistics[1]. There is also an increasing trend towards individual trustees.



Source: ATO Self-managed super funds: A statistical overview 2012–13

The Super System Review remarked at this preference, given that corporate trustees are regarded as the superior structure. Data on the reasons for this decision is limited, but the Review suggested factors included cost and lack of eduction[2].

Advantages of a corporate trustees for an SMSF include limited liability (see Appendix 1), fewer changes required upon the death of a member, easier removal and addition of members and clearer ownership of assets.

I recommend the 2015/16 Federal Budget include two measures to encourage the use of corporate trustees for SMSFs. Firstly, though ASIC offers a lower annual fee for spacial purpose companies, the set up fee remains. This ASIC fee can represent almost 80% of the cost of a company[3]. Provision should be made in the budget for ASIC to reduce this fee for SMSF trustee special purpose companies.

Secondly, provision should be made for research into why individual trustees are increasingly being chosen for SMSFs. Based on this research an education campaign could be conducted by the ATO.

1 https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2012-2013/?page=33
2 Super System Review: Final Report — Part Two: Recommendation packages, Chapter 8, 4.3
3 ASIC fee represents ~76.87% of the cost from provider Cleardocs, https://www.cleardocs.com/products-company-registration.html

2.0 Safe harbour for SMSF LRBAs from non-arm's length income

Since 2014 there has been increasing concern about the potential tax consequences of low-interest and zero interest rate Limited Recourse Borrowing Arrangements (LRBAs) for SMSFs.

Concern was raised following the issue of a number of Private Binding Rulings by the ATO. These rulings set out an argument that zero interest rate LRBAs resulted in Non-Arm's Length Income (NALI). Ordinarily an SMSF in accumulation phase would pay 15% tax on income from an LRBA, while funds in pension phase would pay 0%. The NALI rules increase the tax rate applying to income from the non-arm's length arrangement to 45%, or 47% for years where the Temporary Budget Repair Levy applies.

The ATO followed these private rulings with two Interpretative Decisions (ATO ID 2014/39[4] and 2014/40[5]), late in 2014. These rulings confirmed that low-interest rate LRBAs could lead to NALI for SMSFs.

I do not suggest that LRBAs should be used to artificially increase the income of an SMSF beyond what would be expected from an arm's length investment. However this has created significant uncertainty and concern for SMSF trustees and professionals. To resolve this matter I recommend that a safe harbour provision be created, which would deem an LRBA to not trigger the NALI rules provided the loan meets certain terms, including a minimum benchmark interest rate.

3.0 Extending the ability to save for superannuation

The ability of Australians to save for retirement through superannuation should be increased by removing the limits on making superannuation contributions, retaining the Low Income Superannuation Contribution, and extending Superannuation Guarantee.

3.1 10% rule

The 10% rule, contained in section 290.160[6] of the Income Tax Assessment Act 1997, restricting the ability of employees to claim tax deductions for personal superannuation contributions, should be repealed. The 10% rule only allows tax deductions for personal superannuation contributions to be claimed where that person earns less than 10% of their income from employment. While people may be able to enter into salary sacrifice arrangements with their employer, this is at the discretion of the employer and increases administration costs.

Additionally the 10% rule complicates the decision to contribute to super, potentially leading to tax deductions being denied for otherwise valid contributions, or excess contributions tax.

4 http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID201439%2F00001%22
5 http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID201440%2F00001%22
6 http://www.austlii.edu.au/au/legis/cth/consol_act/itaa1997240/s290.160.html

3.2 Work Test

The work test, contained in Superannuation Industry (Supervision) Regulations 1994 regulation 7.04[7], limiting the ability of older Australians to contribute to super based on gainful employment, should be repealed. As the Australian workforce ages people need flexibility to move between work and retirement whilst saving. The work test also complicates the rules for older Australians making contributions to super.

3.3 Limits based on age

As of 1 July 2013 superannuation guarantee contributions no longer cease at at 70. However this only applies to mandated employer contributions, with Australians over age 75 prevented from making salary sacrifice or personal superannuation contributions. This restriction based solely on age should be repealed. This should include removing the age limit for the three year bring forward rule.

3.4 Superannuation for younger and lower income Australians

The superannuation of younger and lower income Australians would be boosted by removing the exemption from paying superannuation guarantee contributions for those earning under $450 per month and for some people under 18 years of age. This would be of particular benefit to people working multiple jobs.

The Board of Taxation[8] recently recommended changing the $450 monthly threshold to a quarterly threshold of $1350. Removing the thresholds would also simplify the administration of superannuation guarantee for employers, and would be of minimal cost to government, according to the Australian Institute of Superannuation Trustees[9].

3.5 Superannuation Guarantee

I urge the Government to reconsider the decision to delay increases to the superannuation guarantee rate, beyond not only what was previously scheduled, but what was announced at several times as the Minerals Resource Rent Tax (MRRT) repeal was passed.

3.6 Low Income Superannuation Contribution (LISC)

The Low Income Superannuation Contribution (LISC) should be retained past the current end date of 30 June 2017. The LISC is an important measure to increase the superannuation balance of low-income Australians. Without the LISC low income workers face higher taxes on their compulsory superannuation guarantee contributions than their ordinary wages. Through the LISC offsetting the 15% contributions tax these increased savings will continue to accrue investment returns, growing superannuation balances.

7 http://www.austlii.edu.au/au/legis/cth/consol_reg/sir1994582/s7.04.html
8 http://www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/impediments_facing_small_business/default.htm&pageid=007
9 http://www.aist.asn.au/media/561270/22_01_2014_moves_to_lift_super_threshold_will_penalise_low_income_workers.pdf

The LISC has several advantages over the co-contribution, which is arguably not achieving its goal of assisting low-income earners to save to retirement. The LISC is better targeted, and doesn't require additional money to be found to contribute to super.

The cost of the LISC should be weighed against the future benefits to the budget of increased superannuation balances, especially amongst those most likely to be eligible for the age pension.

Additionally I recommend that the LISC be indexed to the rate of the superannuation guarantee (SG). When originally introduced the $500 LISC covered the full amount of contributions tax for those eligible: 9% of $37,000 at 15% = $499.50. However no provision was made for increases in the SG rate. As the SG rate increases the LISC will fall further behind in terms of offsetting the amount of contributions tax. Indexing the LISC to the SG rate will preserve the purpose of the measure.

Appendix 1:

Summary of
Shail Superannuation Fund and Commissioner of Taxation [2011] AATA 940[10]

Mr and Mrs Shail were individual trustees of the Shail Superannuation Fund, an SMSF. During 2005 Mr Shail transferred $ 3,460,000 from the cash management account of the fund into a bank account held in his personal name in Turkey. Neither of them had reached their preservation age. The ATO issued a notice on non-compliance on the fund, assessing tax payable of $1,583,873.68 and penalties of $1,475,322.50. It was accepted that Mrs Shail did not have knowledge of the withdrawal at the time, nor received a benefit from the transaction. It was argued that Mrs Shail should not be responsible for a breach resulting from the actions of another trustee. However the tax and penalties stood.

10 http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/cth/AATA/2011/940.html?