The Tax Institute

26 September 2022

The Hon Dr Jim Chalmers MP, Treasurer
The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services
Parliament House
Canberra ACT 2600

By email: jim.chalmers.mp@aph.gov.au, Stephen.Jones.MP@aph.gov.au

Dear Treasurer and Assistant Treasurer,

Updated Federal Budget 2022–23

We write regarding our views on the priorities for the updated Federal Budget 2022–23. The Federal Budget plays a pivotal role in determining the economic direction of Australia's future, impacting the lives of everyone in the community. We are of the view that this process requires input from a diverse range of stakeholders whose views and experiences can guide the Government in addressing the most pertinent issues.

As the leading professional body for the tax community in Australia, we have consulted with our National Technical Committees and broader membership to deliver a submission that outlines the key issues related to the Australian tax, transfer and superannuation systems that should be prioritised by the Government.

Australians and our economy have endured significant challenges and disruptions since late-2019, with a succession of natural disasters and the global pandemic. In particular, the impacts of COVID-19 have been among the most disruptive in Australia's economic history, requiring significant resources from the Commonwealth Government and State and Territory governments to support individuals and businesses.

A few key COVID-19 and natural disaster related measures have not yet been given legislative effect by Parliament. These include the proposed easing of the residency requirement for self-managed superannuation funds (**SMSFs**), and proposals targeted at ensuring that working holiday makers (**WHM**) and participants in the Seasonal Labour Mobility Program (**SLMP**) are taxed equitably and at the intended rates. We also consider that the Government should take additional steps to ensure that all grants or support payments made to businesses and individuals in response to COVID-19 and the spate of natural disasters are not taxed as assessable income, ensuring recipients receive the full benefit from the amounts received.

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There have also been significant disruptions to the legislative schedule, resulting in an extensive number of announced but unenacted measures (**ABUMs**) that require a strategic approach by the Government. The Tax Institute's Incoming Government Brief: June 2022 (**Brief**) notes these measures and outlines our view on how they should be prioritised given the current needs of Australia's taxation and superannuation systems. Taxpayers need certainty so they can efficiently manage their taxation affairs. Clarifying the Government's intention in relation to dozens of ABUMs would facilitate this.

The measures outlined in the Brief that we consider to be the highest priority still require Government's urgent action and include:

- addressing the issues associated with the non-arm's length income (**NALI**) provisions for superannuation funds;
- reform of the corporate tax residency rules; and
- reform of the Division 7A rules for private companies and privately held groups.

In addition to the outstanding measures outlined in the Brief, there are pervasive issues in our current tax system that require the Government's attention. These include increasing the permanent funding of the Australian Taxation Office (**ATO**) to better support the administrator in assisting taxpayers and tax practitioners to comply with their legislative requirements, and funding to ensure that the Tax Practitioners Board (**TPB**) operates fully independently. We consider opportunities also exist to reduce existing complexity in certain areas such as the Fringe Benefits Tax (**FBT**) regime.

Opportunities also exist for the Government to further examine how the taxation system could be utilised as part of a comprehensive environmental policy to reduce the impacts of climate change.

Our superannuation system requires the Government's attention to ensure that parties are encouraged to contribute to taxpayers' superannuation balances, allowing older Australians to better support themselves during their retirement. In particular, we consider that changes are needed to the excessive penalties imposed on employers who are late to make Superannuation Guarantee (**SG**) contributions. Changes in this regard will encourage them to disclose and make good any historical shortfalls of their employees' superannuation entitlements. There are opportunities to significantly reduce the compliance and costs burden on superannuation funds by allowing them greater flexibility in the rationalisation of legacy products and underlying trust structures. In addition, rationalisation of the various thresholds that apply to indexation across contributions and pensions is recommended. Complexity could be immediately reduced by replacing the proportional Transfer Balance Cap (**TBC**) indexation process with a fixed indexation amount that applies to all superannuants universally, irrespective of when they commenced their income stream(s) and whether they have wholly or partly utilised the general TBC. There is a need to ensure that superannuation balances are treated efficiently and provide taxpayers with flexibility upon death. Currently, several issues prevent this from occurring and require legislative fixes by the Government.

Australia's transfer system plays a key role in complementing the tax system and ensuring Australians are equitably supported. The transfer system can have significant influence over an individual's monetary habits and ability to participate in the workforce. In particular, the Child Care Subsidy (**CCS**) should be amended to be more effective in assisting families. This will aid families in an economy with increased costs and living. More targeted support will also allow parents to participate in the workforce, assisting with easing the pressures created by ongoing shortages in skilled staff.

We urge the Government to act on our recommendations in the upcoming Federal Budget. These steps are necessary to ensure that our taxation and superannuation system is better prepared for the upcoming future challenges. Our recommendations would also enable the new Government to focus on the longer term goal of comprehensive tax reform, as noted in detail in our Case for Change (July 2021) discussion paper.

Our detailed response is contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

If you would like to discuss any of the above, please contact Scott Treatt, General Manager, Tax Policy and Advocacy, on (02) 8223 0008.

Yours faithfully,

Jerome Tse

President

APPENDIX A

Announced but unenacted measures

A significant number of measures remain outstanding following the prorogation of the 46th Parliament ahead of the Federal election held in May 2022. These ABUMs require a strategic response from the Government to provide taxpayers with certainty regarding their taxation affairs.

The Brief sets out The Tax Institute's view on the way in which the ABUMs should be prioritised. The priorities were determined after an extensive analysis of what would benefit most taxpayers and what is most crucial for the health of our taxation and superannuation systems. This included an analysis of a range of factors, including:

- the potential future impact on our economy;
- supporting businesses during a period of rising costs and economic uncertainty;
- the current pressures on tax practitioners to support taxpayers and help them comply with their taxation obligations;
- the existing and future compliance burdens on taxpayers;
- whether the announced measures can assist the Government to better manage the current fiscal pressures;
- the ability of our current systems to manage the implications and additional burdens imposed by implementing the measures at this time; and
- the time required to appropriately design and implement the proposed changes.

We urge the Government to act on the recommendations made in the Brief, particularly those of the highest priority. Below, we re-iterate these highest priority measures that have been announced but remain unenacted. We suggest that the Government should consider starting the process of strategically acting on the other unenacted measures noted in the Brief to ensure that this list does not continue to grow.

Non-arm's length income provisions for superannuation funds

The Tax Institute is of the view that the Government should prioritise legislative amendments to the NALI provisions in section 295-550 of the *Income Tax Assessment Act 1997* (**ITAA 1997**) to rectify the unintended, damaging and disproportionate consequences inherent in the current drafting. Under the current settings, minor or inconsequential actions that invoke the NALI provisions are likely to materially and adversely impact the superannuation balances of all Australians and impose an unnecessary compliance burden on all superannuation funds.

The NALI provisions were originally introduced to deter superannuation funds from entering into schemes to increase member balances through non-arm's length arrangements that resulted in excessive income or not charging expenses. However, the administration of the legislation is likely to have a disproportionate impact compared to the mischief it was intended to target. As noted in the ATO's guidance,[1] the rules can be enlivened for common and minor actions or be inconsistent with trustee obligations, such as the duty to act in the best financial interests of the beneficiary. An example of a relevant action is the use of discounted in-house bookkeeping services or the trustee of an SMSF electing to undertake property repairs to reduce overall expenditure.

Where the NALI rules apply to general expenses, the superannuation fund can be liable for punitive tax at the rate of 45%, compared with the standard superannuation income tax rate of 15%. This is imposed on all income generated by the fund in an income year even if the non-arm's length activity is only minor and, potentially, in all of the future income years of the fund too, including on capital gains. This penalty rate is three times higher than the rates for complying superannuation funds, and its application to all income for minor breaches is draconian. Further, given the frequency and commonality of the actions in question, the NALI provisions may be invoked by all funds including large APRA-regulated funds. The NALI rules represent the single largest tax risk to superannuation funds and member retiring balances by far, due to the gravity of the penalty and the ambiguity and ease with which they can be inadvertently invoked.

These issues, and the likely impacts of the NALI provisions on the superannuation balances of all Australians, are discussed in greater detail in submissions made to the Government in September 2021 and December 2021 by The Tax Institute and many other professional bodies. We call on the Government to act promptly and progress the announcement made by the previous government to address these concerns.

Corporate tax residency

Australia's corporate tax residency rules contain significant complexity and uncertainty. This results in difficulties for taxpayers seeking to understand their taxation obligations and efficiently resolve disputes with the ATO. These factors may also act disincentivise international companies looking to expand their operations into Australia, potentially limiting investment and job opportunities here.

The previous government announced that it would adopt the recommendation made by the Board of Taxation (**Board**) to amend the law so that a company incorporated offshore would be treated as an Australian resident for tax purposes if it has a 'significant economic connection to Australia'. The previous government subsequently announced that it would consult on potentially extending this treatment to corporate limited partnerships (**CLPs**) and trusts.

The proposal by the Board has generally been positively received by industry. It is designed to exclude 'genuine' operating businesses and return the focus to passive holding companies with insufficient substance or commercial purpose.

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[1] See Law Companion Ruling LCR 2021/2: *Non-arm's length income – expenditure incurred under a non-arm's length arrangement* and Practical Compliance Guideline PCG 2020/5: *Applying the non-arm's length income provisions to 'non arm's length expenditure' – ATO compliance approach for complying superannuation entities.*

As we move into a post-COVID-19 world, there is a greater need for clarity and certainty on the issue of corporate residency. Currently, taxpayers are relying on transitional provisions as outlined in the ATO's Practical Compliance Guideline PCG 2018/9, which provides for a transitional compliance approach that dates back to March 2017. Taxpayers require certainty in their business dealings and should not need to rely on continued extensions of the transitional approach from the ATO.

We consider that that the Government should swiftly implement the proposed changes to the corporate tax residency rules after undertaking the announced consultation regarding CLPs and trusts. It is important to ensure greater certainty for corporate taxpayers regarding their tax residency status when conducting their businesses in a global economy. This will enable these businesses to comply with their taxation obligations and likely reduce the number of disputes regarding residency. The amendments may also encourage overseas capital flowing into Australia, on which our economy has historically been heavily reliant.

Division 7A reform

Division 7A of Part III of the *Income Tax Assessment Act 1936* (**ITAA 1936**) was introduced with effect from December 1997 as an anti-avoidance regime to prevent the inappropriate extraction of wealth from private companies and privately held groups. Over time, case law and legislative modifications to Division 7A have created significant complexity and increased compliance costs for taxpayers. This complexity has not been resolved despite the extensive amount of law and ATO guidance products regarding Division 7A, as the complexity arises primarily from the underlying provisions and their potential interpretation.

The Division 7A rules should be revisited and their operation simplified to provide certainty and promote simplicity for taxpayers while ensuring that the rules operate effectively to ensure integrity in the system.

As part of the Federal Budget 2016–17, the previous government announced proposed changes to the Division 7A rules to improve their integrity and operation. These proposed amendments have been deferred multiple times, increasing uncertainty for taxpayers in managing their tax affairs.

The amendments are based on the recommendations of the Board and include:

- simplified Division 7A loan rules to make it easier for taxpayers to comply with the provisions;
- a self-correction mechanism to assist taxpayers to promptly rectify breaches of Division 7A without having to apply for the Commissioner's discretion;
- safe harbour rules that would simplify the compliance burden for taxpayers and provide certainty in the system;
- clarification of the application of the unpaid present entitlement rules relating to trust amounts in Division 7A; and
- other technical amendments designed to improve the integrity and operation of Division 7A.

Many of the proposed reforms would provide certainty for taxpayers and simplify the treatment of structures and transactions involving private companies that are widely used in the small and medium enterprise sector. However, some aspects of the reforms, such as the proposal to increase the period of review to 14 years and remove the concept of ‘distributable surplus’, have caused significant concerns for taxpayers and warrant further consultation.

The Tax Institute considers that the Government should consolidate the various reform ideas and legislate the changes after a further detailed consultation with the tax profession. This is necessary to ensure that the appropriate balance between compliance costs, complexity and integrity is achieved. Division 7A applies to a significant number of private companies and privately held groups. The ongoing compliance burden and uncertainty for these groups should be reduced, enabling them to more efficiently allocate their limited resources towards business activities.

Residency requirements for self-managed superannuation funds

Currently, the trustee functions for an SMSF may be performed outside Australia for a maximum of two years where the trustee temporarily relocates overseas. However, if a trustee remains overseas due to circumstances outside their control, or the active member test is not met (which does not provide for any temporary absence period), the fund will become a non-resident for tax purposes. This has significant adverse tax implications for the SMSF.

Amid the global lockdowns during the COVID-19 pandemic, many trustees found themselves unable to return to Australia within the prescribed time limit due to circumstances outside their control or due to reasonable concerns regarding their health and wellbeing as well as border entry restrictions. This has resulted in impacted SMSFs becoming non-residents and unfairly triggering adverse tax consequences.

As part of the Federal Budget 2021–22, the previous government announced that these residency rules for SMSFs would be relaxed. The proposal would extend the central management and control test safe harbour from two to five years, in addition to removing the active member test for SMSFs and small APRA-regulated funds.

The Tax Institute is of the view that the Government should proceed with and implement this proposal. These changes would:

- rectify the inequitable treatment of superannuation funds unfairly impacted by COVID-19 lockdowns; and
- allow members of SMSFs and small APRA-regulated funds to continue to contribute to their superannuation funds while temporarily overseas.

Encouraging and enabling individuals contribute to their superannuation under most circumstances is consistent with the long-term policy objective of superannuation, allowing individuals to be self-sufficient during retirement and reducing the financial burden on the government and future generations.

Tax treatment of Working Holiday Makers and Seasonal Labour Mobility Program workers

During the COVID-19 pandemic, many WHMs and participants in the SLMP had their visas extended to appropriately manage the impacts of global lockdowns. As a result of these visa extensions, which were made under a new visa subclass, these workers were not able to access the concessionary tax rates that would have otherwise been available to them under their WHM or SLMP visa subclasses.

In response, the previous government released for comment a draft bill and accompanying regulations in September 2021 that proposed to ensure that impacted individuals remain eligible for the concessionary tax rates under their new COVID-19 temporary visa. However, this bill was not introduced into Parliament. As a result, individuals who had their visas extended due to the pandemic may be unfairly taxed at the higher rate that applies to non-residents, depending on their individual circumstances.

We consider that the Government should support the measures in the draft bill and introduce enabling legislation into Parliament as a matter of urgency. Certain sectors of the Australian economy are heavily reliant on overseas employees working in Australia under the WHM and SLMP visa programs, including agriculture, hospitality and tourism. Taxing these workers at a higher rate has reduced the incentives under these programs, contributing to the reduced pool of available labour for these essential sectors. This is placing excessive burdens on businesses and increasing costs during a time when the impact of inflation and labour shortages are affecting almost all industries across Australia. Individuals under the new visa subclasses should be provided with certainty regarding their tax position at the earliest possible opportunity.

COVID-19 and natural disaster payments

During the period from March 2020 to April 2022, the Commonwealth Government and State and Territory governments announced a series of grants and support payments to assist individuals and businesses better manage the impact of successive natural disasters and COVID-19. This included grants to small businesses impacted by COVID-19, and payments to individuals to provide financial assistance during the floods in New South Wales and Queensland in early 2022. These amounts were intended to support impacted taxpayers through a period of significant hardship. However, these amounts risk being treated as assessable income for income tax purposes, thereby reducing the full benefit of the amount of financial assistance received.

Sections 59-97 and 59-98 of the ITAA 1997 allow support payments in relation to the pandemic to be treated as non-assessable non-exempt (**NANE**) income, if certain criteria are met. The legislative requirements include, but are not limited to:

- the business having an aggregated turnover of less than $50 million;
- the payment being in relation to the COVID-19 pandemic; and
- the payment being received in:
  - either the 2020–21 or the 2021–22 income years under a State or Territory government program; or
  - the 2021–22 or a later income year under a Federal Government program.

To be tax-free, payments under these programs also need to be declared eligible in a legislative instrument issued by the Minister. There are several support payments that would otherwise meet the criteria, but are not currently treated as NANE income as they have not been declared eligible for tax-free treatment by way of a legislative instrument. This results in some grants being NANE income while others are taxable, despite the grant being made with the intention of assisting businesses to manage the impacts of the pandemic in a tax-free manner. This inconsistent treatment produces inequitable outcomes and confusion for taxpayers.

Further, payments to individuals impacted by the floods in early 2022 throughout various areas of New South Wales and Queensland have not been declared as NANE income under the ITAA 1997. Currently, recipients are required to declare the payments as assessable income, thereby reducing the benefit of the full amount available to assist them recover from the damage caused by these natural disasters.

The Tax Institute is of the view that the Government should introduce enabling bills or register the necessary legislative instruments, as required, to confirm these amounts are treated as NANE income in the hands of the relevant taxpayers. This would reduce potential confusion and ensure that the recipients are able to receive the benefit of the full value of the financial assistance.

Temporary full expensing amendment

The expanded instant asset write-off measure was introduced by Schedule 1 to the *Coronavirus Economic Response Package Omnibus Act 2020* and enabled businesses with an aggregated turnover of less than $50 million to immediately deduct the cost of depreciating assets that cost less than $150,000. Broadly, the measure intended to assist eligible businesses through the economic difficulties resulting from the COVID-19 pandemic.

This measure was then superseded by the temporary full expensing measure, introduced by Schedule 1 to the *Treasury Laws Amendment (2020 Measures No. 6) Act 2020*. This regime expanded access by allowing businesses with an aggregated turnover of less than $5 billion to fully expense the cost of depreciating assets (no cost limit applies to the assets). An alternative income test was also included for certain entities with an aggregated turnover of $5 billion or more. This temporary measure was originally legislated to end on 30 June 2022 but was extended until 30 June 2023 by Schedule 6 to the *Treasury Laws Amendment (Enhancing Superannuation Outcomes For Australians and Helping Australian Businesses Invest) Act 2021*.

Broadly, the current measure allows eligible businesses with an aggregated turnover of less than $5 billion to immediately deduct the full cost of eligible depreciating assets until 30 June 2023. Section 40-150 of the *Income Tax (Transitional Provisions) Act 1997* (**IT(TP)A**) requires that the asset be first used, or be first installed ready for use, by 30 June 2023. However, recent disruptions to the global supply chain have resulted in many businesses experiencing delays in getting their assets installed ready for use. Delivery and installation delays have continued in 2022 and are expected to continue well into 2023. The disruptions have been a consequence of factors beyond the control of taxpayers looking to utilise this measure. These delays may inequitably result in businesses being ineligible for temporary full expensing, even taking into account the recent extension of the measure to 30 June 2023.

The Tax Institute is of the view that Government should consider the requirements in section 40-150 of the IT(TP)A to:

- include contracts entered onto or before 30 June 2023, even if the depreciating asset is not first used or first installed ready for use by 30 June 2023; or
- require the depreciating asset to be used, or be installed ready for use, by 30 June 2024.

This will ensure that businesses remain eligible for deductions relating to expenditure they incurred or will incur on depreciating assets under the measure, the first use of which is delayed due to the global supply chain issues. We consider that this amendment should not significantly impact the expected revenue or give rise to an integrity concern but would ensure these businesses are not adversely impacted by factors beyond their control.

Administration of taxation and superannuation system

Funding of Australian Taxation Office

The ATO plays an integral role in the administration of Australia's taxation and superannuation systems. This covers a range of responsibilities from collecting revenue to, increasingly, taking responsibility for distributing and managing significant economic incentives. The ATO is also the leading body that provides technical and interpretive guidance to taxpayers and tax practitioners to assist them navigate the complexities and requirements of the relevant legislation. This broad portfolio of responsibilities necessitates the ATO be sufficiently funded to ensure that it can undertake its activities and fulfill its responsibilities and obligations in an expedient and efficient manner. The ATO is currently under-resourced in key areas. This results in a lack of guidance for the community, delays in standard processing including ABN applications, requests for private rulings and responses to objections, and an inability for taxpayers to efficiently resolve ongoing disputes with the ATO. Historically, a significant portion of the ATO's funding has been provided in lump sum amounts for taskforces aimed at recovering monies or increasing taxation collected from specific market segments. Examples include the extension of the current funding for the Tax Avoidance Taskforce as announced in the Mid-Year Economic and Fiscal Outlook 2021–22.

The Tax Institute considers that this approach of allocating temporary and limited funding for specific compliance programs supports the ATO only in addressing a small category of high-risk behaviours through various compliance programs. We consider that the ATO should receive increased and longer-term funding for other business areas that develop interpretative guidance, resolve disputes, support taxpayers in meeting their taxation and superannuation obligations, and modernise underlying technologies that can assist taxpayers and tax practitioners better manage the currently excessive compliance burdens. The provision of greater funding to these business lines would ensure that ATO resources are being applied to assist a greater number of taxpayers to comply with their tax obligations. This would have the flow on effect of increasing voluntary compliance and revenue collection.

Review of the independence of the Tax Practitioners Board

Tax practitioners play a vital role in assisting their clients to navigate the complexities of the taxation and superannuation systems and comply with their tax payment and reporting obligations. It is necessary for registered tax agents and BAS agents to be regulated by a government body that is independent from the ATO, the administrator of our taxation and superannuation systems. Greater independence would ensure improve community confidence by creating a transparent and efficient regulatory system for tax practitioners.

On 5 March 2019, the previous government announced a review concerning the independence of the TPB from the ATO. The review was in response to concerns that the legislative framework surrounding the TPB did not meet the underlying policy objectives of ensuring that tax agent services are provided to the public in accordance with appropriate standards of professional and ethical conduct.

Broadly, the review sought to ensure that the TPB would be able to:

- maintain, protect and enhance the integrity of registered tax agents and BAS agents;
- operate as an independent, efficient and effective regulator; and
- protect all consumers of tax agent services and BAS services.

The final report, released in November 2020, recommended a range of legislative, procedural and funding changes that would ensure that the TPB is able to meet these objectives as a separate government agency with its own appropriation from the Government. The Tax Institute is of the view that the Government consider releasing a formal position supporting independent funding for the TPB. We also consider that Government should consult with the professional associations with a view to implementing the recommendations to ensure that the TPB operates as a fully independent agency.

Supporting Board of Taxation reviews

The Board has undertaken, or is in the process of undertaking, several reviews targeted at improving the operation of the tax system across various issues. The Tax Institute considers that the Government should support ongoing reviews by the Board including reviews concerning the:

- tax treatment of digital assets in Australia
- compliance costs of FBT.

We also consider that the Government should consider acknowledging completed reviews and providing a government response, as well as progressing the recommendations by way of public consultation with the intention of implementing change. These include completed reviews conducted by the Board on:

- capital gains tax (**CGT**) rollovers
- introducing asset merger rollover relief
- the income tax treatment of certain forms of deferred consideration.

It is important for the Government to ensure that potential future legislative developments address existing areas of complexity and do not compound compliance costs for taxpayers. If the Government progresses previous ABUMs such as the proposal to reduce the FBT record-keeping burden or the planned consultation on FBT on car parking benefits, it is important to ensure that any proposal seeks to address systemic issues rather than surface level problems.

Child care subsidy

The Tax Institute is of the view that the CCS should be improved to better assist families during the current economic challenges by providing an immediate increase the household income. We note the changes to the CCS made by the previous government[2] and the Government's announcement to further reduce the cost of child care. The Government's plan includes:

- increasing the maximum rate to 90% for the first child in care;
- increasing that rates for all household income brackets up to $530,000;
- keeping the higher rates for second and additional children in care; and
- undertaking a review to with the aim of implementing a universal 90% subsidy for all families.

The Tax Institute supports the Government's proposal, but considers that further steps are needed to support families who need it the most. Although the rate of the subsidy is important, there are fundamental concerns with other aspects of the CCS which may limit the effectiveness of the subsidy. These include the current thresholds and formulas used in determining a family's eligibility to the CCS.

We recommend that Government consider raising the subsidy to 95%, irrespective of the number of children the family contains. We also recommend that Government consider reviewing the hourly rate cap to better reflect the current costs of living and raising a family. The current hourly rate cap is not reflective of the rapidly increasing costs of childcare, especially in major cities. As the CCS applies to the lower of the hourly fee charged or the hourly rate cap, this means that a growing number of families are more likely to be put in a position where child care is becoming a less viable option.

Furthermore, it is our opinion that the Activity Test should be updated to better reflect the hours of care required for a secondary income earner to work the respective days. Under the current system, families may not be eligible for a subsidy for the secondary income earner's tenth working day, assuming they are on a 5 day working week. This can discourage families from returning to full-time work when they have children in child care. Increasing the effectiveness of the CCS will also encourage parents to participate in the workforce, helping to reduce the pressures on the ongoing skills shortage.

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2 See *Family Assistance Legislation Amendment (Child Care Subsidy) Act 2021* (Cth).

Superannuation

Addressing superannuation guarantee non-compliance

The Tax Institute is of the view that the current penalty rate of 200% imposed on employers for late lodgment of, or failure to provide, a SG statement under Part 7 of the *Superannuation Guarantee (Administration) Act 1992* (**SGAA**) requires urgent reform. The excessive penalty rate applies even if the employer is late by only one day, or if the employer expended the funds by making the contribution before the due date but an SG shortfall arises from a processing delay.

The current laws are not aligned with other penalties that apply to employers that fail to meet their employment obligations, including the late payment of wages under the *Fair Work Act 2009*. The disproportionate penalties under the SGAA act as significant deterrents for non-compliant employers and do not encourage employers to rectify historical SG shortfalls. A more reasonable approach to SG non-compliance is likely to encourage employers to address any historical non-compliance. This was demonstrated by the SG amnesty regime, given effect by the *Treasury Laws Amendment (Recovering Unpaid Superannuation) Act 2020*, when approximately 28,300 employers voluntarily disclosed approximately $911.5 million in previously unpaid superannuation.[3]

We consider that the penalties for SG non-compliance should be aligned with those penalties targeted at employers for non-compliance by the *Fair Work Act 2009*, with the nominal interest component intended to recompense employees for lost earnings and benefits rather than effectively acting as a double penalty for failing to lodge an SG statement and notify the Commissioner of the shortfall. This approach would provide more equitable treatment to employers while retaining the integrity of the SG charge regime.

We note the previous government's attempts to reform aspects of SG non-compliance. The Treasury Legislation Amendment (Repeal Day 2015) Bill 2016 (Cth), which lapsed following the prorogation of Parliament ahead of the 2016 election, which proposed to make the SG charge and penalty regime more proportionate to the employer's non-compliance by, broadly:

- replacing salary or wages as the current basis for calculating SG charge and aligning this with the base used to calculate SG contributions (ordinary time earnings);
- aligning the nominal interest on unpaid or late SG contributions with the period over which they are actually outstanding; and
- removing the additional SG charge penalty imposed under Part 7 of the SGAA and replacing this with the general tax penalty provisions imposed under the *Taxation Administration Act 1953* (Cth).

We recommend that the Government should consider reintroducing this bill after consulting with industry on the suitability of the proposed changes as a framework for reforming SG non-compliance. The consultation would benefit from expanding the scope of any changes to address the issues highlighted in our submission.

[3] ATO, Superannuation guarantee amnesty.

Proportionate indexation of the transfer balance cap

The Tax Institute recommends that the Government should consider abolishing proportionate indexation of the TBC to simplify the superannuation rules from both a compliance and administrative perspective. The TBC limits the amount of capital that an individual can set aside to pay a superannuation income stream. Earnings on such capital are not subject to income tax. Once an individual commences a retirement phase income stream, they obtain a personal TBC that is equal to the general TBC ($1.6 million from 1 July 2017 to 30 June 2021, and $1.7 million from 1 July 2021).

Where an individual does not fully utilise the general TBC, a proportional indexation of their TBC is applied. However, the complexity of proportionate indexation renders it an inefficient and unwieldy mechanism to limit an individual's tax-free earnings in superannuation. Proportionate indexation of the TBC for certain individuals means that thousands of superannuation fund members have a personal TBC that is different from the rest of the population. This complication, together with the current inability to access timely TBC data from the ATO has made it difficult for advisers to provide accurate advice to taxpayers. As the system imposes the same penalties on inadvertent breaches as deliberate non-compliance, superannuation fund members may be faced with unfair penalties as they attempt to navigate the rules with their advisers.

The recent indexation of the general TBC from $1.6 million to $1.7 million from 1 July 2021 was met with significant criticism regarding the resulting complexity created by the proportionate indexation approach for those who had already commenced an income stream. We consider that these difficulties will be compounded during the next round of indexation, which, given the recent inflation figures, could be expected to result in the general TBC increasing to $1.8 million from 1 July 2023.

The Tax Institute recommends that the Government should consider removing proportionate indexation of the TBC and instead apply indexation that universally applies to all superannuation fund members. This change would reduce the complexity of the superannuation system, give superannuation fund members greater certainty around their TBC amount and reduce the administrative burden for the ATO in monitoring and regulating the regime.

We note that proportional indexation does not apply to the low-rate cap that applies to lump sum drawings before the age of 60. The proportional indexation of the general TBC is unusual throughout the tax and superannuation systems as almost all forms of indexation apply equally to all impacted taxpayers. Disparity between the two types of concessionally taxed superannuation drawings is not equitable.

New rollover for product rationalisation

Superannuation funds often create new investment products in response to changes in consumer expectations and the broader investment landscape. As preferences change, it is not uncommon for funds to have a large number of products and underlying investment trust structures over time. Currently, funds are not able to rationalise the various products and underlying trusts without incurring significant CGT liabilities. Many of these therefore become legacies that are costly to maintain and a burden on the broader fund membership.

The Tax Institute is of the view that the Government should consider introducing a CGT rollover similar to those offered to companies for demergers and acquisitions to enable superannuation funds to rationalise and streamline the products offered within the same fund and the supporting investment trust structures, without incurring significant CGT liabilities. The cost base of the fund's investment would carry through until the product is disposed of in the normal course of a portfolio review.

This measure would allow superannuation funds to ensure they can provide fund members with optimal investment options and be adaptable if available investments or economic circumstances change. This would also ensure that funds are provided with sufficient flexibility to achieve their primary goal of maximising members' balances. This could also result in members having larger fund balances and therefore being more able to support themselves in retirement. Ongoing savings in administrative costs by allowing superannuation funds to simplify their products and trust structures with such a rollover would be considerable. One superannuation fund had assessed these costs collectively at more than $100 million per annum, which may be passed onto members.

Ensuring certainty and equity in the event of death

Our superannuation system needs to ensure taxpayers have certainty and flexibility over amounts in the event of an individual's death. Individuals face a significant risk of their superannuation not being left in accordance with their wishes following their death and this can impact dependants' ability to support themselves. Below, we note some key improvements that the Government could consider making to achieve the desired outcomes.

Non-lapsing of binding death benefit nominations

Binding death benefit nominations **(BDBNs**) provide a mechanism for members of superannuation funds to ensure that the trustee of their fund deals with their interest in the fund following their death according to their wishes. The current regulatory framework for BDBNs is complex and applies differently to different types of superannuation funds.

Broadly, a BDBN remains in effect for up to three years from the day it was first signed, last confirmed, or last amended by the member, unless the trust deed specifies a shorter time. This requires members to incur compliance costs and regularly update their BDBNs, even if their underlying circumstances have not changed. The three-year lapsing period for BDBNs does not apply to SMSFs, unless the trust deed specifies otherwise.

The Tax Institute recommends simplifying the BDBN lapsing rules and changing the default position so that BDBNs are non-lapsing for all types of superannuation funds, unless the trust deed specifies otherwise. This would reduce the administrative costs for fund members to ensure that their BDBNs remain effective, and provide greater certainty that their superannuation benefits will be dealt with according to their wishes.

Restrictions on death benefit payouts

Under current legislation, trustees of SMSFs are limited to a maximum of two lump sum payments (**two-lump sum rule**) when a death benefit is paid out to a dependant. The Tax institute is of the view that this places an excessive restriction and compliance burden on trustees and may result in inequitable outcomes for dependants in instances where genuine mistakes are made. Where a death benefit is paid via an in specie transfer of fund assets, there may be multiple 'lump sums' paid in contravention of the two-lump sum rule. As it stands, clarification is required on when the death benefit is taken to have been paid – at the time of the trustee's resolution or when each transfer is made. More broadly, trustees should not be limited in the number of payments they can make, provided the payments are in accordance with the death benefit decision, for the correct amount, and made within a reasonable period.

The Tax Institute is also of the view that that the Government should consider amending the Superannuation Industry (Supervision) Regulations 1994 to allow trustees to make *in specie* distributions of pensions and death benefits. Currently trustees are usually required to make these distributions in the form of cash. However, there are often instances where beneficiaries would prefer the payout to be in the form of an *in specie* distribution, especially when the relevant asset is real estate, securities (shares, units or similar fungible assets) or other assets of a similar nature. The ATO considers in ATO ID 2012/79[4] that a security (e.g. shares) in each separate company is a separate asset. This ATO view precludes *in specie* distributions of securities on death, given the ATO may impose severe penalties on fund trustees. Allowing trustees greater flexibility would minimise transaction costs and better manage the market risks of holding assets, especially when the beneficiary wants the asset for their own use.

Fringe benefits tax on car parking

FBT on car parking remains a complex area of the law, resulting in excessive compliance costs for employers of all sizes. The previous government announced a public consultation on a proposal to amend the definition of a 'commercial parking station' in the *Fringe Benefits Tax Assessment Act 1986* through minor modifications. Broadly, the scope of the proposed amendments would overturn the findings in recent court cases that determined that car parking facilities that charge high penalty rates are 'commercial parking stations' And were contrary to the previously accepted views. In effect, the court cases, and subsequent ATO approach, have likely resulted in a larger number of employers facing an increased or new compliance burden imposed by FBT on car parking benefits.

[4] We note that ATO ID 2012/79 has been withdrawn as sub-regulations 7.04(3) and 7.04(7) of the Superannuation Industry (Supervision) Regulations 1994 have been repealed with effect from 1 July 2017. However, ATO ID 2012/79 continues to be a precedential ATO view in respect of up to the 2016–17 income year and for the underlying principle that is potentially relevant to other sections.

While we would welcome these proposed amendments, the significant complexities and difficulties in complying with the various FBT car parking rules remain for employers. Practically, the rules require employers to keep extensive records on when their employees enter and leave the employer's car parking facility, where the employee is coming from/going to, and how long the employee parks there. Employers must also understand the business model and pricing structure of all car parking facilities within a one-kilometre radius (as travelled by road) to determine if they are a 'commercial parking station' and charge above the annually declared car parking threshold.

If these requirements are met, the employer is then required to calculate the number of car parking benefits provided, for which there are three methods, and the amount of FBT payable on the benefits provided, for which there are a further three methods.

The Tax Institute is of the view that the Government should consider expanding the scope of the consultation proposed by the previous government to undertake a more comprehensive reform of the rules for FBT on car parking benefits. Replacing the existing rules with simpler requirements and fewer calculation methodologies would significantly reduce the complexity and compliance costs for impacted employers.

Tax treaty network

Tax treaties are fundamental to enabling Australian taxpayers to participate effectively in the global economy and allowing non-resident taxpayers to engage in the domestic Australian economy. In addition to acting as mechanisms to prevent double taxation and tax avoidance, tax treaties provide mechanisms for administrative cooperation through information sharing, allowances for cross-border tax collection, and processes for settling disputes.

The previous government announced a public consultation concerning the expansion of Australia's tax treaty network. We understand that treaty negotiations with some of the countries listed in the consultation have progressed. The Tax Institute is of the view that the Government should consider further expanding Australia's tax treaty network and revising existing treaties with key trading partners. These include Hong Kong, the Netherlands, and certain others. We refer to The Tax Institute's submission on Expanding Australia's Tax Treaty Network which sets out further detail on these matters.

Reviewing the taxation of trusts

Trusts are commonly used for numerous investment and business purposes by businesses and individuals across Australia, particularly in the small to medium enterprise sector. The current regime concerning the taxation of trusts is complex and causes taxpayers to incur significant compliance costs. The inherent complications have not been able to be resolved through the issuance of ATO guidance products or administrative approaches and have been further complicated by ongoing developments in case law. There is also a myriad of issues arising from the interaction of the current tax laws affecting trusts with other tax law provisions.

The Tax Institute is of the view that the Government should consider engaging in a process that identifies and addresses the key issues in this regard. This process should contain a detailed consultation process with key industry stakeholders to ensure the proposed solutions can achieve the appropriate balance between upholding integrity without imposing or exacerbating unreasonable compliance costs on taxpayers. We note that Treasury and the Board have undertaken reviews in the past concerning reform options to simplify the taxation of trusts regime. These reviews could form an appropriate basis for beginning the reform process.

Tax incentives to minimise impacts of climate change

Tax can serve as an important tool to influence and direct the behaviours of individuals and businesses. In this regard, tax incentives and concessions may be used as part of a more cohesive government policy to promote environmental sustainability and tackle the growing challenges posed by climate change. The Tax Institute recommends that the Government should consider developing a cohesive environmental policy, seeking public input into how tax and other options available to the Government can be utilised to create a sustainable future for all Australians.

By way of example, the Government could build on the recently introduced Treasury Laws Amendment (Electric Car Discount) Bill 2022 and further incentivise the uptake of zero or low emission vehicles (**ZEVs**). This could include rebates for the purchases of ZEVs and ZEV fleets by individuals and businesses, or targeted investment in infrastructure to support ZEVs.

There are further considerations beyond ZEVs. A sustainable environmental policy should target all aspects of life from minimising non-renewable energy and water usage, to reducing harmful emissions and waste. Appropriate tax mechanisms can include instant asset write-offs or accelerated depreciation of investments by businesses into 'green' technologies and upgrades such as solar panels, energy efficient appliances or investment that encourages the use of recycled water. Additionally, individuals may be provided with incentives in the form of deductions or rebates if they incur significant investment in similar 'green' technology.

The current green (clean) building managed investment trust tax concession could be extended by reducing the withholding tax rate from its current rate of 30% to 10% for non-resident investors. This would provide a notable tax incentive to attract domestic investors such as Australian superannuation funds.

Establishing a pathway to reform

As outlined in our July 2021 Case for Change discussion paper, and submissions regarding the previous government's Federal Budget 2022–23 and Federal Budget 2021–22, The Tax Institute is of the view that Government should undertake an independent review of Australia's taxation and superannuation systems with the intention of beginning a process of comprehensive reform. The reforms should aim to create a system that is based on the core principles of simplicity, equity and efficiency.

We consider that these objectives of holistic tax reform should be at the forefront of discussions regarding changes to our current system. Addressing the issues outlined in our submission and the Brief will better ensure that the Government is well placed to begin the reform process while addressing the current needs of our tax system.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.