



## THE TAX INSTITUTE

THE MARK OF EXPERTISE

26 March 2015

Alex Powell and Catherine Barret  
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SIRN Secretariat  
Australian Taxation Office

By email: [super@ATO.gov.au](mailto:super@ATO.gov.au)

Dear Alex and Catherine

### Re: Trust/SMSF Compliance Update Briefing/Discussion Paper

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (ATO) in relation to the *Trust/SMSF Compliance Update Briefing/Discussion Paper* dated March 2015 (**Discussion Paper**).

We set out below our responses to the questions asked in the Discussion Paper. We note that Daniel Butler, the Chair of our Superannuation Committee attended a telephone conference with you on Monday 23 March 2015 to discuss this feedback on behalf of The Tax Institute.

#### Issues for Discussion

1. *Do the members have any thoughts as to why the level of reporting of non-arm's length income in the SMSF annual return is so low?*

It would be extremely unusual, in our experience, for an SMSF to hold an investment in a discretionary trust that would be classified as item **S** (Discretionary trust – where the main source of income of the trust is from service and management activities) or **T** (Discretionary trust – where the main source of income of the trust is from trading activities). A classification as **I** (Discretionary trust – where the main source of income of the trust is from investment activities) is more understandable, though we expect also in error.

We therefore suggest that the inconsistencies that have been identified in the returns may largely be due to SMSF trustees incorrectly classifying an investment trust as falling within label 11M of the SMSF annual return.

Such errors may simply be coding errors rather than distributions from discretionary trusts. In certain practice management software, when the practitioner creates an investment in the system, they are required to indicate the tax return code. If the code is established incorrectly, the disclosures will be inaccurate.

There has also been uncertainty for many years in terms of classifying trusts that were established as discretionary trusts, but which then had a fixed distribution component – arguably a hybrid trust, but it has not always been a simple matter to clarify. Accordingly, we expect that in many cases the classification has been in error for this reason.

We expect some of the incorrect reporting is likely to have been driven by confusion, including a failure by some tax practitioners to understand that the Schedule 2F definition of fixed entitlement is not applicable to non-arm's length income (**NALI**) decision making in relation to trust distributions made to superannuation funds as per the ATO's established practice under TR 2006/7. Broadly, the position under TR 2006/7 is that, provided unit trust distributions to a super fund are proportionate, the income will not be treated as non-arm's length even though the unit trust deed does not confer a fixed entitlement. In contrast, Schedule 2F ITAA 1936 has a strict fixed trust meaning.

*2. Do the members have any comments which could improve the campaign?*

A relief from penalties could be offered for SMSF trustees who readily seek to correct their returns where they have understated NALI. If a reduction in penalties is to be offered, it should be detailed in the campaign so as to encourage a positive response. A 'voluntary amnesty' for taxpayers to disclose their positions in this area would be welcome, similar to the recent offshore income disclosure initiative 'Project DO IT' last year.

Further, the letters do not outline the ATO position on whether such a distribution would also be treated as a contribution. It may be helpful for this aspect to be clarified. We note that the ATO considers that a distribution from a discretionary trust to an SMSF is a contribution that counts towards a person's concessional contributions cap: TR 2010/1 [142]. Moreover, the ATO also considers the same amount is also subject to NALI under s 295-550 *Income Tax Assessment Act 1997 (ITAA 1997)*.

We reject the argument that a discretionary trust distribution should be treated as a contribution and consider that it should instead solely be dealt with as NALI. Notwithstanding this difference in views, if a discretionary trust distribution is a contribution, and it was in respect of an employee of the trust, then arguably the amount of that contribution should be deductible under s 290-60 of the ITAA 1997. The ATO's position in this regard should be confirmed so that taxpayers know where they stand.

*3. Do the members have any views on the suitability of the draft letter in attachment 1?*

We generally accept the tone of this correspondence, but would include some further information to ensure that clients respond with accurate disclosures, for example, a fact sheet or explanation of the different types of trusts and distributions and when NALI applies.

The issue of whether income meets the description of NALI will not be answered simply by the type of trust. For example, a fixed entitlement may still be NALI and this possibility is not mentioned in the letter.

Also, some comment on the ATO's test of which trust distributions are considered discretionary and confirmation along the lines set out in TR 2006/7 that a discretion as to the quantum of income each unit holder obtains is not problematic provided they share equally. Listed property trusts have some trustee discretion to retain income in the trust, but do not produce NALI as each unit holder's entitlement arises independently of the discretion and each unit holding is treated equally.

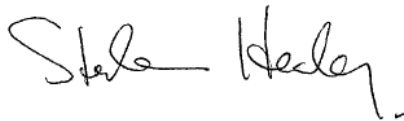
Accordingly, the ATO letter should refer to its views and outline the fixed entitlement in mind in TR 2006/7. That is, as long as the distribution from a unit trust is proportionate, then there should not be any NALI - provided the trust's activities are themselves at arm's length.

The ATO campaign should be followed up with better disclosure on this point in future SMSF return guidelines and more guidance in forms to reduce any misreporting and to improve data integrity.

We also note that the draft correspondence refers to "your client" in the heading of the letter. The letter then addresses "you", identified as the trustee, in the first sentence of the body of the letter. It later refers to helping "your client". Accordingly, it is unclear on the face of the letter whether it is addressed to the tax agent or directly to the trustee of the SMSF. We suggest that the letter should be sent to the tax agent of the SMSF, if one has been engaged.

If you would like to discuss any of the above, please contact either me or Thilini Wickramasuriya, on 02 8223 0044.

Yours sincerely

A handwritten signature in black ink, appearing to read "Steve Healey". The signature is fluid and cursive, with a long horizontal stroke for the first name and a more compact, stylized second name.

**Stephen Healey**  
President