



## THE TAX INSTITUTE

4 February 2022

Sharon Russell  
Australian Taxation Office  
Langton Crescent  
PARKES ACT 2600

By email: [sharonlouise.russell@ato.gov.au](mailto:sharonlouise.russell@ato.gov.au)

Dear Ms Russell

### **TD 2021/D6 and PS LA 2021/D3 – Commissioner’s discretion under subsection 304-10(4) of the *Income Tax Assessment Act 1997***

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to Draft Taxation Determination TD 2021/D6 *Income tax: tax treatment of a superannuation benefit when the Commissioner exercises the discretion in subsection 304-10(4) of the Income Tax Assessment Act 1997 (Draft TD)* and Draft Practice Statement Law Administration PS LA 2021/D3 *Superannuation - Commissioner's discretion where members receive benefits in breach of legislative requirements (Draft PS LA)*, (collectively the **Draft Guidance**).

In the development of this submission, we have consulted with our National Superannuation Committee to prepare a considered response which represents the views of the broader membership of The Tax Institute.

Subsection 304-10(4) of the *Income Tax Assessment Act 1997 (ITAA 1997)* provides that a superannuation member does not need to include an amount covered by subsection 304-10(1) in their assessable income where the Commissioner is satisfied that it would be unreasonable to do so. The Draft Guidance provides further detail regarding the relevant factors and circumstances in which the Commissioner may exercise this discretion.

Although we broadly welcome greater clarity around how the Commissioner will exercise his discretion in respect of subsection 304-10(4), we consider that there are a number of issues that should be further expanded upon in the Draft Guidance. In particular, we consider that the Draft PS LA should provide further guidance and clarity on the differences between an illegal early access scheme and a genuine mistake by a member or trustee. We also consider that the events and circumstances following an incorrect withdrawal should be examined and appropriately dealt with, ensuring that the system promotes self-correction and redress of mistakes. Finally, we consider that the Draft Guidance should take into account the taxpayer’s surrounding events or circumstances, such as the amount of the tax-free component that would be assessed were the discretion not exercised, and the real cost of penalties on taxpayers.

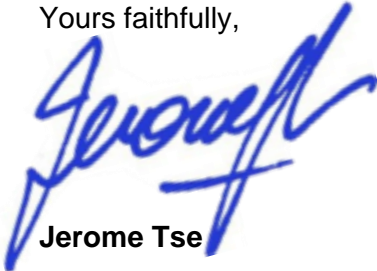
Updating the Draft Guidance to reflect these recommendations will, in our opinion, ensure that it appropriately examines all relevant factors in the exercise of the Commissioner's discretion pursuant to subsection 304-10(4).

The detail of our submission can be found at **Appendix A**. The Tax Institute would be pleased to work with the ATO to further refine the Draft Guidance to ensure that it fulfils its objective of providing clarity to affected taxpayers in respect of the Commissioner's use of this discretion.

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 about The Tax Institute.

If you would like to discuss any of the above, please contact Associate Tax Counsel, Abhishek Shekhawat, on (02) 8223 0013.

Yours faithfully,



**Jerome Tse**

President

## APPENDIX A

We have set out below detailed comments and observations for your consideration to ensure that the Draft Guidance provides the most effective and practical advice for taxpayers and tax professionals.

### Illegal early access schemes

The Tax Institute considers that the Draft PS LA should distinguish between illegal early release schemes and honest mistakes, or instances where a superannuation member has withdrawn amounts due to personal hardships but subsequently attempted to reverse it. We agree that the discretion should not be exercised in favour of members attempting to use illegal early release schemes to inappropriately gain access to their superannuation. However, there are a range of circumstances which will not amount to an illegal access scheme but may raise similar concerns. We consider that the Draft PS LA should explicitly provide guidance for situations where an honest mistake has been made, or where a member has received the superannuation benefit in difficult or extenuating circumstances.

To ensure that the Commissioner's discretion is exercised fairly and appropriately, we consider that the Draft PS LA should require members or trustees to make an application to the Commissioner requesting the exercise of the discretion. The application would cover the reasons why the member believes that the discretion should be exercised in their favour, together with any supporting documentation and evidence. As demonstrated below, this approach will greatly assist in situations where the law is unclear or provides for uncertain outcomes.

An example of such a situation arises where the Commissioner may be required to exercise the discretion in instances where an individual has reached their preservation age and drawn their superannuation under the retirement condition of release. The law contains considerable complexity on this question with reasonable but differing views between industry and the ATO. We consider that in these circumstances, pursuant to the application process outlined above, the Commissioner should exercise the discretion in instances where the trustee of a self-managed superannuation fund (**SMSF**) reasonably believes that the member has retired. The trustee's belief will typically be supported by relevant and contemporaneous documentation such as evidence of a cessation event, or a statement from the member to the trustee and confirmed by a trustee resolution. Further, the exercise of the discretion by the Commissioner as described would be consistent with the definition of 'retirement' in sub-regulation 6.01(7) of the *Superannuation Industry (Supervision) Regulations 1994*.

In the course of exercising the discretion, we consider that the Commissioner should take into account the potential distinction between a person in their capacity as a superannuation member and as the trustee of the SMSF, especially when the same individual is acting both roles. If the discretion is not exercised, we note that the penalty regime could effectively penalise the same person twice. The penalty could be imposed on the trustee of the superannuation fund, while the SMSF member pays tax and the Medicare levy on the amount of the withdrawal. As a result, if the Commissioner disputes the assertions of the SMSF trustee and member, the discretion could be exercised in favour of either the trustee or member of the SMSF, or both, to ensure any resulting penalties are not too onerous while the dispute is being resolved.

## Consideration of post-withdrawal events

We note that the Draft PS LA at Note 12 states:

*If the amount is paid back into the fund, it will be a contribution (see Taxation Ruling TR 2010/1 Income tax: Superannuation contributions). The ordinary rules will apply to determine if the contribution counts towards the concessional or non-concessional contribution caps.*

Feedback from The Tax Institute's members indicates that advisers will frequently advise their clients to rectify any erroneous or illegal withdrawals as soon as possible, especially in instances where the members are unaware of the illegality or consequences of their actions. Given the complexity of our superannuation system, this is a regular occurrence undertaken with the intention of rectifying mistakes and continuing to encourage taxpayers to save in their superannuation funds.

Consistent with the ATO view extracted below, we consider that where a superannuation member has made a genuine mistake, they should be permitted to rectify the situation without penalty:<sup>1</sup>

*The grounds for restitution for mistake concentrate on the principle of unjust enrichment which concerns whether it would be unjust for the recipient to retain the enrichment. It is prima facie unjust for the recipient to retain an enrichment conferred because of mistake, regardless of whether the mistake is a mistake of law or fact (David Securities Pty Ltd v Commonwealth Bank of Australia (1992) 175 CLR 353, at 376-377).*

In this light, we consider that the recontribution of amounts that were incorrectly withdrawn should not be classified as a contribution and should not be taken into account for the purposes of the member's caps. If this approach is not adopted, members may be discouraged from recontributing the funds into their superannuation and instead keep those funds outside of their superannuation. We do not consider this to be an intended outcome of the overall objectives of the superannuation system. Further, adopting this position will potentially seek to encourage self-compliance and promote the proper redress of mistakes.

As a result, we consider that the Draft Guidance should take into account post-withdrawal events when considering whether to exercise the Commissioner's discretion under subsection 304-10(4).

## Tax-free component of account balance

We consider that in exercising the discretion, the Commissioner should also consider the amount of a member's tax-free component that is reflected in the member's superannuation benefit accessed outside of the payment standards.<sup>2</sup>

In the normal course, the components of a lump sum are calculated in accordance with subsection 307-125(2) and paragraph 307-125(3)(b) of the ITAA 1997, in effect as follows:<sup>3</sup>

- work out the tax-free and taxable proportions of the member's super interest just before you pay the lump sum; and
- apply the same proportions when you work out the tax-free and taxable components of the member's lump sum benefit.

---

<sup>1</sup> ATO Interpretative Decision ATO ID 2010/104: Superannuation – Excess contributions tax: restitution of a 'mistaken' contribution.

<sup>2</sup> *Superannuation Industry (Supervision) Act 1993*, Subsection 31(1); and *Superannuation Industry (Supervision) Regulations 1994*, Regulation 6.18.

<sup>3</sup> See <https://www.ato.gov.au/Super/APRA-regulated-funds/Paying-benefits/Calculating-components-of-a-super-benefit/#Lumpsumbenefits>.

Further, section 304-10 provides authority for the following exception:

*The exception is where you have illegally gained early access to your super before you have met a condition of release. In these circumstances, the entire amount of your super benefit will be taxable regardless of whether it has a tax-free component.<sup>4</sup>*

The Commissioner's comments above appear to be based on the application of section 304-10 where no discretion is exercised under subsection 304-10(4).

A tax-free component arises from 'tax paid' contributions and therefore should not be subject to any further tax. Associated earnings from the capital are taxed and included in the taxable component for accumulation balances. In the event that the withdrawal was not undertaken in accordance with an illegal access scheme, we consider the Commissioner should take into account any tax-free component when deciding whether to exercise the discretion under subsection 304-10(4).

### **Other penalties and sanctions**

The Tax Institute also considers that any other penalties or sanctions resulting from the member's incorrect withdrawal should also be taken into account by the Commissioner when exercising the discretion under subsection 304-10(4). The consequences of being rendered a disqualified person is substantial punishment and should only be considered a suitable remedy in the most egregious examples of bad behaviour.

Impacts include adverse employment and professional consequences, and personal mental health difficulties. The impact of other penalties and stresses imposed on the member following an incorrect withdrawal needs to be considered to ensure that the totality of the consequences being imposed are not disproportionate or overbearing.

---

<sup>4</sup> <https://www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-using-your-super/Withdrawing-your-super-and-paying-tax/?anchor=Howtaxappliestoyoursuper#Howtaxappliestoyoursuper>.

## 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.