INCOME TAX ASSESSMENT AMENDMENT BILL (NO. 2) 1984

Date Introduced: 4 April 1984
House: House of Representatives
Presented by: Hon. P.J. Keating, M.P., Treasurer

Purpose

To make a benefit, received by a taxpayer from a section 23F fund, which is deemed excessive or is one which the taxpayer is not entitled to receive under fund rules, fully subject to income tax.

Background

Under the Income Tax Assessment Act 1936 superannuation funds fall into five categories for taxation purposes. Included in these categories are the "section 23F funds". These funds are established by the employer, ostensibly for providing superannuation benefits to the employees. The benefits are to be paid out in accordance with fund rules approved by the Commissioner of Taxation on the basis of the Commissioner's guidelines.

Section 23F funds attract considerable tax advantages namely, the employer's contributions are allowable deductions, and the investment income of the fund is exempt from tax. In order to attain these tax benefits, a fund must comply with the requirements of section 23F of the Principal Act and the 30/20 public securities investment rule.

Under section 23F, a fund must be indefinitely continuing and must be exclusively established and maintained to provide benefits for the employees and/or for the payment of death benefits to their dependants. Furthermore, the benefits being provided by the fund for any employee must be reasonable taking into account a number of factors considered relevant by the Commissioner. Where a fund fails to meet a requirement at any point of time, the Commissioner may determine that the fund is not an exempt section 23F fund for the income year. However, in circumstances where there could be a case of tax avoidance or fraud, the Commissioner may decide that the fund was not a section 23F fund, never had been, and, consequently, all
contributions which had been deducted from the employer could be disallowed.

The 30/20 investment rule requires the superannuation fund to invest 30 per cent of its assets in Government securities, of which 20 per cent must be Commonwealth securities. Funds failing to comply with the 30/20 rule risk having previous contributions to funds disallowed and taxed retrospectively at a rate of 60 per cent. In 1982 the Taxation Commissioner required the 30/20 investment rule to be applied to section 23F funds to ensure that a fund holds real assets for the benefit of its members in order to overcome the "loan back" situation where small companies would establish a section 23F fund, contribute to it to gain tax concessions and then lend funds back to itself at favourable interest rates.

In a press release, dated 14 November 1983, the Treasurer announced that the Government would introduce legislation to overcome tax avoidance through the abuse of section 23F funds. In particular, the legislation would eliminate the so-called tontine arrangements or cherry picker schemes, and payments contrary to the approved terms of trust deeds. Consequently, the Income Tax Assessment Amendment Bill (No. 5) 1983 was introduced into the House of Representatives on 7 December 1983 and clause 5 of that Bill related to section 23F funds. In the Senate, clause 5 was defeated on the question of its retrospectivity to 1 July 1977. The current Bill reintroduces the provisions of clause 5.

By way of explanation, under the tontine arrangements, employers establish superannuation funds which outwardly conform to the requirements of section 23F. The employer makes maximum contributions to provide for superannuation benefits to employees, including proprietor-directors. However, arrangements are also made to ensure that arm's length employees do not receive any of those benefits. The employer terminates the services of such employees before any entitlement to benefits under the rules of the fund arises. This procedure is possible because in most circumstances employees have not been informed of their rights under the superannuation scheme. These "forfeited benefits" then accumulate for the benefit of the remaining members of the fund. The proprietors, who have already received considerable taxation concessions and tax-free investment income, terminate the services of other members of the fund, and then wind-up the fund which is then not liable to tax under existing law. They generally remain the sole recipients of the assets of the fund. At this stage,
because of the accumulated forfeited benefits, the benefits received by the proprietors are usually in excess of those permitted under the guidelines issued by the Commissioner as "reasonable benefits". Under the proposed new section 26AFA, instead of only 5 per cent of the benefit being included in a taxpayer's assessable income, the entire benefit will be taxed, in the case of an excessive benefit. This proposed change is to apply retrospectively to benefits received on or after 1 July 1977.

Main Provisions

Clause 3 provides for the proposed new section 26AFA which allows a benefit received by a taxpayer from a section 23F fund to be included in his assessable income provided the following conditions exist. First of all, the benefit must have been received on or after 1 July 1977 (26AFA(1)(a)). Secondly, the benefit is either one that the taxpayer has no right to receive from the fund or is excessive (26AFA(1)(b)). Thirdly, the Commissioner must be satisfied that the taxpayer received or obtained the benefit by being a member of the fund (26AFA(1)(c)(i)); or a dependant of a member of the fund (26AFA(1)(c)(ii)); or associated with a member of the fund (26AFA(1)(c)(iii)) or with an employer who had made deductible contributions to the fund (26AFA(1)(c)(iv)).

However, under the proposed sub-section 26AFA(2), the Commissioner may consider that, in a case of an excessive benefit, it may be unreasonable, under certain circumstances, for the whole or part of the benefit to be included in assessable income. The Commissioner is required, in making this decision, to have regard to the nature of the fund, the circumstances by reason of which the benefit is excessive and such other matters that he may consider relevant.

Under the proposed sub-section 26AFA(3), a taxpayer's assessable income will also include the amount or value of any consideration received after 1 July 1977 by a taxpayer when transferring to another person a right to receive a benefit from a section 23F fund.

The proposed sub-section 26AFA(4), defines some of the terms used in the new section.

Sub-clause 5(2) provides that the proposed section 26AFA will apply retrospectively from 1 July 1977.

Sub-clause 5(3) is an additional provision when compared with the original legislation. It reinforces the
retrospectivity aspect of the legislation by providing that nothing in section 170 of the Principal Act, which deals with the amendment of an assessment, will prevent the amendment of an assessment made under section 1 of this Act before the commencement of this Act.

Remarks

1. Employee Protection

The Bill is only concerned with the recovery of tax avoided and not with the recovery of superannuation benefits for the disadvantaged employees. However, in New South Wales, the Employment Protection Act 1982 empowers the State Industrial Commission to order various kinds of severance payments to retrenched employees, including gratuities and superannuation payments above the normal entitlement. On the matter of superannuation benefits, the NSW Industrial Commission may make orders under the Act requiring

(i) the payment of benefits from a superannuation scheme of which the employee is a member, as if the benefits ordered to be paid were provided for by the scheme, or

(ii) the payment of an amount to the employee to compensate him for any loss of accrued benefits under a superannuation scheme of which he is a member.

However, application of the Act for the benefit of disadvantaged employees is restricted on a number of grounds such as

(i) the employee would need to be aware of the fund's existence and of his entitlements under the scheme,

(ii) the Act only applies to NSW State awards, and

(iii) concerns employees in workshops with 15 or more employees.

No other Australian State has enacted similar legislation.

2. Excessive Benefits

Unless the Commissioner decides otherwise, the receipt of an "excessive" benefit from any section 23F fund will be fully taxable as income. Previously, only 5 per cent of such benefits were taxable. This change will apply
to all superannuation funds not only those being used for tax avoidance purposes. Furthermore, it is not the excess benefit which is taxable but rather the entire benefit.

For further information, if required, contact:

Economics and Commerce Group
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LEGISLATIVE RESEARCH SERVICE