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The Two Superannuation Sole Purpose Tests and Super Tax Death Strategies; Tax Scheme or Clever Planning?

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Introduction

Superannuation has existed in Australia for over 160 years[1]. The earliest known superannuation fund was commenced In 1862; the Bank of New South Wales Provident Fund. This was established to pay retirement pensions for men who retired from the Bank after 60 years of age.

It took the Federal Government almost 50 years to introduce an old age pension in 1910, which was means-tested and only available to men at age 65[2]. Women were entitled to that government pension if they were widows, or part of a married couple, the money being paid to their husbands. Primary 'funding' for the age pension eventually came via the Income Tax and Social Services Contribution Assessment Act, which became known to be the Income Tax Assessment Act when *Social Services Contribution* was dropped from the name in 1966. This amendment represented an admission that the Federal Government was no longer setting aside from its tax collections sufficient to fund pensions for Australians in retirement.

This recognition underpins todays politically accepted view that the Australian retirement saving scheme needs to remain in the private sector[3].

For most of the early years of superannuation it was only available for employees of Government bodies and large organizations. Its social objective of leading to non-Government retirement pensions encouraged the tax system of the day to treat Australian superannuation with favourable tax status; employer contributions were tax deductible as an employment cost and the earnings on the fund were tax free. Benefit receipt suffered only minimal taxation.

The Australian Constitution does not empower the Federal Government to make rules for superannuation in Australia. This could only be achieved (or at least so it was thought) via the taxation power. Taxation became both the carrot that encouraged voluntary superannuation and the stick that punished those that stepped outside of the taxation boundaries that were developed.

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[1] The Bank of New South Wales Provident Fund available to male employees of the bank first evolved in the 1860s, when all new young men had to provide money – like a bond or guarantee – as proof of their good character and to protect the bank against any losses, accidental or otherwise, during their employment. This pool of money, held as the "Fidelity Guarantee Fund", grew over time as there were very few incidents resulting in losses. At the behest of employees in 1862, the fund was altered so pensions could be drawn once the men reached retirement age – 60 years. The bank agreed to pay interest, and from 1872 male staff could pay additional annual contributions and Australia's first superannuation fund was created.

[2] Australian male life expectancy in 1910 was approximately to age 57.2, females was 61.1 - Life expectancy trends - Australian Bureau of Statistics.

3 Calls to nationalise Australian superannuation are regularly raised and regularly dismissed. In 2017 the former Coalition treasurer Peter Costello said "there is a fair argument that compulsory (super) payments, the so-called default payments, should be allocated to a national safety net administrator, let's call it the Super Guarantee Agency".

The most important of these taxation boundaries was developed in the 1966 High Court decision of *Scott v Federal Commissioner of Taxation (No. 2)*[4]. It was the judgement of Justice Windeyer in which the sole purpose test of superannuation was first developed. The first part of this paper will consider the lessons learned from the original sole purpose test and what this may mean for superannuation management today.

The sole purpose test was extended to superannuation contributions, most notably in two 1991 Federal Court decisions which will be the subject of the second part of this paper.

The third part of this paper will consider a narrow but critical aspect of the taxation of the superannuation death benefit. Until 1993 a person's accumulated superannuation was free of taxation when paid on their death. This changed with the introduction of taxation (capped via a rebate to 15%) on superannuation that was paid to superannuation dependants of the deceased (direct or via the estate of the deceased) who were not tax free dependents. But the real taxation challenge on death benefit superannuation payments did not arise until the 2006 Federal Budget that exempted entirely from income tax superannuation benefits that were paid to people aged 60 and over[5].

The contrast in the superannuation death benefit became apparent from the 2006 tax free change. Since that time 'strategies' have been recommended to overcome or avoid the superannuation death benefit tax impost for non tax free dependants of the deceased. The third part of this paper questions the effectiveness of these strategies; are these tax schemes or careful planning?

[4] *Scott v Federal Commissioner of Taxation (No. 2); Associated Provident Funds Pty Limited v Federal Commissioner Of Taxation; Belvidere Investments Pty Limited v Federal Commissioner Of Taxation High Court of Australia, 07 October 1966,* (1966) 14 ATD 333

[5] "One of the worst taxation policy decisions of the past 20 years (and there's a fair bit of competition for this 'honour', in my opinion)". Saul Eslake Director, Productivity Growth Program – The Grattan Institute and Advisor, Economics & Policy, PricewaterhouseCoopers Australia in a 2011 paper Australia's Tax Reform Challenge, at page 8.

Part 1 - Sole Purpose

The original sole purpose test, as with the majority of the history of Australian superannuation, was found in taxation law.

Former section 23(j)[6] provided that;

> *The following income shall be exempt from income tax:—*
>
> *(j) the incomes of the following funds, provided that the particular fund is being applied for the purpose for which it was established—*
>
> *(i) a provident, benefit or superannuation fund established for the benefit of employees."* (emphasis added)

The first 'declaration' of the sole purpose test is attributed to Windeyer J in 1966 in Scott's No2;

> *there is no essential single attribute of a superannuation fund established for the benefit of employees except that it must be a fund bona fide devoted as its sole purpose to providing for employees who are participants money benefits (or benefits having a monetary value) upon their reaching a prescribed age.*[7]

The approach of Windeyer J was to examine the nature and intent of the relationship of the principal guiding mind behind the superannuation fund with the fund investments.

Scott's No.2 involved a solicitor who was extensively involved in buying and selling land, principally through private companies. He created a superannuation fund with the members being himself, his wife and his wife's parents[8]. Over a five year period the fund received approximately £5,500 of contributions whilst its assets grew ten-fold to £59,869.

> Who would have thought that the most well known tax case in superannuation involved what today would be called a self-managed super fund.

The questions before the Court were;

(a) Whether the income of a fund of which Associated Provident Funds Pty. Limited was trustee was exempt from income tax by virtue of the provisions of s. 23 (j) (i) of the *Income Tax and Social Services Contribution Assessment Act 1936–1962*?

[6] Income Tax Assessment Act, 1936

[7] *Scott v Federal Commissioner of Taxation (No. 2); Associated Provident Funds Pty Limited v Federal Commissioner Of Taxation; Belvidere Investments Pty Limited v Federal Commissioner Of Taxation, High Court of Australia,* (1966) 14 ATD 333

[8] Today this would be recognised as a self managed superannuation fund under section 17A of the SIS Act.

(b) Whether contributions to the said fund by Belvidere Investments Pty. Limited were deductible under s. 66 of the said Act in arriving at the taxable income of the company?

(c) Whether contributions to the said fund by Scott were deductible under s. 82H(1) of the said Act in arriving at his taxable income?

The Court examined the relationship of Mr Scott to both the trustee of the fund and the company in which the fund held all shares, he was the governing director of both;

> *He was not always ready to recognize that they were nevertheless puppets whose actions he manipulated as he wished.*

The Commissioner pressed the Court on two particular transactions involving the superannuation fund. With the first, by way of background it was described that Scott acquired companies with carry forward tax losses and turned these toward property developing, but as the losses were used up he did not allow them to continue to profit, he caused the companies to sell their lands to the superannuation fund; *Scott for the vendors agreed to sell and Scott for the purchaser agreed to buy*. No part of the purchase price was in fact paid at the time to either vendor. The whole amounts were treated as loans to be paid off as the superannuation fund sold the lands.

The second transaction arose after the Commissioner took a great deal of interest in the superannuation fund, the transaction engaged in took place after the ATO began a review into the activities of the superannuation fund. The transaction involved the fund in transferring property developed lands with apparent latent profits at a loss to a tax loss carrying company owned by the Scotts. The Court observed *this was surely a strange way for the trustee of a superannuation fund to deal with an asset of the fund. It certainly was not for the benefit of the beneficiaries of the fund*.

The Court noted that section 66(1) provided an allowable tax deduction *Where a taxpayer, for the purpose of making provision for individual personal benefits, pensions or retiring allowances for, or for dependants of, employees of the taxpayer… sets apart or pays in the year of income a sum as or to a fund.* This led the Court to examine the relationship of Scott and his wife as contributors to the superannuation fund and also of Scott's parents-in-laws as employees and as directors of Belvedere, a company formed by and controlled by Scott.

Ultimately the Court did not need to come to a firm conclusion on the employment relationship but it did observe that when the parents-in-law *became "employees" of Belvidere they were each well past the retiring ages mentioned in the deed. Moreover, it seems questionable whether when they applied for membership of the fund they were "engaged in the business of the Founder" within the meaning of the definition of "employee" in the deed.*

From the perspective of benefits from the fund the Court closely examined the purported payment of £5,000 from the fund to the father-in-law and interest payments on this amount that was later loaned back by the father-in-law to the fund. For the mother-in-law her entitlement on her retirement was £7,066 18s. 8d *but instead of* *paying her this amount at once he* (Scott) *had decided she should have it at the rate of £1,000 a year. But in fact, he said, she has only had "about £600 up till now"; the reason given for this is that the fund was short of liquid assets.*

It was the actions of Mr Scott that created and proved to be the undoing of the superannuation fund. The Court ultimately concluded that the fund was not actually a superannuation fund. This resulted in its loss of tax exempt status and any employer/employee contributions to it lost the tax deductibility of contributions.

> *"On the other hand, if the scheme, including the deed, was intended to be a mere facade behind which activities might be carried on which were not to be really directed to the stated purposes but to other ends, the words of the deed should be disregarded ...A disguise is a real thing: it may be an elaborate and carefully prepared thing; but it is nevertheless a disguise. The difficult and debatable philosophic questions of the meaning and relationship of reality, substance and form are for the purposes of our law generally resolved by asking did the parties who entered into the ostensible transaction mean it to be, and in fact use it as, merely a disguise, a facade, a sham, a false front - all these words have been metaphorically used - concealing their real transaction ..."*[9]

Whilst the first recognition of the sole purpose test is claimed to be attributed to Windeyer J in Scott's No2, the case in fact stands for the superannuation fund failing on the basis of it being a sham.

This is not to say that the sole purpose of test was not enunciated, it was;

> *There is no essential single attribute of a "superannuation fund established for the benefit of employees"… except that it must be a bona fide fund devoted as its sole purpose to providing for employees … money benefits … upon their reaching a prescribed age.*

It is submitted that Scott's No.2 was not decided on sole purpose, it was a tax sham case.

The outcome in Scott's No.2 was simply the result of a more fundamental view, that the fact of the superannuation fund trust deed and the financial statements of the fund as well as the payment of contributions and benefits to or in respect of its members was a sham! To this view the Court added and concluded;

> *I should add that Mr. Scott believed, and may have been advised by accountants, that by doing what he did he could somehow make appearance and pretence into reality. In this he was not dishonest or fraudulent, merely mistaken.*

[9] Scott v. Federal Commissioner of Taxation (No. 2) (1966) 40 ALJR 260 Windeyer J. said (p 279).

If this view of Scott's No.2 is accepted it leads to the position that the case is not about the sole purpose test, it is about using superannuation as a tax device to achieve a tax purpose. In the writer's view this is the mistake by many who promote superannuation as a taxation opportunity not to be missed, such a promotion is, as Scott's No. 2 demonstrates, not only a potential failure of the sole purpose test but an even more fundamental superannuation fund failure.

The High Court decision in Scott's No. 2 is less about the sole purpose test in superannuation and more about the abject failure of superannuation when it is pursued as a tax minimisation device.

Superannuation Extracted from Taxation Laws

Superannuation was first extracted from taxation laws with the 1987 *Occupational Superannuation Standards Act 1987*. That Act contained, in s 3(1), a definition of "superannuation fund". Expressed in terms of sole purpose, this was a fund that (among other things):

> *<u>is maintained solely</u> for either or both of the following purposes:*
>
> *(i) the provision of benefits for each member of the fund in the event of the retirement of the member from any business, trade, profession, vocation, calling, occupation or employment in which the member is engaged;*
>
> *(ii) the provision of benefits for dependants of each member of the fund in the event of the death of the member;*
>
> *or for either or both of those purposes <u>and for such ancillary purposes</u> as the [Insurance and Superannuation] Commissioner approves.*

Omitting the original section 23(j) "*being applied"* and expanding this to *is maintained,* in the view of the writer, opened up the context of the sole purpose test, sufficient to allow a superannuation fund to conduct a business[10]. The Australian Taxation Office implicitly accepts this in Taxation ruling TR 93/17 which considers income tax deductions available to superannuation funds. It states that "a superannuation fund that carries on such a business may rely on the second limb of section 8-1, which covers expenditure necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income".

The *Occupational Superannuation Standards Act 1987,* though it expressed standards expected of superannuation funds, it was still wholly reliant on the Taxation power in the Australian Constitution. The most substantial change in Australian superannuation came about 130 years after its origins with the development of the *Superannuation Industry (Supervision) Act* 1993 (SIS Act). In a stroke of potential parliamentary draftsman's genius, the SIS Act was designed to rely upon at least two Constitutional powers; Taxation and Pensions or Taxation and Corporations. This was adopted by;

[10] The dominant view until the OSSA was that a superannuation fund could not conduct a business.

- Requiring superannuation funds to submit to the SIS Act if it wished to tax concessionary treatment (- invoking the Taxation power); and

- Requiring each superannuation fund to either have;

    - A constitutional corporation (a company) as its trustee (- invoking the Corporations power) or
    - If natural persons were to be the trustee, promising to pay a pension (- and thereby invoking the Pensions power).

This expanded the powers of the Commonwealth in its ability to regulate and legislate Australian superannuation. The blunt power of taxation was for the first time aligned and suplemented with an ability to impose fines, Court enforceable orders upon trustees and create strict liability offences. And in all of these changes the sole purpose test remained. Today it is found in section 62 of the SIS Act.

The generally accepted view has been that the section 62 sole purpose test is the primary legislative architecture that all superannuation funds must achieve. However, this view was somewhat reliant on the history of superannuation and the sole purpose being expressed as essential to the fund that claimed to be of a superannuation nature. This view was largely built upon an interpretation of Scott's No. 2, which as earlier expressed goes further than a mere sole purpose test recognition.

More recently it has been said of section 62 of the SIS Act;

> *I do not think that it is necessarily of assistance to describe the criteria in s 62 as imposing a "strict standard" or a "high standard". The provision does not adopt such language. There is a danger that such descriptions can unduly influence the construction of a provision or its application to the facts.*[11]

In other words the sole purpose test within section 62 is just another standard within the SIS Act.

Forty years after Scott's Case (No2) the sole purpose test was again considered in *Deputy Commissioner of Taxation (Superannuation) v Graham Family Superannuation Pty Limited*[12]. The self managed superannuation fund held a residential property that was leased to the son of the trustee-directors (also members of the fund). Rent was not paid and $60,762 was outstanding by 30 June 2012. The fund also had acquired a caravan, stud cattle and motor vehicles for the use of the sons, none of which generated income for the fund. Unexplained expenditure was treated as loans.

> The SIS Act section 62 sole purpose test is just another section of the SIS Act, it is no more fundamental than any other section.

Among other issues, the fund's residential property was leased to a related party and rent was not collected, the sole purpose test was contravened. In consequence of the

[11] Per Besanko J, *Aussiegolfa Pty Ltd (Trustee)* v *Commissioner of Taxation* [2018] FCAFC 122 at 231(h).
[12] [2014] FCA 1101

foregoing, the fund was declared non-complying at any point. The Court concluded, among other breaches, that the fund contravened;

> *Section 62* (of the SIS Act) *by failing to ensure that the Fund was maintained solely for one or more of the purposes prescribed in s 62(1) of the Act, instead maintaining the Fund for the purpose or significant purpose of making loans to provide financial accommodation to the second and third respondents on non-arm's length terms.*
> (emphasis added)[13]

A sole purpose assessment is an objective assessment[14], intention is to be ascertained by an objective view of the facts.

Whilst the case rested upon a failure of the section 62 SIS Act sole purpose, a more correct and fundamental perspective would have been to recognise that the so-called superannuation fund was not such a fund, it was a financial device for the benefit of family members.

It would be a mistake to view the sole purpose test issue from the perspective of the benefit gained by the other party. In *AAT Case 6059 (1990)*[15] the Tribunal had to consider interest free and undocumented loans by the superannuation fund to private property development unit trust schemes that due to later trust cash flow problems were later converted to units[16]. The Commissioner sought to argue that the interest free loans constituted a breach of the sole purpose test.

The Tribunal considered the actions of the superannuation fund trustee and concluded that he was an aggressive businessman who was acting outside his normal milieu in dealing with his responsibilities as a trustee … a brusque man not given to any deep consideration of the long term outcome of his actions, nor given to seeking advice from his professional advisers in reaching investment decisions. He was overly influenced by business acquaintances, preferring their proposals to advice from his professional advisers and he was drawn because of this into investment in a minor role in development type propositions, a practice which was to cost the fund dearly in the long run.

The conclusion of the Tribunal was;

> *An incidental, as opposed to a purposeful, benefit to parties other than the employees by the trustee, is not a contravention of the sole purpose test enshrined in s 23F(2)(a). There was nothing in the circumstances surrounding the loans that encompassed a positive purpose of advantaging any one of those entities at the expense of members of C Fund. The non-payment of interest on all money loaned arose from practical commercial considerations and not from any desire or intent on the part of the taxpayer of benefiting the entities to whom*

[13] Ibid at 1102
[14] This is the view of the ATO expressed in SMSFR 2008/2.
[15] 21ATR3477
[16] Note at all times any unitholding did not exceed 50% of issued units.

> *the funds were loaned, with the resultant disadvantage to the members of C Fund.*[17]

The context is not what advantage was obtained by the other party, the context is; what is the objective purpose of the superannuation fund and this is best viewed with an understanding of the relationship between the superannuation fund and the other party. Whilst not expressly stated as such, the sole purpose test has an 'arm's length' standard to it, if an investment is at arm's length it is reasonable to conclude that the purpose was to achieve or maintain retirement benefits.

This 'arm's length' standard is perhaps best illustrated by the full Federal Court decision in *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation*[18] . The Court took an arm's length analysis of the superannuation fund investment circumstances that resulted in a daughter of the super fund member/trustee-director residing in property in which the fund held an interest. The Commissioner challenged the fund arguing that it failed the section 62 SIS Act sole purpose test.

The Benson Family Superannuation Fund invested 7.83% of its assets (with related entities) in a managed investment scheme structure that acquired student accommodation real estate. Initially the property was occupied by third party students but on the third occasion the daughter of the member/trustee-director entered into a lease for the property, via an independent manager of the property, she paying rent that was equal to that which was paid by the first two occupants and which the manager leased other accommodation to other students.

The initial Federal Court agreed with the Commissioner that the investment breached the sole purpose test. However the full Federal Court decided the investment did not breach the sole purpose test as the terms of the rental arrangement were the same as they were with arm's-length tenants. The facts assisted the conclusion; the timing of the investment was well before the property was leased to the member's daughter, the member's daughter was a suitable tenant, the property was first leased to other arm's-length tenants before the member's daughter, the tenancies were arranged through the property manager with no involvement from the member and the property was otherwise presented as a suitable investment.

Moshinsky J referred to a distinction between purpose and motive, concluding that the sole purpose test is concerned with the way a fund is being maintained, not with the reason or motivation for the investment. Moshinsky J stated that the sole purpose test is not contravened simply because of a related party transaction, the sole purpose test calls for a finding of a mischief of 'financial or other non-incidental benefit[s]' being obtained. Moshinsky J stated '[i]t is true that Ms Benson would obtain a benefit in the sense that she obtains accommodation. But in circumstances where this is obtained at market rent, it does not appear to be a relevant benefit for present purposes'. The Court stated that the outcome would have been different if the rent was not a market

[17] Ibid at 3485-49
[18] [2018] FCAFC 122

rent, or if the Benson Fund's investment policy had been affected by the leasing of the property to Mr Benson's daughter.

Steward J added that the purpose of Mr Benson personally was not relevant — the Court had to ascertain the purpose of the corporate trustee. He was undisturbed with the fund dealing with a related person or entity who thereby gained a benefit, especially if 'the income and the assets of the fund are enhanced, or at least preserved…' In particular, Steward J stated:

> *… there is no necessary dichotomy between the maintenance of a fund for core and/or ancillary purposes and the receipt by a related person or entity of a benefit. In some cases, the conferral of a benefit may reveal the presence of a purpose which is collateral to the core and ancillary purposes defined by s 62. Investing directly in rental property which is leased to a relative for a peppercorn rent would justify an inference that there existed a collateral purpose. But if the rent paid is market value, and if the property otherwise constitutes a prudent investment, the personality of the tenant may not justify a similar inference.*[19]

The Court also considered the sole purpose test context of a work email that Mr Bension in his capacity as the Victorian State Manager for DomaCom Fund which facilitated the student accommodation, sent to colleagues wherein he suggested that his daughter's rental arrangement would test 'the related party use of residential property within' self managed superannuation funds. This was distinguished on the basis that the father Mr Benson sent the email in his employee capacity, not in his super fund trustee director capacity; the email was not an expression of the super fund trustee's corporate intent.

Aussiegolfa again illustrates that the sole purpose test has an objective 'arm's length' standard to it, it is not an examination of what benefits are gained by other than the superannuation fund, it is an examination of the benefits gained by the fund in its purpose or function of securing or maintaining retirement benefits. As long as this is not diminished by benefits gained by another, when assessed on an arm's length standard, regardless of any connection to the fund, there is no inconsistency with the sole purpose test.

> the sole purpose test has an objective 'arm's length' standard to it

The Blunt (Taxation) Instrument of Non-compliance

A complying superannuation fund that is found to no longer be complying is subject to the extremely blunt taxation instrument of section 295-325. This section brings into the assessable income for the non-complying fund;

[19] Ibid at 231(f).

Sum of the market values of the fund's assets just before the start of the income year	minus	Sum of the part of the crystallised undeducted contributions … after 30 June 1983 and the contribution segment for current members at that time so far as they have not been, and cannot be, deducted.

In other words, the whole of the assets of the superannuation fund less undeducted contributions is deemed to be income. And this is taxed at the top marginal rate together with income otherwise earned in the year. This is devastating taxation, in many cases it can result in an almost halving of the superannuation fund.

The devastating taxation is worse where the superannuation fund has engaged in a limited recourse borrowing arrangement. The view of the ATO is that the "some of the market values of the funds assets" is not net of any loan arrangement, it is the total gross value of assets that is deemed to be income of the fund (less undeducted contributions). In other words, the existence of any loan is not taken into account when including in the newly non complying superannuation fund tax return the value of all assets.

By way of example, assume that a superannuation fund comprises solely of real property with a gross value of $1 million and a limited recourse borrowing arrangement of $700,000[20]. The net value of the fund to its members is $300,000. If we also assume that there are no undeducted contributions to be excluded, the amount to be included in the newly non complying superannuation fund income for the year in which it became non-compliant is $1 million, no allowance is made for the loan. Applying the non-complying tax rate of 45% will result in a tax liability of $450,000 and a situation whereby the whole of the net value of the superannuation fund disappears to taxation!

Making a fund non complying is generally considered by the ATO to be a measure of last resort. This is reserved for the most serious of contraventions. The ATO prefers to issue education orders, impose penalties or disqualify the individuals who were the responsible trustees. As an indication of the ATO's approach, set against a background of around 600,000 funds in 2019, there were less than 500 enforcement actions, of which 26 were notices of non-compliance and 145 disqualified trustees.

> Set against a background of 600,000 smsf's in 2019, there were less than 500 enforcement actions of which only 26 were notices of non-compliance

Having said this it is notable that in all cases of notice of non-compliance it was found that the superannuation fund did not comply with the sole purpose test, among other failed superannuation standards.

[20] Practical Compliance Guideline PCG 2016/5 accepts loan to value ratio for a related party limited recourse borrowing arrangement of up to 70% at paragraph 7.

Coronica and Commissioner of Taxation[21] reflects this ATO perspective that a taxpayer has to try hard to achieve a non-compliance notice. Giuseppe Coronic was an experienced accountant, tax agent and an experienced valuer who clearly preferred his own interpretation of the SIS Act and Regulations to that of anybody else, the ATO included.

Over the period under review the ATO argued that there were 45 breaches of the SIS Act and whilst the Tribunal affirmed that non arms' length is a strong indicator of a sole purpose breach, it accepted that the existence of multiple breaches of the SIS Act also led to a conclusion of a sole purpose breach.

> *The continued contravention of the accounting requirements, the access to superannuation saving through the unauthorised acquisition of assets from members, the mixing of personal assets with fund assets supports a finding that the Sole Purpose Test was also contravened.*[22]

Perhaps the following is demonstrative of the reason that the ATO proceeded to the issue of a non complying notice as well as a trustee disqualification;

> *As a witness, Mr Coronica appeared to be a very proud man. That pride interfered with a proper understanding as to the boundaries of his competence and the benefits of a good governance model. This and his sole practitioner history contributed to him not understanding when the boundaries of his competence were challenged. There may also have been a factor that he did not appropriately prioritise complying with his personal affairs.*[23]

Even with this as a 'professional' judgement the Tribunal upheld the ATO non compliance notice but reversed the trustee disqualification adopting the view that a;

> *Disqualification is a prophylactic. It is designed to protect the investing public against the risk that people with a track record of misconduct will offend again.*[24]

With respect to the disqualification the Tribunal preferred to avoid this outcome where the nature, content and form of an enforceable undertaking will have the effect of both protecting the superannuation fund as well as the public.

Sole Purpose Not the only Arm's Length Standard – Consider other SIS Act Sections

A principal objective in applying the sole purpose test to a superannuation fund activity lies in assessing whether the activity is carried out in an arm's length manner. But this is not the only SIS Act standard that considers arm's length.

[21] [2021] AATA 745 (1 April 2021)
[22] At paragraph 308
[23] At paragraph 362
[24] Citing with approval from *Re The Taxpayer and Commissioner of Taxation* (2002) 51 ATR 1192, 1195 [12]–[13].

By contrast to an arm's length objectivity standard, section 65 proscribes a prohibition on lending or giving any other financial assistance using the resources of a superannuation fund to a member or a relative of a member.

Under this section, arm's length is identity based, in fact.

Under section 66 of the SIS Act, arm's length is once again identity based, in fact. A superannuation fund must not intentionally acquire an asset from a related party[25] of the fund other than business real property, listed securities[26] or an in-house asset[27].

The prohibition is strictly interpreted, a superannuation fund can acquire business real property from a member but it must not acquire an option to acquire that same property. According to the Australian Taxation Office "The acquisition of the right or option contravenes subsection 66(1)[28]

It is notable that section 66 has a general anti-avoidance provision that extends its application to a scheme to circumvent the member asset prohibition.

Another 'arm's length identify prohibition' is expressed in Part 8 of the SIS Act. This acts to prohibit the acquisition or maintenance of assets that would constitute an in-house asset that is representative of more than 5% of the market value of assets of the particular fund calculated as at the end of the financial year[29]. The meaning of an in-house asset in section 71 is broad but is fundamentally a loan to or an investment in a related party, investment in a related trust or a lease to a related party.

For these purposes a related party[30] is a member[31] of the fund, a standard employer-sponsor[32] of the fund and/or a Part 8 associate[33] of the foregoing.

The investment in the related party must not be more than 50%, as measured by an equity or control interest.

The Commissioner has extensive powers available in connection with an in-house asset determination. By section 70A of the SIS Act the Commissioner may '*determine*

[25] Refer to the discussion on what is a Related Party under the preceding commentary on section 65.
[26] Refer section 66(5) for the meaning of business real property or listed securities.
[27] Section 66(2A).
[28] See paragraphs 22 and 118 to 120 of SMSFR 2010/1.
[29] Refer specifically to section 82.
[30] Section 10(1) SIS Act.
[31] Section 10(3) extends member to include a person who receives a pension from a self managed superannuation fund.
[32] This is defined in section 16(2) to be an employer of a member who contribute to the relevant superannuation fund 'pursuant to an arrangement between the employer and a trustee of the regulated superannuation fund'. Where the member directs the employer where to pay the superannuation contributions, they are an employer sponsor, were the employer makes this decision and they deal with the superannuation fund, they are a standard employer sponsor.
[33] The meaning of Part 8 Associates in sections 70B through 70E is very broad and great care is needed. It extends beyond relatives to corporate, partnership and trust relationships though often requiring the relevant test individual to have a controlling interest in fact or by custom. Parties that are Part 8 Associates will become connected even if there is no direct connection.

in writing that a person, who is not a standard employer-sponsor of a … superannuation fund within the meaning of subsection 16(2), is taken to be a standard employer-sponsor of the fund'. And section 71(4) empowers the Commissioner to determine that an asset that otherwise is not an in-house asset is such an in-house asset with respect to a specified party.

Whilst not specifically addressed in *Aussiegolfa*[34] in connection with section 71(4) the Court observed that the power appeared to be unlimited. The Court questioned its constitutional validity; "A provision cast in such terms, raises the possibility that it is an unconstitutional delegation of legislative power."[35] The issue did not need to be addressed as the Court found that the investment was an in-house asset based on the particular and peculiar features of the investment.

There are various exceptions to the in-house asset rule, these are principally found in Division 13.3A of the Superannuation Industry (Supervision) Regulations, 1994. When examined the same non-arm's length prescription is applied throughout.

The SIS Act prohibition sections prescribe the identity of the person with whom the superannuation fund must not transact. Section 109 does not preclude non-arm's length transactions, it merely requires the terms and conditions of the transaction to be no more favourable to the other party than those which it is reasonable to expect would apply in an arm's length transaction.

Looked at another way, section 109 proscribes a one-way assessment. If parties to the relevant transaction are not dealing with each other at arm's length in respect of the transaction, it is the benefits from the terms and conditions that are enjoyed by the non-superannuation party that is to be examined. A breach of section 109 will apply where such a benefit is more than which it is reasonable to expect would apply if they were dealing at arm's length in the same circumstances.

Not only is section 109 to be read as one-way assessment of value that can favour a superannuation fund but not the other party, the section is limited to *the* transaction.

In the decision of *Montgomery Wools*[36], a self-managed superannuation fund held as part of its investments all of the units in a private unit trust. The trustee of the unit trust was under the same essential management as the trustee of the superannuation fund. It allowed the unit trust assets to be used to support a family business. The Administrative Appeals Tribunal took the view that because the fund only passively allowed the unit trust to operate in this way, the arm's length rule of section 109 was not contravened.

In particular, senior member J L Redfern stated:

> *However, the wording of the subsection, which only applies if the trustee is 'required to deal', appears to be curiously narrow. The commissioner did not address this submission, although Montgomery Wools submitted that as a*

[34] Supra at note 22.
[35] Ibid at paragraph 227.
[36] [2012] AATA 61

> *matter of statutory construction and on the facts of this case, s109(1A) simply did not apply.*
>
> *Even if I was of the view that 'required to deal' should be given a broad meaning to simply cover dealings with the related party investment by the trustee, Montgomery Wools was not required to deal with the units by reason of the events that took place in 2004. There was no sale of or dealing in the units, but rather the underlying investment owned by the MPT (the unit trust). It is not clear that this provision is intended to apply in these circumstances and in this regard I note that that this was one of the reasons why the in-house assets rules were amended in 1999.*
>
> *I, therefore, find that Montgomery Wools did not breach [the relevant part of the arm's length rule] in 2004.*

While the section 109 SIS Act arm's length rule was not contravened in Montgomery Wools, the sole purpose test was. The facts were not caught by the narrow arm's length rule in section 109, but they were caught by the broader arm's length rule within the sole purpose test.

Can a Taxation Purpose be a Sole Purpose Failure?

> Can an objective view that the taxpayer individual embraced superannuation principally for its taxation advantages be a sole purpose failure?

It is the Writer's view that in the right (or perhaps it should be better said the *wrong*) circumstances of approaching a superannuation investment with a predominance of a taxation saving being the objective, this will constitute at the very least a sole purpose failure, and potentially an abject superannuation failure.

It has already been stated that a sole purpose assessment is an objective assessment, intention is to be ascertained by an objective view of the facts. Can an objective view that the taxpayer individual embraced superannuation principally for its taxation advantages be a sole purpose failure? In the writer's view, yes.

Ordinarily, a contribution to superannuation is evidence of the fact itself, a contribution toward the funding of a future retirement benefit of the individual in respect of whom the contribution was made. This is somewhat aided by the provisions of the SIS Act and regulations which prescribes that attainment of the retirement benefits cannot be enjoyed prior to the attainment of the member's preservation age. For all members this is no less than age 60 and is fully achieved at age 65.

It follows that as attractive as the tax concessions may be within superannuation, a contribution in respect of an individual taxpayer who has not achieved their preservation age results in the fund investment being inaccessible until attainment of that age, which commonly coincides with retirement. For this reason it can be said that a contribution to superannuation for or in respect of a taxpayer that has yet to achieve a preservation age is evidence of itself of seeking to achieve a retirement benefit. This is of course, consistent with the sole purpose test.

It is the writer's view that too much emphasis on tax outcomes can, in the right circumstances, lead to fundamental failure of the superannuation tax strategy.
The best way to protect this risk is with a well crafted and defined investment strategy that is expressed around the members personal retirement plans and objectives.

But consider the situation of a taxpayer who is otherwise independently wealthy and has attained their preservation age such that there are no conditions of release that would apply to any superannuation interest. In the right circumstances it could be concluded that the creation of a superannuation fund and making maximum contributions so as to direct superannuation investments in a particular manner with the express purpose of benefiting from superannuation taxation concessions, is a breach of the sole purpose test.

In such a situation it is the writer's view that the investment strategy covenant of section 52 of the SIS Act, if properly embraced and applied, presents a rebuttal to the pursuit of the tax objective and support for the sole purpose of obtaining retirement benefits. This is also the view of the ATO in SMSFR 2008/2.

> *Factors that would weigh in favour of a conclusion that an SMSF is being maintained in accordance with section 62 despite the provision of benefits not specified in section 62 include…*
>
> > *All of the SMSF's investments and activities are undertaken as part of or are consistent with a properly considered and formulated investment strategy*[37]*.*

In the writer's view it is not merely enough to have an investment strategy as such, it is necessary to express the investment strategy having regard to the retirement interests of the member or members of the superannuation fund. An investment strategy that merely identifies a balanced approach to investments says very little in the context of assessing a sole purpose of pursuing retirement benefits. By contrast, an investment strategy that considers the age of the member or members, their anticipated longevity and the intention to enjoy a French champagne expensive retirement, expresses a reasoning that can impress a superannuation supported retirement benefit.

Put another way, a clearly defined investment strategy is not only compliant with a SIS Act covenant, it provides support that the existence and maintaining of the superannuation fund is sole purpose compliant with the attaining of retirement benefits.

Writer's view on the current state of the sole purpose test?

I express below a range of views of the sole purpose test of today;

1. As contained in section 62 of the SIS Act, it is no more fundamental than any other SIS Act standard.

[37] SMSFR 2008/2, Self-managed superannuation funds - issuing a notice of non-compliance, at paragraph 13.

2. The ‘original’ sole purpose test from Scott’s Case No.2 is more about the issue of sham and façade than a rule of sole purpose conduct with respect to superannuation.
3. The sham and façade application from Scott’s Case No.2 has as much application to a superannuation arrangement today as it did 58 years ago, where the circumstances exist.
4. A claim of sole purpose test failure is too often claimed by auditors, a single failure of another SIS Act standard does not lead to a conclusion that the trustee has also failed the sole purpose test of section 62.

Part 2 - Sole Purpose Contributions Test

Whilst Justice Windeyer concluded that the superannuation arrangement in Scott's Case No. 2 was a sham or facade in pursuit of the taxation superannuation concessions, it is notable that in examining the facts he considered the *purpose* behind the contribution by the employer[38] and also by the employee[39]. Was this the first reference to there being a *purpose* contribution test?

Section 290-60 of the Income Tax Assessment Act, 1997 provides that;

> *You can deduct a contribution you make to a superannuation fund …, for the purpose of providing superannuation benefits for another person who is your employee when the contribution is made*

And Section 290-150 provides deductibility for an individual taxpayer.

> *You can deduct a contribution you make to a superannuation fund…, for the purpose of providing superannuation benefits for yourself*

A contribution into superannuation must satisfy a purpose of providing superannuation benefits, but is this a sole purpose?

Many Court cases that involved a finding of a failure by or in connection with the superannuation fund structure of the sole purpose test have resulted in loss of deductibility of the superannuation contribution, but until 1991 few cases considered the purpose test with respect to the contribution. The 1991 decisions of Raymor Contractors[40] and Roche's Case[41] are instructive in their analysis of the *purpose contribution test*.

Raymor Contractors involved a tontine scheme[42]. Superannuation contributions were made to the company fund in circumstances where most of the employees were short term employees who were not expected to qualify to receive a retirement benefit from age 65. Even the long term employees were not informed that they had an entitlement under the fund.

Management even kept an eye on those employees who might qualify for benefits. A list was drawn up on 21 February 1977 setting out the names of the eleven employees who could attain ordinary retiring age within the following five years. None of the eleven

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[38] Section 66(1), ITAA '36
[39] Section 82H(1), ITAA '36
[40] Re Raymor Contractors Pty Ltd v Commissioner of Taxation [1991] FCA 103 (27 March 1991)
[41] Re Commissioner of Taxation of the Commonwealth of Australia v Richard Patrick Roche; Kenneth John Laverty and the Trustees of the Mckinnon, Laverty and Roche Superannuation Fund [1991] FCA 606 (9 December 1991)
[42] Interestingly a Tontine arrangement has recently been considered by Treasury as a 'solution' to the retirement income policy of Australia. Refer to a paper: New thinking on how to solve Australia's post-retirement challenge, Paul Newfield, Presented to the Actuaries Institute Financial Services Forum 5 – 6 May 2014 Sydney.

employees remained in employment until that age. If someone got close to age 65, their employment would be formally terminated and if appropriate they would be re-employed but not offered membership of the company superannuation fund. The accumulated benefits of terminated members was forfeited and added to the benefits available for the continuing members of the fund, who were the founder and his family members.

In concluding that the contributions to the company superannuation fund were not deductible the Court stated that (i)*t is not the purpose of the fund which is to be considered, it is the purpose of the taxpayer* in making the contribution.

The Court stated at paragraph 45:

> *Generally speaking a person will be said to intend the natural and probable consequences of his acts and likewise his purpose may be inferred from them. In the present case the taxpayer's purpose in making the payments in each year of income may be inferred from the objective evidence that in the years of income in question benefits were continually being forfeited and only one person was in fact paid out, that person being a director of the appellant. Coupled with the fact that virtually the whole of the contributions were lent back to the contributing companies these facts suggest that the appellant's purpose was not to benefit those persons who were members of the fund; or certainly that that was not the sole or dominant purpose in making the contributions in the years in question.*

Later in 1991, Roche's Case took this purpose contribution test further.

That case involved a former partnership of three accountants in respect of which one retired and was employed by the other two as a consultant. It was agreed that a superannuation fund and contribution in respect of him be made and that the fund should provide him with a payment of $42,000 on his retirement 5 years later. The same amount was to be payable to him in the event of premature termination of the employment by reason of death or disability.

Whilst not concluded by the Court the facts looked very much like an arrangement to achieve a payout of a partnership equity in a tax effective (superannuation promoted) manner for the continuing partners.

The Court acknowledged the view in Raymor Contractors that *generally speaking a person will be said to intend the natural and probable consequences of his acts and likewise his purpose may be inferred from them.* However the Court later went on to support the view of Hill J. in Raymor Contractors [43] that there is "*much to be said for the view that the* (super contribution deduction) *section is concerned with sole*

[43] At 4271

purpose". And later the Court cited the following with approval from the High Court in *Driclad Pty Limited* v *Commissioner of Taxation*;

> *we find in that* (contribution deduction) *section a very precise requirement that the payments allowed as deductions must be for the purpose of making provision for individual personal benefits of employees and <u>for that purpose only</u>*[44]*.*
>
> *what the High Court said about s.66 appears to me relevant to the construction of the references to purpose in the sections with which I am concerned, namely s.82AAC and s.82AAE.*[45]
>
> *if the s.82AAC purpose test, as to a payment, is not complied with, no part of the payment is deductible; there is no provision for apportioning a payment which has not the requisite purpose.*[46]

Roche's Case concluded that the nature of the 'contribution purpose test' is more narrow and stringent than the 'superannuation fund maintenance sole purpose test', which allows a purpose that is incidental to the purpose of maintaining the superannuation fund.

> the 'contribution purpose test' is more narrow and stringent than the 'superannuation fund maintenance sole purpose test'

It is clear that there is not only a purpose test that would apply to sections 290-60 and 290-150, this is a true sole purpose test, that is, there is no room for any other purpose, even an incidental purpose.

An example of the foregoing lies in ATO ID 2015/10, though this was expressed upon section 62 and 65 SIS Act compliance. The issue addressed was:

> *Does a self managed superannuation fund contravene section 62 and paragraph 65(1)(b) of the SIS Act by purchasing a life insurance policy over the life of a member of the SMSF where the purchase is a condition and consequence of a buy-sell agreement the member has entered into with his brother as co-owners of their business?*

The relevant parties the subject of the ATO ID entered into an agreement that *specifies that these* (contribution) *amounts are to be used by the trustee to pay the premiums on the policy. These contributions are in addition to any other contributions the company is required by law to make (for example, superannuation guarantee*

[44] The Court in Roche cited with approval the comments of the High Court in *Driclad Pty Limited* v *Commissioner of Taxation* (1968) 121 CLR 45 at 67
[45] At paragraph 39
[46] At paragraph 41

contributions), or as part of an arrangement with the Member (for example, as part of a salary sacrifice arrangement).

The conclusion was that the life insurance buy-sell agreement via the SMSF contravened section 62 and section 65, however it is contended that rather than taking a super fund perspective, the better approach is to recognize it as a breach of the sole purpose contributions test and consequently no part of the relevant contributions was tax deductible to the taxpayer company.

It is notable that the ATO mentioned that *The SMSF is required to use contributions made to it in a manner that may not accord with its investment strategy.* Perhaps this was why the ATO took the broader super fund purpose test instead of the more narrow and stricter purpose contribution test.

Having a well constructed investment strategy that reflects not only the adopted strategy of investment but expresses the basis upon which it is framed is, in the writer's view a potential significant response to any claim of non compliance or non deductibility of superannuation contributions.

Part 3 - Strategies to 'Manage' the Taxation of the Super Death Benefit; tax schemes or careful planning?

The third part of this paper seeks to consider the strategies that are currently promoted with respect to the taxation of superannuation death benefit payments and in particular answer the question; are these illegal tax evasion or sensible superannuation planning?

Background

Of course the background to the issue is taxation and the process and circumstances that lead to its liability and the subsequent steps that lead to no liability arising. Most commonly the issue is raised for those who have attained the age of 60 and who thereby enjoy tax free superannuation. Section 301-10 ITAA '97 states that;

> *If you are 60 years or over when you receive a superannuation benefit, the benefit is not assessable income and is not exempt income.*

But if that same superannuation benefit is paid in consequence of the death of the member, tax will be payable on the same amount from the same source depending upon;

- the dependency of the recipient on the deceased member; and
- the taxed versus untaxed components of the benefit.

This is where dependency needs to be understood as being different for SIS Act and for ITAA'97 purposes.

Where the recipient of the death benefit, either direct or via a deceased estate, is a *death benefit dependent*, section 302-60 ITAA '97 states that the benefit is not assessable income and is not exempt income. So who is a death benefit dependent? This is found in section 302-195 to be, in respect of a person who has died;

> *(a) the deceased person's spouse or former spouse; or*
> *(b) the deceased person's child, aged less than 18; or*
> *(c) any other person with whom the deceased person had an interdependency relationship under section 302-200 <u>just before</u> he or she died; or*
> *(d) any other person who was a dependant of the deceased person <u>just before</u> he or she died.*

An interdependency is found to exist where;

> *(1) Two persons (whether or not related by family) have an interdependency relationship under this section if:*
>
> > *(a) they have a close personal relationship; and*
> > *(b) they live together; and*
> > *(c) one or each of them provides the other with financial support; and*
> > *(d) one or each of them provides the other with domestic support and personal care.*

> *(2) In addition, 2 persons (whether or not related by family) also have an interdependency relationship under this section if:*
>
> > *(a) they have a close personal relationship; and*
> >
> > *(b) they do not satisfy one or more of the requirements of an interdependency relationship mentioned in paragraphs (1)(b), (c) and (d); and*
> >
> > *(c) the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.*

Being financially dependent on the deceased requires the person to be able to demonstrate that they were in fact reliant on the deceased for their necessary financial support. The nature of the financial dependency does not have to be complete, it is sufficient that it is substantial[47].

All other persons who become recipients of superannuation death benefits enjoy the tax free component of the payment free of taxation[48] but are liable to taxation on the taxable component[49]. The amount of tax payable is limited by way of a rebate to 15% for the element taxed in the fund and 30% for the untaxed element.

In simple terms the tax free component is the accumulation of all contributions after 30 June 2007 to the superannuation fund that has not been taxed to the fund on receipt. The most obvious example of this is after tax monies contributed by a person into their superannuation account. It also extends to the CGT exempt component under Division 152, from a Small Business Relief benefit and the home Downsizer Contribution[50]. Other amounts can fall into this tax free category, though these other amounts are less common.

For many their superannuation will comprise principally of taxable component. This is because they will not have made any or many additional after-tax contributions to their superannuation. Note that salary sacrificed additional superannuation contributions do not come within this tax free component due to it being a tax deductible contribution to the employer payer.

The taxable component is the total value of the benefit payment less the tax free component[51].

For the majority of Australians, the taxable component of the superannuation benefit will only or predominantly comprise of a taxed element, which is the amount that can be taxed at up to 15%. This taxed element arises where the superannuation benefit is sourced to a superannuation arrangement that has been subject to superannuation taxation, which applie to the majority of superannuation members in Australia. Certain constitutionally protected superannuation funds are not liable to annual

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[47] This substantial view of the ATO is expressed in ATOID 2014/6 where an over age 18 child living at home and in receipt of the Youth Allowance was determined to be a financial dependent of their parents.
[48] Section 302-140 ITAA'97
[49] Section 302-145 ITAA '97
[50] recognized in section 292-102 ITAA'97
[51] Section 307-215 ITAA'97

superannuation taxation and to that extent these are recognized with untaxed elements of any superannuation payment. This is where the rebate to reduce the effective tax on the death benefit is limited to 30%.

So by way of summary; the taxable component part of a superannuation death benefit paid to a non death benefits dependent is liable to maximum taxation of between 15% (for most) and 30% (for some). However, the same taxable component part of a superannuation amount paid to a member who is alive and over 60 years of age is tax free if from a taxed element and capped at 15% if from an untaxed element.

For the remainder of this paper I refer only to payments that comprise of tax element, which is what applies to the vast majority of Australians.

Timing of Superannuation is Apparently Important

The ATO hold to the view that the knowledge of the superannuation administrator impacts the character of the benefit payment. Receipt of a member benefit claim form that is processed but paid to or in respect of the member after their death is considered by the ATO to be a member benefit payment and not a death benefit payment. Member benefit payment paid to a member over 60 years of age will be received by them free of taxation. This is despite the fact that the member may be, at the time of payment, deceased.

This was the conclusion of the ATO in a 30 June 2022 private binding ruling authorization number 1051988780639. The ATO explained its view as follows;

> *A 'superannuation member benefit' payment is defined in column 2 of item 1 of subsection 307-5(1) of the ITAA 1997 as 'a payment to you from a superannuation fund because you are a fund member'. In this case, the deceased made an application to the Fund for the release of benefits prior to her death. The application was accepted and the process commenced prior to her death, with the actual payment paid to the deceased's account after death. The Fund made a payment to the member for meeting the condition of release for attaining the age of 65.*
> *Based on the relevant facts, the payment made by the Fund to the Deceased's bank account is not a superannuation death benefit for the purposes of section 307-5 of the ITAA 1997 and is instead a superannuation member benefit.*

The ATO also applied the above conclusion to a superannuation member benefit withdrawal undertaken pursuant to a power of attorney in the 15 March 2022 private binding ruling authorization number 1051950892840. Timing was clearly important, In May 20XX the taxpayer's Attorney lodged several requests for lump sum withdrawals on the taxpayer's behalf. The Fund has provided confirmations that these were received and processed. The taxpayer passed away in May 20XX. The Fund has provided evidence confirming the nominated benefits were released in May 20XX and June 20XX.

The ATO concluded that *in this case, the payments were made by the Fund to the nominated bank account as requested by the Deceased's Attorney immediately prior to his death. As such, the payments are superannuation member benefits paid by the Fund to the Deceased.*

One wonders what the ATO view may have been had there been 'evidence' as to the intended purpose of the attorney. If it was clearly evident that the attorney was motivated to achieve the withdrawal by the intention to avoid the super death tax, the ATO decision, in the writer's view, will be different and it will favour the wielding of its Part IVA powers.

Whilst not expressly stated it would appear that the superannuation arrangement referred to in the PBR was an APRA regulated superannuation fund. A similar view is not expressed by the ATO where the particular superannuation arrangement involves an smsf. On its website the ATO states two examples[52];

> *Example: SMSF paying a death benefit*
> *Jack and Jill are spouses, and members and trustees of the Hill SMSF. Jack has a terminal medical condition. He makes a request to his SMSF for release of his super.*
> *Before the benefit payment is made, Jack passes away. It is then paid to an account belonging to his legal personal representative, forming part of Jack's deceased estate.*
> *At the time of payment Jill, as the surviving trustee, considered the above factors and determined that the payment is a death benefit. Notably:*
> - *the terms of the trust deed of the Hill SMSF allow for release where a member meets a condition of release, including both the terminal medical and death conditions the trustee of the SMSF knew Jack had passed away before authorizing the payment*
> - *Jack's super benefits are being paid to his legal personal representative's account*
> - *the payment is being made as soon as reasonably practicable to satisfy the compulsory cashing requirement that applies when a member dies, rather than in accordance with Jack's prior request.*
>
> *End of example*
>
> *Example: APRA-regulated fund paying a member benefit*
> *Satine is a member of an Australian Prudential Regulation Authority (APRA) regulated super fund. She has a terminal medical condition. Satine makes a request to her fund for release of her super benefits.*
> *Before the benefit payment is made, Satine passes away. The trustee does not become aware of this until after the benefit is paid to the account in Satine's request.*

[52] Death of a Member

> *The terms of the trust deed allow for release where a member meets a condition of release under Schedule 1 of the Superannuation Industry (Supervision) Regulations 1994 (SISR) with a nil cashing restriction.*
> *At the time of payment, the trustee considers the above factors and determines that the payment is a member benefit. Notably, the trustee:*
>
> - *is not aware that Satine has passed away*
> - *makes the payment to Satine's personal bank account and expects she is alive to personally receive it*
> - *makes the payment in line with Satine's request to release money and not any other requirement*

The only apparent distinction between these two circumstances is the actual knowledge of the trustee as to the death of the member and what this was at the specific time of drawing and paying the benefit in respect of the member. There is also a reference to the benefit payment being made into the member's personal account or the LPR account. This would hardly appear to be conclusive.

Turning to the strategies, where a prospective superannuation death benefit is received by the superannuation member *before* their death and they are aged at least 60 years of age[53], the amount will be received as a member benefit and is free of taxation. On their subsequent death no amount of superannuation death benefit taxes is paid.

By contrast if the prospective superannuation death benefit is received by a (non tax-free) person *after* the death of the superannuation member, the amount received will most commonly be taxed at up to 15% on the taxable component, if the person derives the benefit via a deceased estate and up to 17% (with the medicare levy etc) if the person derives it directly.

The amount of taxation that may be saved can be substantial. The July 2021 average superannuation balance of a member of a self-managed superannuation fund is $790,808[54]. Often the majority of this falls into the taxable component. If we assume a tax free component of 30% (representative of after taxed contributions) the amount of tax payable by a person who receives this $790,808 who is not a tax free dependent is, subject to the rebate, up to $94,106.15[55].

> The amount of taxation that may be saved can be substantial. If we assume a tax free component of 30% on the 2021 average super balance of $790,808, the death benefits tax payable is up to $94,106.15. It is $0 is the same super is paid out prior to death.

If the same $790,808 was withdrawn by the superannuation member prior to their death and inherited by the same person, the amount of tax payable is $nil. This is because in our example the superannuation member was aged over 60.

[53] Or the payment is a recognised terminal super death benefit pursuant to section 303-10 ITAA'97
[54] Self-managed super fund quarterly statistical report – March 2023, ATO, Table 9
[55] $790,808 x 70% x (15%. plus 2% medicare levy)

Therein lies the strategy, withdraw the prospective superannuation death benefit before death and no tax is payable, after death and substantial tax may be payable.

So when is it legally tax permissible to avoid the super death benefits tax on the taxable component and when is it not? In the following parts of the paper various scenarios are profiled where this question is specifically raised and answered. But before addressing this an examination of Part IVA of the ITAA'36 is appropriate.

Overview of Part IVA

Part IVA of the ITAA'36 contains the general anti-avoidance rules that the ATO may apply to deny a taxpayer the tax benefit of a scheme they have entered into. The provisions set out the scope of potential application. Whilst it has been said that it was designed to combat 'blatant, artificial or contrived' tax avoidance activities it has been held on many occasions to just be another part of the taxation law that applies to any activities that have the result of a tax benefit.

For Part IVA to apply the ATO must successfully identify;

- a scheme, engaged in with
- a dominant purpose of obtaining
- a tax benefit.

For the purposes of this paper Part IVA is looked at in the context of recent cases.

The decision in *Mylan Australia Holding Pty Ltd* v *FCT (No 2)*[56] confirms that Pt IVA requires an objective assessment of purpose against the eight factors in section 177D. And the outcome of this objective assessment needs to be that the tax benefit obtained must be the ruling or most influential purpose of the scheme. In undertaking the Part IVA review, the commercial and financial consequences of the steps and actions that make up the scheme must be considered, in addition to any tax benefit obtained.

To determine the tax benefit, it is necessary look at the taxpayer's tax position under the scheme compared to the tax position that would arise, or may reasonably be expected to, if the taxpayer had not entered into the scheme. This is sometimes described as identifying the 'counter-factual'.

Obtaining tax benefits is not sufficient, the tax motivation must objectively be the most influential purpose. But this is not asking to find a single tax purpose that dominates all other purposes combined, all that is required is that the tax purpose is in and of itself, greater than each other purpose that may be objectively and sensibly identified. The mere fact that less tax is paid under the sequence or circumstances that is the scheme than under an alternative is not determinative. The objectively identified other purposes and outcomes of a non-tax nature must be considered.

[56] [2024] FCA 253

This leads to the view that an influence of tax considerations can and is acceptable, where the dominant purpose is not the obtaining of the tax benefit. The actual subjective purpose of the taxpayer is not determinative.

The ATO cannot selectively focus on particular aspects of an arrangement in assessing purpose. The arrangement must be viewed holistically, in its full context. However, the more contrived the steps, or the more artificial the distinctions from the alternative, the greater the Pt IVA risk.

Part IVA applies to the Taxpayer, therefore is it the Taxpayer's tax-purpose that must be found? The answer is no. To seek the Taxpayer's purpose is to pursue their subjective intent. The Courts are clear that it is an objective determination of a dominant tax purpose that must be found to exist. It is for this reason that the subjective intent of another person can be influential to identifying the objective purpose arising from the scheme.

This approach is found in *Commissioner of Taxation* v *Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023]). Whilst the ATO failed in its section 100A ITAA'36 arguments it succeeded in its Part IVA argument with what was identified as the 2013 scheme. The Court stated that;

> *it is considered that the manner in which the 2013 related scheme was entered into and carried out supports a conclusion that Mr Springer, Guardian or AITCS (<u>or those advising them</u>) entered into or carried out that scheme for the dominant purpose*
> emphasis added

The observation to draw from the foregoing is that the relevant objective finding of purpose need not be found personally in Mr Springer who was the taxpayer or in entities that he directed and controlled, it is enough to find the purpose or tax reason in *those advising.* Put another way, the objective purpose of obtaining a dominant tax purpose with a scheme can be supported by a conclusion that an advisor to the taxpayer personally held that objective in mind.

Returning to the context of Part 3 of this paper, the Part IVA question to be addressed is whether:

> having regard to the eight matters listed in section 177D, can it be objectively determined that the steps and actions taken to achieve an avoidance of the superannuation death taxes was the dominant purpose?

This question is considered in the most common scenarios that follow.

The Estate LPR as the Taxpayer

A deceased estate is assessable to taxation as though it were a trust pursuant to Division 6 of the Income Tax Assessment Act, 1936. This comes about by way of the definition of a trustee in Section 6 as including;

> *(a) an executor or administrator, guardian, committee, receiver, or liquidator; and*
> *(b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability;*

Division 302 of the ITAA '97 addresses *Superannuation death benefits paid from complying plans etc* with Section 302-10 dealing with *superannuation death benefits paid to trustees*[57] *of deceased estate.* This section 302-10 requires the legal personal representative[58] (LPR) to be satisfied as to the tax dependency characteristics of the person who will, via the estate, benefit from the superannuation death benefit.

> Section 302-10 requires the LPR to be satisfied as to the tax dependency characteristics of the person who will, via the estate, benefit from the superannuation death benefit

Where the ultimate recipient is a *death benefits dependent* the LPR is deemed to be a *death benefits dependent* for the purposes of the taxation of the benefit to the estate. Where the ultimate recipient is not a *death benefits dependent* the LPR is deemed to not be for the purposes of the estate and taxation, subject to the rebate cap, is payable by the estate. What is very important to understand is that section 254 of the ITAA'36 has the effect that the LPR (executor or administrator) of the estate is made personally liable to taxation to the extent that taxation is found to be due by the estate but they did not hold back enough to pay that taxation. In other words, the risk of personal tax liability is high for the LPR if they get their assessment wrong as to whether an estate beneficiary is or is not a a *death benefits dependent.*

There is a marginal effective tax difference for the taxable component that is paid to the estate versus paid directly to an individual. The estate is not liable to the additional medicare levy whilst the individual will be. The practical expectant maximum taxation for the estate to the extent of the taxable component is 15% but to an individual recipient it is 17%.

The Estate LPR and Appropriation Impact Upon Taxation

An LPR in receipt of a superannuation death benefit where the estate is proportionally divided between death benefit dependents and non death benefit dependents prime

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[57] Trustees in this sense refers to the Court appointed Executor of an estate subject to probate over a will or the Administrator where letters of administration are Court issued for an intestate estate where there is no will.
[58] Executor or Administrator of the estate.

facie results in the LPR being able to assert only partial tax free receipt of the death benefit.

Consider an example involving an estate with $500,000 cash and $500,000 wholly taxable component death benefit that is evenly divided between two children, one a financial dependent and therefore a tax free death benefit dependent and the other is not. Prime facie and without more, they are each entitled to half, resulting in the LPR being liable to up to $37,500.00[59]. The result is a net after tax estate interest of $962,500 to be divided evenly among the beneficiaries.

> Unless expressly empowered by the will, the LPR should document the estate beneficiaries agreement to any exercise of an appropriation power that allocates taxable superannuation to a tax free death benefit dependent

To address this tax impost the LPR could adopt an appropriation of the assets of the estate, hopefully with the benefit of an appropriation power contained in the will or by expressing their LPR Trustee appropriation right under a State Trustee Act or other Act[60]. Commonly this will require the LPR to undertake the appropriation with the consent of the beneficiaries if the local State law is to be relied upon. By appropriating the cash to one and the whole of the superannuation death benefit to the death benefit dependent, the LPR can then be satisfied in terms of section 302-10(2) and no tax will arise to the estate.

But is Appropriation Evasion? Can Part IVA Apply to an Estate Super Appropriation?

There is a dearth of guidance on if or when the tax avoidance concerns of the taxation laws and administration could or should apply to the payment of a superannuation death benefit.

The example expressed above involved the LPR in making a decision (and likely co-opting the beneficiaries into agreement), with the outcome (and purpose?) of avoiding the superannuation death benefits tax that would otherwise fall upon the LPR in their representative capacity. Surely the steps undertaken constitute a scheme to secure a tax benefit for the taxpayer LPR? And looking at the scheme from a counterfactual perspective, it is clear that if the LPR had not applied the appropriations power the proportionate approach to identifying the taxation outcome would have applied.

So can the appropriation action be part of a scheme to obtain a tax benefit and therefore Part IVA of the ITAA'36 can be enlivened by the ATO?

Whilst not directly on point, by analogy the example likely deserves the treatment expressed by section 177C(2) which excludes a tax benefit from PartIVA where *the tax benefit is attributable to the making of a declaration, agreement, election, selection or choice, the giving of a notice or the exercise of an option by any person expressly*

[59] Super death benefit of $500k x 50% (non death benefit dependent share) x 15% rebate capped tax.
[60] In NSW this is found in section 46, Trustee Act, 1925.

provided for under the ITAA'36 or '97. Within this context it can be argued that not only was the LPR merely exercising an option that was available to them (the appropriation of estate assets selectively), it is likely incumbent on them to do so.

It is therefore suggested that no, Part IVA cannot apply to an estate appropriation by an LPR the result of which is that there is no death benefits tax payable. What the LPR has done is exercised a lawful right that was available to them and is available to all assets of the estate. The exercise of the available right is, in the writer's opinion, analogous to the rights recognized by section 177C(2) with the result that Part IVA is excluded from being able to apply.

Other Strategies for Pre-death Superannuation Withdrawal

There is a certain broad advice among financial advisers and accountants that clients should plan for actions that will avoid the death benefits tax. The most common of these strategies involves the withdrawal of the superannuation benefit to the over age 60 superannuant free of taxation.

We can start this review by taking the earlier example of wealth of $500,000 cash and $500,000 wholly taxable component superannuation that is intended to be evenly divided between two children, one a financial dependent and therefore a tax free death benefit dependent and the other is not.

In the context of that example consider the following three scenarios;

- the superannuant withdraws the superannuation and deposits the resultant cash of $500,000 with their other cash to have an estate cash amount of $1,000,000.
- the superannuant does nothing knowing that a clause in their smsf trust deed states that instantly that the member dies the trustee no longer holds their interest for the superannuation fund but they hold it on absolute entitlement for the deceased 'former member'.
- a child of the superannuant, with knowledge of the imminent death of their parent and acting under their appointment of power of attorney, withdraws the superannuation and deposits the resultant cash of $500,000 with their other cash to have an estate cash amount of $1,000,000.

Clearly the express and intended purpose of the person that is carrying out the particular act is important.

Super Member Withdraws pre-Death

The first scenario is as much explainable from an objective of seeking orderliness of their estate as it may be argued that the parent did it to avoid the super death benefit tax. Indeed the actions of the parent who is later the deceased, even if somewhat influenced by the tax free outcome, may be wholly within a context of no knowledge or involvement of their future prospective LPR or children. In other words, to the extent that it is argued that there is a tax benefit this is argued to be an outcome of the deceased making decisions (of superannuation withdrawal) that was available to them.

In the writer's view it is most unlikely that such a situation can fall under a Part IVA determination. It is said to be most unlikely because if it is provable that the actions of the parent were wholly or principally motivated by saving the super death tax impost that would fall upon children, it is arguable that Part IVA can apply.

Super Trust Deed Expresses Death Automatic Absolute Entitlement in the Deceased

The second scenario relies on a deeming of absolute entitlement by the superannuation trustee in favour of the superannuant. It is claimed that at the instant of death the effect of these deeming clauses is that the $500,000 (in our example) is no longer held by the superannuation trustee as trustee of the superannuation fund, it is held absolutely by the trustee for the superannuant who has ipso facto derived the benefit. Immediately following death it is claimed that there is no superannuation interest of the member that falls under their estate.

There is nothing in the SIS Act that would prohibit such a deeming clause, but it is suggested, the ATO is unlikely to accept this 'solution'. Where the relevant smsf of which the superannuant is a member has more than one member beneficiary, it is suggested that the ATO would not accept the so-called instant deeming of absolute entitlement. The ATO argues that this cannot exist in any trust arrangement that involves more than one beneficiary. Each beneficiary has an interest in the whole of the trust arrangement assets, commonly on an indistinguishable basis.

If the scenario involved a single member smsf arrangement would this change things? Unlikely not since the most common smsf trust arrangement will recognize dependents of the member as potential beneficiaries that subject to the superannuation trust deed may have nothing more than a mere expectancy but may have also have a default interest. The ATO is still likely to argue that the absolute entitlement cannot arise due to the multiple beneficiary situation.

Assuming however that the apparent absolute entitlement deeming has trust law merit, the question still remains as to whether Part IVA could apply.

In the absence of there being any other reason for the existence of the absolute entitlement deeming clause, it is suggested that that the ATO could seek to invoke Part IVA to the arrangement. There is a whole regime with the SIS Act and Regulations that refers to the manner and process for the making of benefit payments. What is missing within this is any concept of an absolute entitlement deeming approach. Indeed the SIS Regulations address payment obligations and the process for benefit withdrawals, which would suggest that the absolute entitlement deeming approach has no general application in Australian superannuation[61].

[61] This conclusion is consistent with the Federal Court decision in *Kafataris* v *The Deputy Commissioner of Taxation* [2008] FCA 1454

Child with Power of Attorney Acts

Perhaps the least most controversial about the probable application of Part IVA is the third scenario that involves the child of the soon to be deceased superannuant invoking their power of attorney in favour of their parent to withdraw the parent's superannuation prior to their passing. It is a little difficult to easily see a non-tax reason for the withdrawal of the (exampled) $500,000.

What about the situation of the child of the soon to be deceased using their power of attorney to withdraw their parent's superannuation prior to death, when the withdrawal is free of taxation?

The scheme being the withdrawal of the superannuation under the power of attorney, whilst not ostensibly against the interest of the parent, is not readily clear as to why it *is in their favour*[62]. Indeed the action of the attorney is to take the superannuation out of the annual tax concessional area of superannuation and to deposit this, commonly in cash, in a bank for the parent who will bear personal income tax on the earnings. This is hardly in the best interests of the principal of the power of attorney.

Can a Death Benefit that passes through the estate and into a testamentary trust be tax free?

The facts described in a 23 November 2021 private binding ruling authorization number 1051920326857 led the ATO to conclude no.

> *Where death benefits have been paid from an estate into a testamentary trust established under a will, the Trustee of the testamentary trust holds the assets of the deceased that have been transferred to the trust, for and on behalf of, the nominated beneficiaries. Therefore, consideration of the terms of the trust and who has or may be expected to benefit from the superannuation death benefits is required in order to determine the relevant tax treatment of the death benefits paid to the deceased's estate.*
> *In this case, the Trustee holds the balance of the Residuary Estate (which includes the superannuation death benefit proceeds) on the testamentary trust set out in the Will. The deceased's spouse is a death benefit dependant under subsection 302-195(1) of the ITAA 1997.*
> *The terms of the Will prescribe the way in which the capital of the TD Trust will be held and distributed, and any income or capital gains derived from the superannuation death benefit accumulated, paid or applied for the benefit of one or more of the Primary and Secondary Beneficiaries.*
> *Who will benefit, or may be expected to benefit, from the capital, or income generated by the death benefit capital of the trust depends on future events the outcome of which cannot be determined at the present time as some of the Beneficiaries encompass a range of individuals and entities, including those not yet in existence. For subsection 302-10(2) of the ITAA 1997 to apply, there needs to be a certainty that death benefit dependants will benefit from the*

[62] Powers Of Attorney Regulation 2016 - Schedule 2 – *Prescribed forms for power of attorney* proscribes that "An attorney must always act in your <u>best</u> interest"

> *superannuation death benefits in their entirety. The terms of the Will or Trust do not provide certainty that death benefits dependants will benefit from the capital, or the income generated by the death benefit capital.*
> *Accordingly, subsection 302-10(3) of the ITAA 1997 applies in this case and the death benefits paid to the estate of the deceased are subject to tax as if it were paid to a non-dependant of the deceased.*

Perhaps The outcome may have been different if the terms of the testamentary trust required the superannuation to be kept separate for the benefit of the spouse, who was the appointor of the testamentary trust.

Can a Payment of a Grandchild's Education make them a (tax free) Dependent?

It has certainly been promoted that where a taxpayer runs out of otherwise tax free superannuation death benefit dependents, they can consider making payment for a grandchild's education and this will be sufficient for the grandchild to be a tax free dependent.

The question of the degree of financial dependency was considered in the matter of *Re Malek* v. *Federal Commissioner of Taxation*[63] Senior Member Pascoe clarified financial dependence:

> *In my view, the question is not to be decided by counting up the dollars required to be spent on the necessities of life for [Mrs Malek], then calculating the proportion of those dollars provided by the [son] and regarding her as a dependant only if that proportion exceeds 50%...In my view, the relevant financial support is that required to maintain the persons normal standard of living and the question of fact to be answered is whether the alleged dependant was reliant on the regular continuous contribution of the other person to maintain that standard.*

It is submitted that the mere payment of a grandchild's school fees is not enough. It is further submitted that the person more properly liable for the school fees will be the parent who has entered into the school fee arrangement. The person is not in fact providing financial support to the grandchild, it is to their own child, the parent of the grandchild.

> The mere payment of a grandchild's school fees is not enough to make them a superannuation dependent. Anyway, isn't the school fee charged to the parents and not the child?

Re-contribution Strategy to reduce death benefits taxation

A re-contribution strategy involves a withdrawal of a superannuation benefit and a re-contribution back into super in the name of the same person. A lump sum withdrawal from superannuation will, according to the proportioning rules, be made up of taxable

[63] [1999] AATA 678

and non-taxable components. But when received by the over age 60 member, the benefit will simply become a cash amount.

By re-contributing this into superannuation, the amount contributed will be an after tax payment, it will be a non-concessional contribution. To the receiving superannuation fund the amount will add to its non-taxable component in respect of the member.

If we look at an example of a superannuation balance of $1,000,000 that comprises of equal amounts of taxable and non-taxable components. If the member were to withdraw $300,000 this will comprise of the same equal amounts. B but this fact is irrelevant to the over age 60 superannuant who receives the withdrawn amount tax free. If the $300,000 were to be re-contributed to the superannuation fund the new calculation of the taxable component will be $350,000 and the non-taxable $650,000.

If this were done again and again, eventually almost all of the superannuation will have the character of non-taxable component; that which was to have been taxable is no longer taxable in the hands of the non death benefit dependents. Ultimately, this may result in a reduction or cancelation of the potential tax payable if the super passes to non death benefit dependents.

Having regard to the expectant purpose that underpins a personal re-contribution strategy it is suggested that there is room for the ATO to apply Part IVA, though in practical terms it is unlikely that the ATO will become aware of the issue. The difficulty that arises is that at the time of the re-contribution strategy, there was no taxpayer against whom a tax purpose may be considered. The relevant taxpayer is the LPR of the superannuant or their adult children who commonly would not have been involved in the re-contribution and are the recipients of the ‘re-contribution washed’ non taxable component dominated superannuation death benefit perhaps years after the event.

However, as pragmatic as these later comments may appear to be, the ATO has in other circumstances made clear its willingness to apply Part IVA to a recontribution strategy, including where the purpose outcome is to save the super death benefits tax.

The following is drawn from the ATO website at Super Scheme Smart: Individuals information pack[64].

> ***Refund of excess non-concessional contributions to reduce taxable components***
>
> *Gavin and Mary, both in their 50s, decide they want to slow down and travel. They both have long service leave due and Gavin is worried about his health. Gavin feels that as he isn’t getting any younger, they should take their leave and head off on a trip around Australia.*

[64] https://www.ato.gov.au/General/Gen/Super-Scheme-Smart--Individuals-information-pack/?page=2

Gavin's father recently passed away and Gavin, being the only child, inherited $700,000 (which included the house). Gavin considers putting $500,000 into a bank term deposit and $200,000 into a savings account to support them while they are travelling. However, Gavin realises that the interest made would then be taxed at his highest marginal tax rate as his salary is over $180,000 a year. This idea is not appealing.

What is the arrangement?

Gavin's friend John tells him that he should put all the money into his self-managed super fund (SMSF) because the interest made inside the SMSF will be taxed at the concessional rate of 15%. John also tells Gavin not to worry if it is over the contribution limits as the ATO will just send him a letter to withdraw the excess so there won't be any problems. John goes on to say, that when Gavin withdraws the money, he can reduce the taxable component of his superannuation interest and he will save later on tax. John assures Gavin that this arrangement is above board as there is currently no legislation requiring that the excess funds must be withdrawn from the same non-concessional contribution (NCC) funds that were put into the SMSF.

Gavin knows the $700,000 will exceed the NCC limit (including the 'bring forward' provisions) so he decides to contact the ATO for advice. We advise Gavin of the following concerns on this arrangement:

- *It is an attempt to reduce the taxable component of the super interest and ultimately lower the amount of tax payable when the super benefit is eventually paid.*
- *While super benefits taken by a member over 60 years old are not part of the member's assessable income, there are concerns with this arrangement when*
    - *the member withdraws super benefits before turning 60, as the taxable components are included in the member's assessable income*
    - *in the case of estate planning where the super benefit is paid to a non-dependent upon the member's death, the taxable component (concessional contribution) will be taxed at the beneficiary's marginal tax rate.*
- *If Gavin goes ahead and deliberately contributes in excess of his cap, and then withdraws the excess resulting in a reduction of his taxable component, he could be subject to the anti-avoidance rules in Part IVA of the Income Tax Assessment Act 1936.*

In its Gavin and Mary example the ATO has specifically identified the superannuation death benefits tax as an issue and its potential and ability to apply Part IVA to undo the tax benefit that has been obtained. This is why the ATO concludes its story:

> *Mary tells Gavin she is worried about withdrawing the excess. She thinks his friend is not telling the truth as he isn't a professional advisor and it sounds like a scheme to avoid paying the correct amount of tax. After considering the advice of the ATO, Gavin decides to only contribute up to his available NCC limit of $300,000 (including the 'bring-forward' provisions) which keeps him from having excess contributions.*

Is there any hope with the application of Part IVA to an outcome of no superannuation death benefits tax being payable? It all turns on the purpose of the withdrawal of the superannuation on or around the occurrence of the death; was it for dominant purpose of the tax benefit, even if this purpose was that of an advisor, or was it for some other dominant purpose? What other dominant purpose could there be? Orderly administration of the estate and pre-death preparing for this. Perhaps avoiding the complexity and delay that is often involved in superannuation death payments. Maybe there is an objective of removing a person's wealth in a superannuation context from the risk of litigation by having the benefit enjoy the certainty of a deceased estate administration.

The correct answer must lie in an objective assessment of the purpose and what exists to demonstrate this.

Promoter Penalty for Tax Free Death Benefit Promotions?

If some of the suggested conclusions that some of the death benefit strategies bear the hallmarks of tax evasion, there seems every reason why the promoter penalty provisions[65] should have application.

The promoter penalty regime operates to impose penalties on the promoter of tax schemes that are designed to or evade tax. A person will be a promoter if all the following conditions are met (subsection 290-60(1)):

- they market the scheme or otherwise encourage interest in it;
- they or an associate receives consideration arising from the scheme; and
- it is reasonable to conclude that they had a substantial role in marketing the scheme.

However, a person will not be a promoter merely because they provide advice about the relevant scheme (subsection 290-60(2)). Further, an employee is not taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another (subsection 290-60(3)).

A scheme will be a tax exploitation scheme if it is (section 290-65):

- reasonable to conclude that an whoever entered into or carried out the scheme did so with the sole or dominant purpose of getting a scheme benefit (whether or not the scheme is implemented); and
- not reasonably arguable that the scheme benefit is available at law, or would be if the scheme were implemented.

Broadly, if the promoter penalty provisions apply, the relevant penalty will be the greater of:

- 5,000 penalty units (currently $1.565 million) for an individual, or 25,000 penalty units (currently $7.825 million) for a body corporate; or
- twice the consideration received or receivable (directly or indirectly) by the entity or its associates in respect of the scheme.

If the writer's view is accepted that there some circumstances where the promotion of avoiding the super death benefits tax is evasion, it follows that the promoter of such steps is liable under the promoter penalty provisions.

It seems to the writer that it applies to the circumstance of an advisor advising a power of attorney holder in respect of a parent to withdraw and re-contribute or to simply withdraw the benefit before death so as to avoid the death benefit taxation outcome. This should fall under the meaning of a tax exploitation scheme[66] if;

[65] contained in Division 290 of Schedule 1 to the Taxation Administration Act 1953 (TAA),
[66] Refer section 290-65(1), *Taxation Administration Act 1953* Schedule 1

> *it is reasonable to conclude that an entity* (the attorney) …. *entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a *scheme benefit from the scheme.*

But having regard to the fact that ATO members have superannuation and no doubt this will include taxable components, perhaps the ATO may not be motivated to press this issue? 😊

A Superannuation Epilogue

Much of the foregoing turns on the history of superannuation, especially when it was largely tax free and virtually limitless. The progressive lowering of the superannuation non concessional caps and the 1 July 2017 introduction of the $1,600,000 transfer balance cap which limited the amount of a tax free pension and the amount that may continue within a super fund upon the death of a member, began the slippery slope of superannuation becoming less attractive.

This slope will become more slippery with the commencement of the 1 July 2025 'Better Targeted Superannuation Concessions' measures. From that date individuals with a super balance exceeding $3 million will be subject to an additional 15% tax on investment earnings on the portion of their super balance which exceeds $3 million. At this stage there is no indexation of the $3 million threshold so whilst it is only expected to impact a modest number of Australians, its impact will grow with time.

Of greatest issue with the new measures is that the tax will be imposed by reference to the growth in value of a member's Total Superannuation Balance. This will result in a tax arising on unrealized gains. Why adopt this approach? Treasury's Consultation Paper states:

> *The approach to estimate earnings seeks to be simple and minimise unnecessary or additional compliance costs by largely relying on data reported through existing arrangements. …*

There is going to be a great demand for valuers and valuations as at 30 June 2025 from when the $3 million benchmark excess will be measured. Perhaps that is why the ATO was keen to reissue its thoughts on valuations in October 2022.

And what will legislating the objective of superannuation achieve? The Superannuation (Objective) Bill 2023 proposes to impress that the objective of superannuation is;

> *'to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.'*

In time we will learn what a dignified retirement looks like.

And yet despite the lowering attractiveness of superannuation it remains the writer's view that it is still the best legal tax avoidance scheme in the world!

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