

SMSF Working Group

Issues paper on Illegal Early Release

April 2011

PROPOSED REFORM

Superannuation benefits can only be accessed upon the occurrence of specific events, which are generally retirement or age related. Early release of superannuation benefits is permitted in limited circumstances such as severe financial hardship and compassionate grounds.

Illegally accessing superannuation benefits before the occurrence of an approved event poses a significant risk to community confidence in the superannuation system as well as to the retirement savings of the individuals involved.

The Super System Review recommended stronger sanctions for promoters of schemes designed to access benefits early. The review also recommended greater penalties for those who receive their benefits without meeting specified conditions of release.

These measures are intended to have a deterrence effect on promoters of illegal access schemes and those who access their benefits early without meeting a condition of release.

ISSUES

Issue 1

Recommendation 8.24 – Scheme promoters

The Government supports the recommendation to pass legislation to provide for criminal and civil sanctions to enable the ATO to penalise and discourage illegal early release (IER) scheme promoters.

Schemes that facilitate the illegal release of superannuation benefits undermine the Government's retirement income policy and harm the retirement savings of members.

Existing laws enabling the ATO to target and address illegal tax scheme promoters do not apply to the *Superannuation Industry (Supervision) Act 1993* (SIS Act). ASIC can prosecute promoters on the grounds that they are providing unlicensed financial advice.

Publication

Current ATO activity focuses on other compliance treatments that disrupt and/or close down schemes from operating. The introduction of criminal and civil sanctions for IER scheme promoters will enhance the ATO's ability to effectively deal with these promoters and deter others from undertaking this activity.

Possible models

It has been suggested that this recommendation can be implemented by amending the existing promoter penalty laws in the *Tax Administration Act 1953* (TAA). This option is considered to be problematic as it would require significant changes to the existing law so as to make the new penalties only apply to schemes involving superannuation. For example, concepts in the current law do not lend themselves to IER schemes, resulting in major additions to the existing law being required to cover these schemes. Also, current laws only provide for civil penalties, meaning a reworking of the penalty provisions would be needed to provide for criminal penalties.

It is considered that the new penalties for IER promoters should be included in the SIS Act. There are two possible models to consider:

1. Amend section 307 of the SIS Act. Currently section 307 applies to incorrectly keeping records with the intention of deceiving or misleading. The amendment would make it an offence to use an approved form or encourage others to use an approved form with the intention of contravening a regulatory provision or aiding another person to contravene a regulatory provision.
2. Introduce a new penalty regime into the SIS Act, modelled on existing promoter penalty laws but restricted to SIS issues.

Model 1 captures a common feature of IER schemes. Promoters establish an SMSF by lodging or encouraging others to lodge an *Application for ABN registration for superannuation entities* form. Previous cases have shown this to be one of the main mechanical provisions that apply to all IER schemes. Section 307 of the SIS Act only prescribes criminal penalties; civil penalties can be imposed by the operation of sections 193 and 194 of the SIS Act.

Model 2 would involve the introduction of a new penalty regime based on current promoter penalty laws into the SIS Act and restricted to SIS issues. This regime would contain general measures currently available under the existing penalty promoter laws, such as civil penalties, statutory injunctions and voluntary undertakings.

Model 2 is the preferred approach. The existence of specific superannuation promoter penalty laws should provide a strong and transparent deterrent effect against promotion of IER schemes. It would be based on existing mechanisms and provide the most flexibility in effectively dealing with scheme promoters.

Questions

Which model is considered to be the most appropriate to penalise and discourage promoters of IER schemes?

Are there any other models or options to consider?

Issue 2

Recommendation 8.25 – Participants

The Government supports the recommendation to amend existing tax laws so that amounts accessed illegally are taxed at the superannuation non-complying rate and an additional penalty, based on a sliding scale of penalties that takes into account individual circumstances, applies.

The introduction of a higher tax rate for amounts accessed illegally and a penalty for recipients will act as a deterrent to this behaviour and ensure those who illegally access their superannuation benefits early do not enjoy the same tax treatment as those who legally access their superannuation early.

Amounts taxed at the superannuation non-complying rate

Currently, amounts accessed illegally (IER amount) must be included in the recipient's income tax return. These amounts are taxed at the recipient's marginal tax rate. This results in amounts accessed early attracting the same tax treatment regardless of whether the amount was withdrawn legally or not.

Under the proposed measure, one possible model is for the IER amount to be included in the individual's tax return at the 'other income' label. This would then be picked up by the ATO system which will apply the non-complying tax rate of 45% to the IER amount. If the individual fails to disclose the IER amount on their income tax return, they will be subject to a shortfall penalty in addition to having the IER amount taxed at 45% if and when the non-disclosure is detected.

Additional penalty

Currently there is no specific penalty imposed on those who access their superannuation benefits illegally.

Such a penalty may be imposed in the form of a shortfall penalty. A shortfall penalty can be imposed if individuals fail to disclose their IER amount in their income tax return. The amount of shortfall penalty for which a taxpayer may be liable would depend on the behaviour that resulted in the shortfall amount. This approach allows for the penalty to be remitted.

Additionally, a new penalty may be applied under Recommendation 8.2 for trustees who breach an operating standard.

Questions

Are there any other options for the imposition of an additional penalty?

What circumstances should be considered in determining the level of the additional penalty?

Should the additional penalty be remitted to zero in some circumstances?