Australian Government

Commonwealth Superannuation Corporation

Tax Transparency Report

For the year ended 30 June 2018

Commonwealth Superannuation Corporation

Contents

Introduction

I am pleased to provide the Commonwealth Superannuation Corporation's (CSC) Tax Transparency Report for the year ended 30 June 2018 (FY18). CSC is a signatory to the Board of Taxation's Voluntary Tax Transparency Code (TTC) and has prepared this report on this basis.

CSC was established on 1 July 2011 to meet the superannuation needs of Australian Government employees and members of the Australian Defence Force (ADF). CSC's purpose and vision is to build, support and protect better retirement outcomes for all our members and their families.

CSC is committed to meeting its Australian and overseas tax obligations. Our organisation supports transparency within the Australian taxation landscape and is committed to contributing to the TTC initiative for future years. This report forms part of CSC's ongoing work to maintain strong tax governance and transparency.

Andy Young
Chief Operating Officer
27 DECEMBER 2018

About CSC

For the purposes of this report, CSC comprises of five regulated public sector and ADF superannuation funds, as well as a single pooled vehicle (known as the ARIA Investments Trust or the AIT) that is used to make investments. The AIT had $45 billion in funds under management as at 30 June 2018.

The five regulated public sector and ADF superannuation funds are:

- Commonwealth Superannuation Scheme (CSS)
- Public Sector Superannuation Scheme (PSS)
- Military Superannuation and Benefits Scheme (MilitarySuper)
- Public Sector Superannuation accumulation plan (PSSap)
- Australian Defence Force Superannuation scheme (ADF Super).

This Tax Transparency Report should be read together with CSC's 2017-18 Annual Report, which can be found at **csc.gov.au**.

Assurance Regimes Applicable to the Business

CSC is a holder of a Registrable Superannuation Entity licence and an Australian Financial Services licence. This means that it is regulated by the Australian Prudential Regulation Authority under the *Superannuation Industry (Supervision) Act 1993* (Cth), and the Australian Securities and Investments Commission under the *Corporations Act 2001* (Cth).

Tax Strategy

CSC's tax strategy is to maintain a high level of diligence and accountability through tax policies and procedures that reflect 'best practice' as determined by the Australian Tax Office (ATO). CSC considers that its focus on acting with integrity, and achieving strong tax compliance is consistent with its long-held objective of building, supporting and protecting better retirement outcomes for its members and their families.

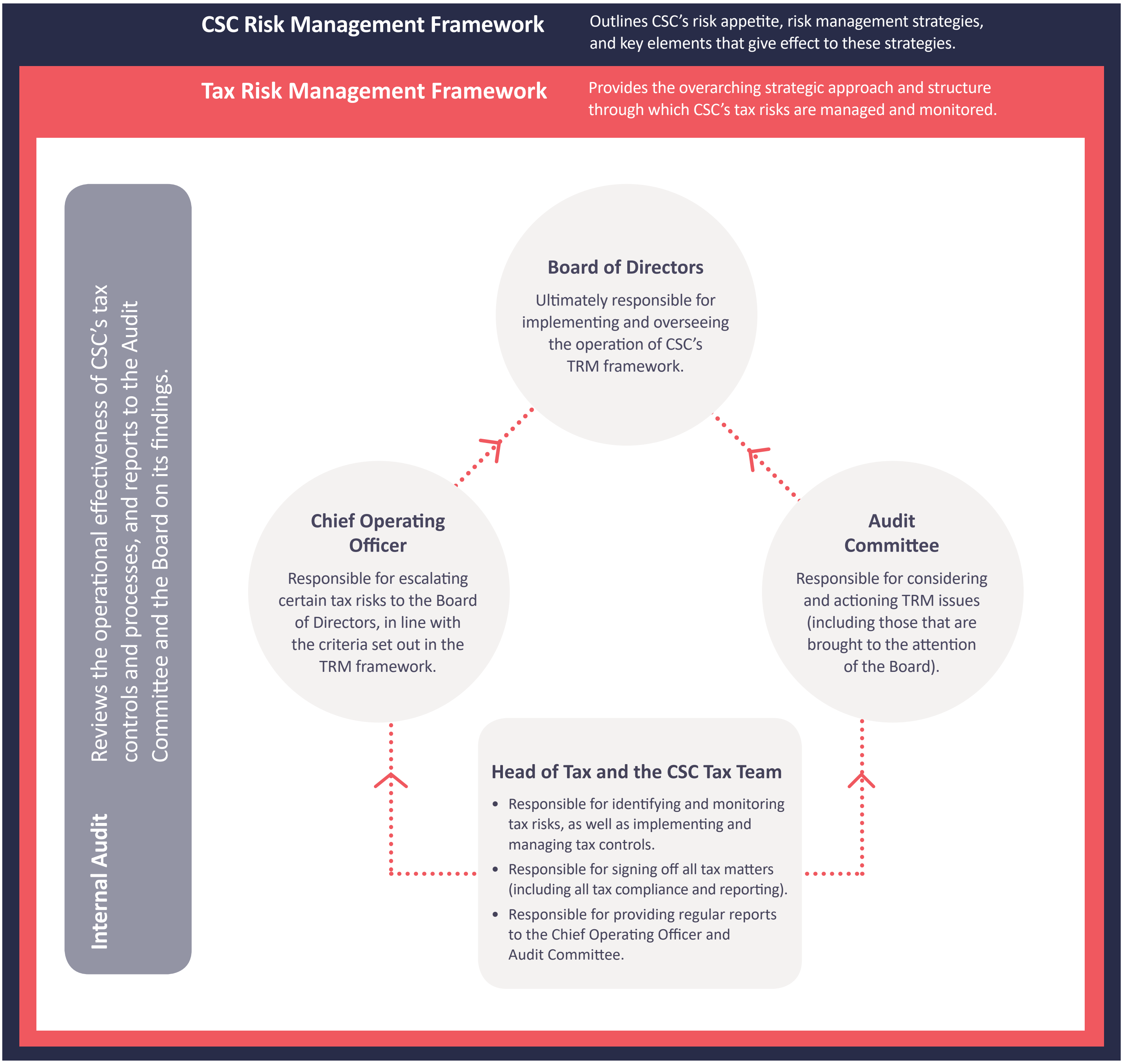
CSC's tax strategy is implemented through a tax risk management (TRM) framework that ensures a high degree of transparency and accountability. Tax risk extends beyond CSC's relationship with tax authorities, and affects almost every area of the organisation, including: investments, investment operations, finance, member and employer services, people, scheme administration and legal and compliance. A negative impact in any one of these areas can have a significantly adverse impact on CSC's reputation.

CSC's TRM framework forms part of a wider risk management framework that incorporates clear risk management procedures and responsibilities across all of CSC's staff members. This is reflected in CSC's internal risk and compliance functions, as well as its Board. In line with this wider risk management framework, CSC's TRM framework is supported by:

- Documented tax controls that facilitate the appropriate management and oversight of tax risks and issues. This includes streamlined reporting and sign-off procedures for all transactions involving tax, and for all tax compliance and reporting obligations
- Regular engagement on significant tax matters and risks with the Audit Committee and/or the Board
- Regular reviews (undertaken as part of CSC's internal audit program) of the effectiveness of CSC's tax policies, procedures and controls. Internal audit findings and recommendations are reported to both the Audit Committee and the Board, and
- Engagement with external advisors (where appropriate) to ensure that complex tax issues (including those that arise from changes in tax legislation) are proactively managed.

CSC is a participant in the ATO's 'Top 1,000 Tax Performance Program'. The program forms part of the ATO's 'Justified Trust' initiative, and examines the taxpayer's tax governance, its approach to meeting tax compliance and tax accounting obligations, and its management of tax risks arising from transactions and emerging issues affecting the superannuation industry as a whole. CSC continues to work collaboratively with the ATO to enhance market transparency and build confidence within the community that the largest Australian businesses are paying the right amount of tax.

The following diagram illustrates the relationship between CSC's TRM framework and its wider Risk Management Framework.



CSC's TRM framework has been subject to an independent review, which concluded that it is consistent with the ATO's tax corporate governance expectations, as set out in its *Tax Risk Management and Governance Review Guide.*

Attitudes to Tax Planning

In accordance with CSC's TRM framework, CSC maintains a low tax risk appetite. This means that CSC will only adopt tax positions where the application of the tax law is straight–forward or where there is clear authority to support the position. CSC proactively engages with its external tax advisers and tax authorities (including the ATO) to ensure that tax positions adopted accord with those stated objectives. CSC considers that a proactive approach to tax risk management supports a robust tax strategy, and a strong relationship with the ATO that is built on integrity and transparency.

CSC holds investments in Australia and various overseas jurisdictions. In doing so:

- CSC does not shift or accumulate profits in low tax jurisdictions, nor does it use the laws of overseas jurisdictions to shelter its income or assets
- Investment income and gains are repatriated back to Australia (and are subject to Australian tax)
- CSC fully complies with overseas tax laws and compliance obligations.

Tax Contribution

CSC is subject to Australian income tax at a rate of 15%, which is the standard income tax rate for superannuation funds in Australia. However, differences can arise depending on the nature of the income. For example, long-term capital gains and franking credits can reduce the effective tax rate below 15%.

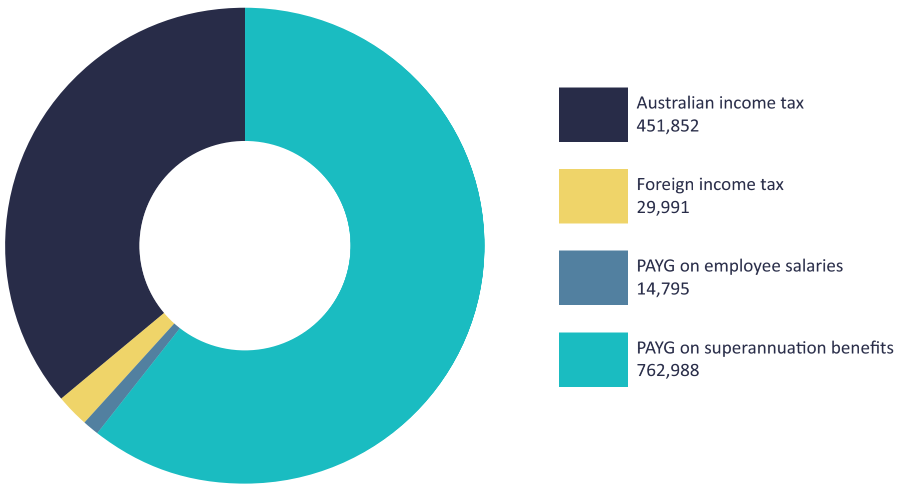
In addition, CSC pays foreign taxes on its overseas investment income. The rate of foreign tax paid may be different to the 15% tax rate in Australia for superannuation entities. As this foreign income is also subject to Australian income tax, CSC's foreign investments may give rise to a risk of double taxation. To mitigate this risk, CSC is allowed to claim a foreign income tax offset (FITO) in Australia for these foreign taxes paid.

The difference between CSC's effective income tax rate and the 15% tax rate is illustrated in the 'Effective Income Tax Rate' section of this report.

CSC is also subject to Goods and Services Tax (GST) and employment taxes–including Fringe Benefits Tax (FBT) where applicable.
In addition, CSC remits Pay-As-You-Go (PAYG) withholding tax from superannuation benefit payments to members and remits PAYG withholding tax deducted from employee salaries.

The following diagram provides a summary of the taxes that were paid in 2018. Note that the diagram below excludes immaterial amounts relating to GST ($156,647 net refund) and FBT ($67,908 paid). Refer to Appendix A for further details.

Taxes paid in 2018 ($000)



Effective Income Tax Rate

CSC's effective income tax rate is calculated as total income tax expense, divided by the sum of net investment and contribution income (after subtracting related expenses). This calculation is not based on accounting profit, as superannuation funds now exclude certain revenue and expense items from the income statement (such as superannuation contributions and other items affecting member liabilities).[1] These items may be regarded as assessable income or deductible expenses for tax purposes and as such, should be included in calculating CSC's effective income tax rate.

Taxpayers often report both an Australian effective income tax rate (which covers taxes paid on Australian operations), as well as a 'global' effective income tax rate that also includes taxes paid on overseas operations. While CSC has international investments that affect its financial performance, these foreign interests are of a minority and passive nature, and neither CSC nor any controlled entities have any international operations. Therefore, CSC's Australian effective income tax rate is the same as its global effective income tax rate. CSC's effective income tax rate is set out below.

	CSC ($000)	
	2018	**2017**
Benefits accrued as a result of operations before income tax	7,091,917	6,621,779
Total tax expense (based on the Profit and Loss Statements)	539,571	549,505
CSC's effective income tax rate under the TTC requirements	**7.6%**	**8.3%**

The difference between CSC's tax rate and the 15% tax rate is largely due to the following:

	Percentage difference	
	2018	**2017**
Contributions not subject to tax	3.0%	3.0%
Franking credits and foreign income tax offsets	2.1%	1.9%
Investment revenue already taxed	2.6%	1.6%
Other adjustments	(0.3)%	0.2%
Total difference from the standard income tax rate of 15%	**7.4%**	**6.7%**

Reconciliation of Accounting Profit and Income Tax Expense

In determining CSC's current tax expense, differences arise between 'benefits accrued as a result of operations before income tax' (as determined under accounting standards) and 'taxable income' (which is used to determine income tax expense). These differences are referred to as temporary and non-temporary differences.

Temporary differences arise due to the mismatch between the Australian tax and financial accounting rules in determining the timing of when revenue and expenses are recognised. For example, CSC's 2018 accounting income includes transactions that have already been included in CSC's 2017 taxable income.

Non-temporary differences occur when there are differences between accounting and tax that do not arise from differences in the timing of when revenue and expenses are recognised. These differences may arise because Australian taxation law may include (or exclude) an item in (or from) taxable income that does not follow the same treatment for accounting purposes. For example, some expenses are never deductible for tax purposes

The table below provides a reconciliation of CSC's aggregated accounting profit against CSC's total income tax expense and current income tax expense. As mentioned above in the 'Effective Income Tax Rate' section, CSC's calculation of income tax expense includes taxes paid on CSC's accounting profits on investments and superannuation contributions (net of related expenses).

[1] This relates to the introduction of accounting standard AASB 1056 *Superannuation Entities* which replaced AAS 25 *Financial Reporting by Superannuation Plans* with effect from the year ended 30 June 2017.

	CSC ($000)	
	2018	2017
Benefits accrued as a result of operations before income tax		
Superannuation contributions	2,943,608	2,859,296
Investment income	4,148,309	3,762,483
Total	**7,091,917**	**6,621,779**
Initial income tax calculated at 15%	1,063,788	993,267
Non-temporary differences (investments)		
Investment revenue already taxed [A]	(186,328)	(105,870)
Franking credits and foreign income tax offsets [B]	(149,880)	(127,818)
Capital gains adjustments	(2,233)	(16,949)
Under / (over) provision for income tax relating to prior income years [C]	23,875	6,836
Other items [D]	21	1,535
Non-temporary differences (contributions)		
Contributions and transfers not subject to tax [E]	(209,544)	(200,901)
No-TFN-quoted contributions subject to additional tax	(118)	243
Anti-detriment deduction	0	(865)
Under / (over) provision for income tax relating to prior income years	(10)	26
Income tax expense (current income tax and deferred income tax)	**539,571**	**549,505**
Temporary differences:		
Unrealised taxable capital gains and revenue losses [F]	(135,237)	(239,146)
Accrued income and expenses [G]	30,824	10,711
Deferred franking credits and foreign income tax offsets	6,149	532
Adjustments recognised in the period for current tax of prior periods	10,470	4,285
Other items [H]	75	(583)
Current tax expense (income tax paid and payable in respect of the current income year)	**451,852**	**325,304**

[A] This amount largely represents movements in the fair value of units of the AIT that are held by CSC's five regulated public sector and ADF superannuation funds and trust distributions that have already been subject to income tax in prior income years. An adjustment is made to prevent them from being taxed twice.

[B] Franking credits arise from Australian income taxes that have been paid by companies. These are passed onto shareholders through franked dividends, thereby reducing the incidence of double taxation. Franking credits reduce the total income tax expense. CSC also pays various foreign taxes in relation to its overseas investment income. This income is also subject to Australian income tax. To prevent double taxation, Australian tax law permits CSC to claim a tax offset in Australia for these foreign taxes paid.

[C] These adjustments relate to differences between the current and deferred tax expense recorded in the current and prior years, when compared against the actual tax paid in respect of that year. These differences generally arise due to additional adjustments made as part of preparing and lodging CSC's income tax returns.

[D] These amounts represent other adjustments which are required under Australian tax law, but are not recognised for accounting purposes.

[E] Under Australian tax law, certain forms of contributions received by superannuation funds are not subject to tax (including personal superannuation contributions where the member has not claimed an income tax deduction, contributions made on behalf of a spouse, government co-contributions and rolled-over superannuation benefits). Amounts that have been transferred from other superannuation funds are generally not recognised as 'superannuation contributions' and are therefore not subject to tax. However, if these amounts have not yet been subject to tax, an adjustment is required to increase the income tax expense.

[F] This amount represents unrealised capital gains and revenue losses on investments held in the AIT. Under Australian tax law, this amount is not subject to tax until the investment is realised. As such, an adjustment is required to reduce current tax expense. However, because unrealised gains and revenue losses give rise to tax/deductions in the future, there is no impact on total income tax expense.

[G] These adjustments represent investment income and expenses that have been recognised for accounting purposes, but are not yet recognised for tax purposes (either because the revenue has not yet been received, or because the expenses have not yet been paid). These amounts are not immediately reflected in current tax expense, but will be reflected for tax purposes in later income years (therefore, there is no change to total income tax expense).

[H] Other temporary differences include interest receivable and insurance premiums that are deductible or charged to member's accounts.

International Related Party Dealings

CSC did not enter into any international related party dealings during FY17 and FY18.

Material Tax Risks or At Risk Tax Positions

CSC has not identified any material tax risks or at risk tax positions for FY17 and FY18.

Appendix A - Tax Contribution

	Income tax paid and payable to the ATO and to overseas tax authorities ($000)	GST remitted to (refunded by) the ATO[A] ($000)	FBT paid by CSC to the ATO[B] ($000)	PAYG withholding remitted to the ATO (from employee salaries) ($000)	PAYG withholding remitted to the ATO (from member benefits) ($000)	Total ($000)
2018						
Australian federal taxes	451,852	(157)	68	14,795	762,988	1,229,546
Other jurisdictions	29,991					29,991
Total (2018)	**481,843**	**(157)**	**68**	**14,795**	**762,988**	**1,259,537**
2017						
Australian federal taxes	325,304	6,469	98	13,262	725,622	1,070,755
Other jurisdictions	27,840					27,840
Total (2017)	**353,144**	**6,469**	**98**	**13,262**	**725,622**	**1,098,595**

A further breakdown of the total variance between GST remitted to the ATO in 2017 and 2018 is provided below:

Explanation of the movement in GST remitted to the ATO	($000)
Increased management, custodian and trustee fees - CSC incurred additional costs for the year. This resulted in a higher input tax credit entitlement.	**2,704**
Sale of property - CSC sold an existing property interest during the year, resulting in a decrease in total taxable supplies made for the year.	**2,212**
Relocation costs - CSC incurred costs relocating to its new business premises. This resulted in an increase in capital acquisitions for the year and an increase in CSC's input tax credit entitlement.	**1,710**
Total movement in GST remitted	**6,626**

[A] For the year ended 30 June 2018, CSC was in a net refundable GST position.

[B] This includes FBT paid by CSC on non-cash benefits provided to its employees for the FBT years ended 31 March 2018 and 31 March 2017.

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