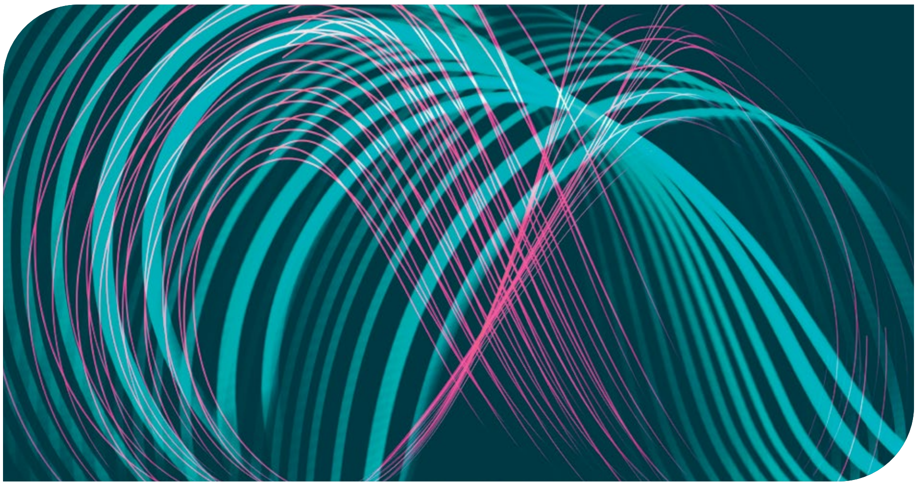
Nexia Australia

Superannuation Solutions

Edition 19



Welcome

Welcome to the latest edition of our Superannuation Solutions Newsletter.

In this edition we discuss Payday super contributions, NALE amendments which are now before the Federal Parliament, how to remedy in-house asset breaches, and the impacts or anomalies of the new tax on super balances over $3m.

We hope you find this newsletter informative. Should you have any questions in relation to how these changes may impact you, please contact one of our SMSF Specialists.

Important Dates

15 January 2024
2023 annual returns for medium/large super funds due for lodgement

28 January 2024
December 2023 super guarantee contributions due to be made to super fund by employers

28 February 2024
December quarter Superannuation Guarantee Charge lodgement and payment due if contributions not made by 28 January 2024

Payday Super

In the 2023-24 Budget the Federal Government announced its intention to move to a situation where compulsory super contributions must be made at the same time as wages are paid: so-called "payday super". The aim is this will apply to all employers from 1 July 2026. We reported on this proposal in Superannuation Newsletter 17.

Currently, compulsory superannuation guarantee contributions (SG contributions) relating to wages and salary paid in a particular quarter are required to be paid to super funds by employers no later than the 28th day after the end of the quarter. So, super contributions relating to wages paid in the quarter ended 31 December 2023 will be required to be paid to the employees' super funds no later than 28 January 2024. Failure to pay super contributions by the due date results in an employer becoming liable to super guarantee charge ("SG charge"), which is not tax deductible, and possibly other penalties.

Earlier payment of super is expected to ultimately improve retirement incomes from super funds significantly. At the same time, the widespread implementation of Single Touch Payroll offers the potential for the ATO to detect non-payment of super contributions much sooner than at present. The ATO has noted that businesses often enter liquidation or bankruptcy before the non-payment is identified, and estimates that as at 28 February 2022 $1.1 billion of super guarantee charge debt was subject to insolvency and unlikely to ever be recovered.

The Treasury Department has released a consultation paper, *Securing Australians' Superannuation: Budget 2023-24*, which seeks comment on how this proposal might be practically implemented.

Data matching

From 2023 the ATO will invest in creating a new unified database which will match Single Touch Payroll data from employers and Member Account Transaction data from superannuation funds. This is intended to provide a single source showing the near real time recorded super guarantee position of employers and employees, to enable the ATO to identify instances and patterns of late or underpayment of super guarantee. The Federal Government will also set up unpaid SG recovery targets for the ATO, to be reported on an annual basis.

Definition of "Payday"

The consultation paper suggests that there are two models that could be used. An 'employer payment' model that would impose the requirement on the employer to make payment of the SG contributions on the day that wages and salary is made or a 'due date' model that requires contributions to be received by the superannuation fund within a certain number of days following 'payday'. 'Payday' would capture every time a payment with an ordinary times earnings ("OTE") component is made to an employee. Employee SG contributions will be based on the OTE paid to the employee on the payday.

Updating the Super Guarantee Charge

The current quarterly system would be updated to ensure that employees who receive contributions late should always be compensated for forgone earnings, while employers should not be unduly penalised for circumstances outside of their control or for small administrative errors. These changes could include amendments to the rate of nominal interest and the size of the administration fee in a payday super model. Also, the ATO could be granted some flexibility to remit or reduce the SG charge or extend the due date under discrete circumstances where the employer is unable to meet the SG due date due to circumstances beyond their control.

Under the employer payment model, the SG charge could be based upon a requirement that the employer make the payment of an SG contribution on payday. Where a payment is not made on payday, an employer would become liable to pay the SG charge from this date. This would require new reporting and data mechanisms, and potentially the use of real-time payment platforms.

Under the due date model the current model could be retained in which a liability to SG charge arises if super contributions are not with a fund by a specified due date, being a certain number of days after the payday. The consultation paper suggests that, using legacy systems, a feasible due date for super contributions to reach funds would be between 8 to 13 days after payday. This could be reduced to less than 3 days using real-time payment technology.

Compliance mechanisms

If the ATO identifies that an employee's superannuation contributions were not with the fund, in full, by the due date or paid on payday, the first step would be for the ATO to contact the employer through a 'nudge' to encourage rectification of any underpayment. Where a contribution continues to be unpaid, the ATO will investigate and contact the employer again to inform them of their liability to pay the SG charge by issuing an SG charge assessment. As currently, the SG charge assessment would detail the amount of SG charge owing to the ATO. Once that assessment becomes due and payable, general interest charge will then accrue on any unpaid SG shortfall amounts.

Rather than issuing SG charge assessments as soon as the debt accrues, the ATO will complete regular, scheduled 'reconciliations' where they issue all SG charge assessments that have accrued in the preceding period. The frequency of reconciliations is yet to be determined.

Currently the ATO has limited discretion to remit the SG charge. Under the new system, the ATO might be granted more flexibility to amend or exempt application of the SG charge in cases where an employer cannot meet its SG obligations due to unforeseeable circumstances that are beyond their control. This might include natural disasters or where a new employee has not provided fund details.

Current arrangements include permitting an employee a choice of super fund, the use of a default fund where no fund is chosen, and the "stapling" of a fund to an employee to avoid employees having multiple funds. Currently, employers are required to offer new employees the opportunity to choose their fund. If no choice is made, the employer must check with the ATO if the employee has an existing 'stapled' fund. If there is no stapled fund, the employer can create an account with their 'default' fund for the employee. A recent review has shown that the current process creates an administrative burden for employers during onboarding new employees, and the ATO intends to introduce a more efficient procedure, including a new digital ATO service that employees and employers can use to confirm the right super fund details.

The role of SMSFs

Member Account Transaction data from super funds which the ATO intends to use to detect underpaid super is only generated by APRA regulated funds. SMSFs do not provide this data, and the member information contained in the SMSF annual return is not sufficiently detailed to allow the ATO to match super payments to be reported in Single Touch Payroll with super contributions received by the fund. The consultation paper raises the question of whether there should be any change to the reporting framework for SMSFs, but it is unlikely that any useful change would be feasible, given the small-scale nature of SMSFs.

Response by Joint Accounting Bodies

Chartered Accountants Australia and New Zealand, CPA Australia, the Institute of Public Accountants, the SMSF Association, Financial Advice Association Australia and The Tax Institute have lodged a detailed 30 page submission in response to the consultation paper.

Please contact your Nexia advisor is you would like any more information on these proposed changes.

NALE legislation now before federal parliament

The controversial amendments proposed by the Federal Government to the non-arm's length expenses provisions of the tax law are now before Federal Parliament in Schedule 7 of the Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023. We reported on the details of these proposed changes in Superannuation Solutions Newsletter 18.

Chartered Accountants Australia and New Zealand, CPA Australia, Institute of Public Accountants, SMSF Association and The Tax Institute have made a joint submission to the Senate Standing Committee on Economics. Not surprisingly, the submission is highly critical of the legislation.

There has been a long-running debate between the Federal Government and professional bodies about the problems associated with the 2018 NALE provisions and whether there is a need for them at all. The joint bodies made a submission in February when the legislation was at the exposure draft stage. The latest comments basically echo their earlier criticisms, claiming that the proposals only alters legislation that is now outdated.

Under the draft legislation, large APRA funds (mainly retail funds, industry funds and tax-exempt public sector funds) will be completely exempted from the NALE rules for both general and specific expenses, but will still be subject to the original NALI provisions. The submission argues that "This differential treatment raises concerns, particularly since the trustees of all superannuation funds are held to the same standard regarding legal obligations, such as the statutory best financial interests duty, common law fiduciary duties, and the sole purpose test, making the inconsistency in treatment questionable."

For funds with 6 or fewer members (including SMSFs), a distinction will be made between expenses that do not relate to any particular asset or assets of the fund (general expenses) and expenses that relate to a particular asset. Where a NALE general expense has been incurred, the maximum amount of fund income that can be treated as NALI will be twice the difference between the amount that would have been incurred as an arm's length expense and the amount that was actually incurred by the fund, but this will be capped at a maximum of the fund's taxable income not including assessable contributions.

The submission asserts:

> It is crucial to prioritise efficiency, equity, and simplicity when formulating tax laws and policy.
>
> The Joint Bodies recognise that there is often a trade-off among these principles. For instance, dealing with an integrity issue may necessitate complex rules, and a judgment must be made on whether the benefits of including an integrity rule outweigh the costs of increased complexity in administering that rule. Above all, equity should not be compromised when implementing integrity measures.

For the past three years, the superannuation sector, tax professional associations and industry, have strongly advocated for these concerns to be addressed, recognising that these rules are potentially detrimental to the retirement savings of Australians.

We would expect the Bill to pass the House of Representatives. The success or otherwise of these proposals now seems to depend on the judgement of the opposition and cross bench parties in the Senate.

How to remedy in-house asset breaches

Generally, an in-house asset is any of:

- a loan to, or an investment in, a related party of a super fund,
- an investment in a related trust of a fund, or
- an asset of a fund that is leased to a related party of the fund.

There are a number of exceptions, such as

- "business real property" that is leased by a fund to related party
- some investments in related non-geared trusts or companies, or
- assets specifically declared to be an exceptions.

The super law limits the size of in-house assets in a super fund to not more than 5% of the market value of the total assets. If at the end of a financial year the level of in-house assets exceeds this threshold, the fund must prepare a written plan to reduce the market value of in-house assets to 5% or less. The plan must be prepared before the end of the next financial year, and the steps in the plan must be carried out. Specifically, the law requires that the plan must set out steps to take in order to ensure that:

- one or more of the fund's in-house assets held at the end of the financial year are disposed of during the next financial year, and
- the value of the assets so disposed of is equal to or greater than the excess in the value of in-house assets.

It is important to note that, although certain actions could reduce the level of in-house assets below the 5% limit, they might not satisfy the specific requirement to **dispose** of sufficient in-house assets. For example, a property owned by a super fund may be treated as an in-house asset because it has been leased to a related party. The fund might consider correcting the situation by simply terminating the lease. However, a view expressed by the ATO in July 2012 to the former NTLG Superannuation Technical Sub-group seems to require the disposal of the property:

> As it is the residential property the subject of the lease to the related party of the fund, rather than that lease, that is an in-house asset, the ATO considers that the cessation of a lease of an asset to a related party of the fund does not result in the in-house asset (the residential property) being 'disposed of' for the purposes of section 82 of the SISA. The residential property remains an asset of the fund after the cessation of that lease.
>
> Accordingly, cessation of the lease to the related party of the fund would not satisfy the requirements of section 82, notwithstanding that it might reduce the market value ratio of the fund's in-house assets to below the 5% limit. As a consequence, the scenario raised in this question could also lead to a contravention of section 82 [the requirement to prepare a plan] and consequently another contravention of the civil penalty provision in section 84 of the SISA.

The law also seems to rule out restructuring arrangements outside the super fund to eliminate related parties as an acceptable plan, or situations where other assets of the fund are reliably expected to increase in value.

We recommend contacting your Nexia advisor if your fund is confronted with this problem, to ensure that any action taken is consistent with the requirements of the super law.

Potential impact of the new tax on super balances over $3m

In Superannuation Newsletter 17 we reported on the proposal by the Federal Government to introduce an additional 15% tax on a proportion of the super "earnings" of a member where the member's total super balance is greater than $3m at the end of a financial year. The new tax is intended to be first levied in the 2025-26 financial year.

Research on the potential impact of the new tax

At the request of the SMSF Association, the International Centre for Financial Services at the University of Adelaide has researched the wider aspects of the potential effect of the proposed new tax on super fund members.

The research involved analysing the data of over 720,000 SMSF members by "backtesting" the proposed changes against data from 2021 and 2022. This represents more than 67% of the total number of SMSF members. The data was extracted from the databases of three major SMSF platforms - Class, BGL and Super Concepts - after any information that would identify the fund or members had been removed.

The tests were run on both an "unbalanced panel" of members and a "balanced panel" of members. An unbalanced panel comprises all the members in the data, irrespective of whether they appeared in just one, or both years. As a result, the unbalanced panel is sensitive to new account openings and account closures. A balanced panel comprises only those individuals who were SMSF members in both 2021 and 2022.

How many SMSF members will be affected by the new tax?

By taking the proportion of members in the balanced panel who would have been affected by the new tax in 2021 or 2022 and multiplying this by the total number of SMSF members nationally, the research indicates that a minimum of 44,000 to 50,000 SMSF members would be affected. This is likely to be a low estimate, as members may have super assets outside their SMSFs which cannot be taken into account in the testing, and the value of super assets can be expected to increase between 2022 and 2026 when the new tax will come into effect.

Distribution of estimated tax liabilities

Not surprisingly, the revenue estimates and distributions were affected by the wider economic climate, with 2021 being widely a bull capital market and 2022 being largely a bear capital market. The research indicated that the total estimated revenue that would have been raised by the new tax in 2021 is $2.78 billion, but only $1.14 billion in 2022.

One significant finding is that the distribution of the tax liability across individual members is highly skewed towards those with the highest total super balances. In 2021 the average tax liability was $89,000 but the median (middle score) was only $28,000. In 2022 the average tax liability was $83,000 but the median was only $9,000. In fact, the top 1% of affected members would have contributed 27% of total revenue in 2021 and almost 60% in 2022.

This may have significant political implications for the Federal Government in selling the new tax to the electorate. Instead of dealing with the very important equity issues such as the taxation of unrealised gains, the tax will probably be characterised for political purposes as something that need not concern the average Australian, but will only affect the "very rich". In terms of the economic trade-off between providing tax concessions to super funds on the one hand and saving on payments of the age pension on the other, the Federal Government probably sees the new tax as a gain with little chance of loss, as the members targeted by the tax are extremely unlikely to ever qualify for the age pension.

Fund liquidity and payment of the tax

The new tax is designed to be imposed on the member, with the option of arranging for the fund to pay the tax. The researchers had no data on the ability of members to pay the tax from their own financial resources, but did examine how fund liquidity stacked up against the potential tax liability.

Based on the unbalanced panel and considering each of 2021 and 2022 independently, the research indicated that between 3% (in 2022) and 11% (in 2021) of all SMSFs would find it difficult to cover payment of the new tax from their own liquid assets. This represented members with an estimated tax liability of greater than the fund cash balance plus $5,000.

Using the balanced panel, the researchers were able to estimate the number of members who would experience cash flow problems if their fund had to pay the 2021 and then in addition the 2022 tax. In this situation there was a four-fold increase in the 2022 rate of liquidity problems, from 3.1% to 13.5%. Again, it is not at all surprising that the basic design flaw of taxing unrealised gains should give rise to liquidity problems.

Clearly, there are major issues still to be resolved in relation to the government's proposed new tax on super balances.

Please contact your Nexia advisor if you would like to discuss any aspect of the proposed new tax.

Anomalies in the new tax on super balances of $3m

A number of major anomalies in the Federal Government's proposed new tax on total super balances over $3m have become apparent with the release of draft legislation. We have summarised a number below for the information of clients.

Negative earnings cannot be carried back

The combination of including unrealised gains in the calculation of "earnings" in one year and the inability to carry back negative earnings from a later year can produce arbitrary and unjust results. For example, a member may have a total super balance greater than $3m at the end of year one and be liable for the tax due to an unrealised capital gain on a super fund asset, then incur a loss in year two if the gain reverses, but never be able to use the loss if their total super balance never exceeds $3m again. They have in effect paid tax on a gain that was never realised.

TPD insurance

A member who has received a "structured settlement contribution" (a compensation payment for personal injury paid under a court decision) at any time in the past is not liable to pay Div 296 tax at all. This is intended to recognise that these contributions are usually large payments that can provide the funds for ongoing medical and care expenses resulting from serious injury and income loss. However, a member whose super fund receives a total and permanent disability (TPD) insurance payment does not enjoy this concession. Under the proposed legislation the receipt of a TPD insurance payment by the fund is excluded from the new tax by including it in the total of "contributions" subtracted in the calculation of "earnings" in the year it is received, but any earnings in later years arising from the investment of the TPD payment will be subject to the new tax. There seems to be an assumption that an insurance payout is more easily obtained and somehow less worthy of a major concession than a payment from a court verdict.

Death

The estate of a member who dies "before the last year of the year" is not liable to the new tax. But the member's estate is still liable if the member dies on 30 June. We have not seen an explanation of this odd inconsistency.

LRBA balances

Under the current rules, the total super balance of an SMSF member can include a share of certain limited recourse borrowing arrangements (LRBAs) entered into by the SMSF. This applies to LRBAs entered into on or after 1 July 2018, if either the LRBA is between the fund and an associate of the fund, or the member concerned has met a condition of release with a nil cashing restriction. These conditions of release are retirement, terminal medical condition, permanent incapacity and reaching 65 years of age.

When introduced, the increase in total super balance where the LRBA is with an associate was said to address the risk that the terms of the LRBA were not on arm's length terms. The increase in total super balance where a member has met a condition of release with a nil cashing restriction was said to address the risk of LRBAs being used to facilitate a recontribution strategy to overcome the restrictions of contribution caps. This would involve withdrawing an amount from the fund then arranging for an LRBA to inject funds instead of making a contribution. It should be said that neither expressed justification makes sense.

For the purposes of calculating the member's total super balance for the purposes of the new tax, this adjustment arising from an LRBA is disregarded. It is a pity that the Government did not take the opportunity to repeal the adjustment entirely.

Nexia Australia

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