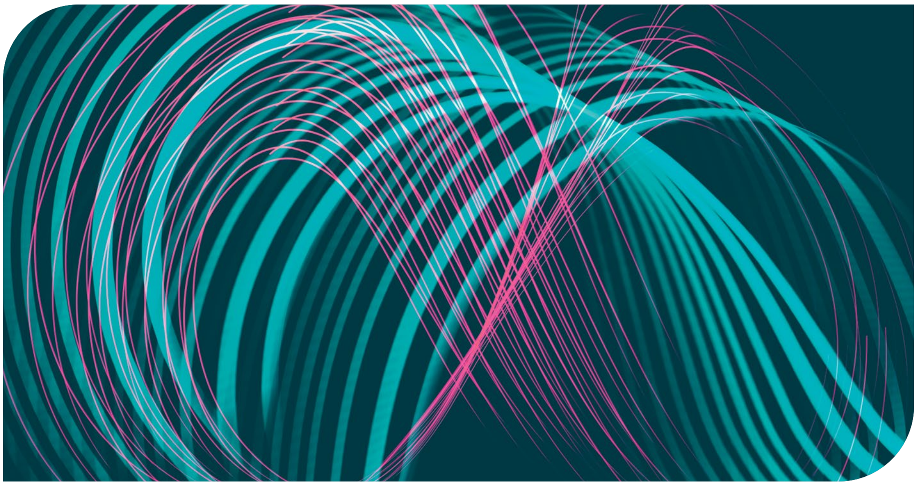
Nexia Australia

Superannuation Solutions

Edition 21



Welcome

Welcome to the latest edition of our Superannuation Solutions Newsletter.

In this edition we discuss non-arms length expenditure rule changes, understanding the criteria for the wholesale investor test and distinguishing between wholesale and retail investors, and a current list of important superannuation rates and caps which have changed from 1 July 2024.

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

28 July 2024
Make minimum super guarantee contributions for the quarter ended 30 June 2024 to funds by this date.

28 August 2024
Lodge and pay super guarantee charge statement if minimum super contributions were not made in the quarter ended 30 June 2024.

Non-arm's length expenditure changes new law

In earlier editions of Superannuation Solutions we have described the effects of the non-arm's length expense (NALE) rules which were introduced into the income tax law with effect from 1 July 2018. The rules as originally introduced suffered from a number of major problems. Federal Parliament has recently passed the changes proposed by the Federal Government in an attempt to remedy some of these issues. Trustees of SMSFs should understand how these rules operate and the potential compliance challenges that may arise.

Background

The NALE rules target expenses, losses, or outgoings that are not incurred by a super fund on arm's length terms. If a fund incurs an expense that is less than what would have been incurred had the parties been dealing at arm's length, the income of the fund related to this expense may be treated as non-arm's length income (NALI). This income is taxed at the highest marginal tax rate, rather than the concessional rate typically applied to super funds.

The NALE provisions can potentially apply to any expenses incurred by super funds. In the provisions as originally enacted, the issue of "general expenses" was of particular concern. A number of super fund expenses such as accounting, audit and actuarial fees potentially relate to all income derived by a fund. In a situation where, for example, the fund is provided with free accounting services by a firm related to a member, the non-arm's length nature of this relatively minor expenditure could result in the entire income of the fund being treated as non-arm's length income (NALI).

The changes just passed

Under the new rules, which will be deemed to operate from 1 July 2018, 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 non-arm's length income (NALI) provisions.

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.

There are still problems

The proposed "twice the difference" cap will only apply to general expenses, and not to NALE expenses incurred in relation to specific assets. Where, for example, a property is acquired by a fund for less than its market value, all the rental income and any capital gain on ultimate disposal will be regarded as NALI. An even more severe example would be that of a tradie member of a super fund who gives his labour for free to make repairs to a property owned by the fund. As the fund was not charged an arm's-length fee for the member's labour, this is an example of a NALE expense which relates to a specific asset. All income arising from the property concerned, and any ultimate capital gain, will be regarded as NALI and subject to tax at penalty rates without the restriction of the "twice the difference cap", even if the member's work on the property was relatively minor.

It should also be noted that where the income from a long term asset has been tainted as NALI, there is currently no provision to allow this to be rectified. In the example above of a property, there is nothing the fund can do to reverse the problem of a non-arm's length expense.

A further problem is that the proposed "twice the difference" cap will only apply to general expenses of a revenue nature, and not to general expenses of a capital nature. One example of a general expense which might be of a capital nature is the cost of updating the fund's trust deed. It is possible that if a fund does not pay an arm's length fee for the updating its trust deed, the entire income of the fund in that year could be rendered NALI and taxed at 45%.

It would be wise for trustees to obtain and keep documentation supporting the arm's length nature of fund expenses in case the ATO wishes to review the fund's operations.

There are also situations in which the "twice the difference" cap rules clash with the calculation of capital gains in the fund, and these will need further legislative changes to be fixed.

Please contact your Nexia advisor if you have any questions in relation to NALI or NALE and your super fund.

Enquiry into the wholesale investor test

Clients may be aware of the wholesale investor test, which is used to distinguish between wholesale and retail investors. The most common ways an individual may seek to qualify as a wholesale investor are:

- Having net assets of at least $2.5 million, or
- Having gross income for each of the last two financial years of at least $250,000

as certified by an accountant. The certificate lasts for two years before requiring to be renewed.

An individual who is classified as a wholesale investor by meeting one of these limbs can access wholesale investment products. Managed investment schemes designed for wholesale clients only may provide more attractive rates of return. But the trade-off is that wholesale clients do not have the benefit of retail consumer protections such as the Design and Distribution Obligations regime which obliges financial product issuers to take reasonable steps to ensure distribution is consistent with the target market of the product, bans on conflicted remuneration, and they may not have access to dispute resolution processes or to a compensation scheme of last resort in certain circumstances.

Many stakeholders have called for the test to be revised and updated. One encouraging development is that the Federal Parliamentary Joint Committee on Corporations and Financial Services, has commenced an enquiry into the wholesale investor test.

The thresholds were set in 2002 and have not been subject to any form of review, update or indexation since, with the result that they are no longer reliable indicators of the relative wealth of an individual. In its submission to the enquiry, the Financial Services Council points out that in 2002 around 1% of households met the thresholds but today around 12% of households are potentially classified as wholesale investors. The largest factor in this change is the value of the individual's house, which under the current rules in included in their net assets. The FSC recommends increasing the net assets test threshold to at least $5m, which would reduce the number of households potentially meeting the test to 3%.

The SMSF Association proposes a different solution, by recommending that an individual's principal place of residence be excluded from the net assets test. They also recommend the removal of the requirement for an accountant's certificate.

In some cases, providers of financial products provide template certificates that require an accountant to attest to information beyond the statement of fact required to meet the test.

There are particular issues with the tests in relation to SMSFs. In the case of an SMSF trustee seeking to have their SMSF treated as a wholesale investor, a net asset threshold of $10m potentially applies. In 2014 ASIC released media release 14-191MR, in which stated it "would not take action" if an SMSF trustee was treated as a wholesale investor on the basis of the general $2.5m net assets test, but that "this will not affect any private rights of action that may be available to third parties. Persons providing financial services to trustees of SMSFs need to make their own commercial decisions after considering the legal risks".

In the case of individual trustees, it is also unclear if the tests should be applied at the trustee level or on the basis of the individual member's interest in the fund.

Hopefully the enquiry will produce meaningful recommendations to improve this very important aspect of financial consumer protection.

Please contact your Nexia advisor if you have any questions.

Important super caps and rates

We summarise a number of important superannuation rates and caps for your convenience, especially where they have changed from 1 July 2024.

	2023-24 year	2024-25 year
Concessional contributions cap	$27,500	$30,000
Non-concessional contributions cap	$110,000	$120,000
Super guarantee contribution rate	11%	11.5%
Div 293 adjusted tax income threshold	$250,000	$250,000
General transfer balance cap	$1,900,000	$1,900,000
CGT small business concession lifetime contributions cap	$1,705,000	$1,780,000

Minimum pension factors

Age on previous 30 June	Minimum percentage of opening account balance required to be drawn
Under 65	4
65 to 74	5
75 to 79	6
80 to 84	7
85 to 89	9
90 to 94	11
95 and over	14

In the year a pension commences:

If pension is commenced before 1 June, the minimum is prorated by the number of days in the financial year that includes and follows the commencement day.

If pension is commenced between 1 June and 30 June, no minimum payment is required.

In the year of a commutation the minimum is prorated by the number of days in the financial year up to the date of commutation.

A pre-commutation minimum payment is not required if:

- The commutation is a partial commutation and the remaining account balance is enough to meet the minimum payment, or
- The commutation results from death, family law split, surcharge payment or exercise of right under a financial product cooling off period.

In addition to the above minimums, transition to retirement pensions are subject to a maximum annual drawdown of 10% of the opening account balance, which is not prorated.

2024-25 Individual tax rates

Taxable Income	Tax on this income
$0 to $18,200	Nil
$18,201 to $45,000	16c for each $1 over $18,200
$45,000 to $135,000	$4,288 plus 30c for each $1 over $45,000
$135,001 to $190,000	$31,288 plus 37c for each $1 over $135,000
$190,001 and over	$51,638 plus 45c for each dollar over $190,000

Bring forward periods and caps for non-concessional contributions.

2023-2024	2023-2024	2024-2025	2024-25	
Total super balance on 30 June of previous year	Non-concessional contributions cap for the first year	Total super balance on 30 June of previous year	Non-concessional contributions cap for the first year	Bring-forward period
Less than $1.48m	$330,000	Less than $1.66m	$360,000	3 years
$1.48m to less than $1.59m	$220,000	$1.66m to less than $1.78m	$240,000	2 years
$1.59m to less than $1.7m	$110,000	$1.78m to less than $1.9m	$120,000	No bring forward period. General non-concessional contributions cap applies.
$1.7m or more	Nil	$1.9m or more	Nil	Non-concessional contributions cap is zero.

In addition the member must be under 75 at some time during the tax year.

Nexia Australia

Who we are

At Nexia Australia, our purpose is to connect you with your true potential. With education specialists in each state, we are your personal and financial partners in making quality lifelong learning possible. From taxation, to reporting, audits, and general advice — get accounting solutions designed to identify risks and create realistic plans to meet statutory obligations and grow your business.

With the wealth of knowledge that comes with 30 years of excellence, a global network, and connections like Bursars' Associations, Independent Schools Associations, the Department of Education, Employment, and Workplace Relations, as well as consulting and bank executives — you can focus on setting 'new' goals instead of worrying about 'how' to reach your current ones.

We take pride in being responsive, progressive, and proactive in identifying and implementing the solution to your success.

Contact us

Learn how Nexia Australia can help set you and your organisation up for success. Contact your local Nexia Advisor below to get started.

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