smarter smsf

#smsfhero

SMSF update for the year ahead

Aaron Dunn
CEO, Smarter SMSF

May 2023

SMSF Association Accredited Educator

Agenda

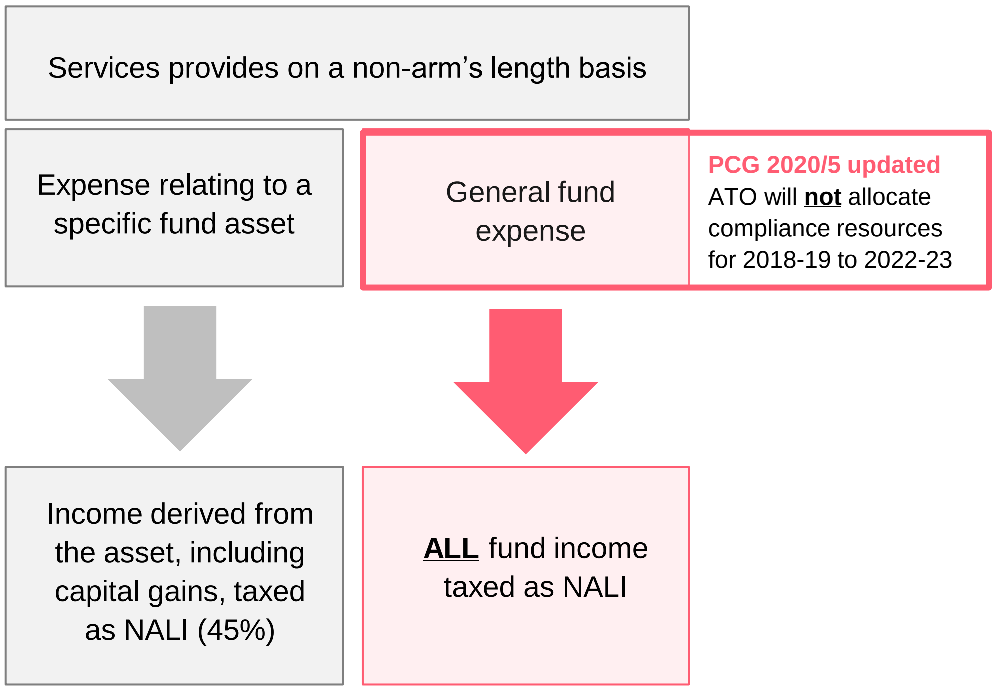
In today's session:

- NALI budget amendments
- What else for the year ahead?
    - Rates & thresholds
    - TBAR changes from 1 July
    - LRBA safe harbour
    - SuperStream rollover on wind-up

NALI budget amendments

NALI budget amendments

- In the Federal Budget, the Government finalised their response to the ongoing concerns on the NALE rules within s.295-550 of the ITAA 1997.
    - Follows a short Treasury consultation period in January 2023
- ATO's current views in LCR 2021/2 provide a severely disproportionate outcome for breaches relating to **general expenses** of the fund
    - stakeholder concerns raised, including onerous burden on compliance
- ATO advised in February 2023 that they ***do not*** intend to extend the current transitional relief (PCG 2020/5).



NALI budget amendments

- Outcome for SMSFs is a factor-based approach, setting an upper limit on the amount of fund income taxable as NALI due to a general expenses breach.
- Maximum amount of fund income taxable at NALI rate would be ***2 times*** the level of the general expenditure breach (90%, or 2 x 45%)
    - Treasury consultation initially proposed 5 times!
    - Fund income taxable as NALI will exclude contributions.
    - Exempting expenditure that occurred prior to the 2018-19 income year (i.e. application date remains at 1 July 2018)
- Calculated as the difference between:
    - The amount that would have been charged as an arm's length expense; and
    - The amount that was actually charged to the fund.
- Where the product of the ***2x breach*** is **greater** than all fund income, then all fund income will be taxed at 45%

SMSF using an accounting service

Example

- An SMSF uses his brother's accountancy service, which would usually cost $5,000 if provided under an arm's length arrangement. As his brother charges the SMSF $0 for these services, this is a non-arm's length arrangement.
- The SMSF's income (after relevant expenses) in the 2023-24 financial year is $100,000, ordinarily subject to a 15% applicable tax rate.
  - The income includes $15,000 concessional contributions
- Under the ***current NALI rules***, there is a sufficient nexus between the accounting services expense and all of the fund's income. The total income in the financial year would be taxed as NALI, at the highest MTR of 45%, or $45,000.

SMSF using an accounting service

Example

- Under the proposed amendments, the income ‘tainted’ as NALI would be limited by the market value of the accounting service, since no fee was charged to the fund.
- The amount of income would be calculated by applying a 2x factor on the difference between the:
    - market value of accounting service; and
    - Actual fee charged.
- **The trustee would pay tax at a rate of 45% on $10,000, and a 15% tax rate on the remaining $90,000 of income, resulting in $18,000 in tax (after-tax income of $82,000).**
- By comparison, under an arm’s length arrangement (i.e. fund paid $5k for the accounting services), the SMSF would pay $14,250 in tax ($95,000 taxable income x 15%).

Why 2 times?

Good question… Example, where SMSF derives $100,000 of assessable income for the financial year (2023-24)

If all taxed as NALI (45%) – current law	**$45,000 tax** ($100k x 45%)
2x NALI measure - proposed law	? **$18,000 tax** [($10k x 45%) + ($90k x 15%)]
If concessionally taxed at 15%	**$15,000 tax** ($100k x 15%)

Original 5x NALI proposal
= $22,500 tax
[($25k x 45%) + ($75k x 15%)]

SMSF using an accounting service (lower fund income)

Example 1B

- As in our prior example, the SMSF trustee uses his brother's accountancy service that would usually cost $5,000, but charges $0. The SMSF's income (after relevant expenses) for the 2023-24 financial year is $20,000 (including $15k of concessional contribution).
- Under the proposed amendments, the trustee would pay tax at a rate of 45% on all fund income (excl. contributions), as 2 times the NALE breach is greater than the total income taxable as NALI.
- To work this out, the comparison is the lessor of:
    1. $5,000 x 2 x 45% = $4,500 in tax; or
    2. $5,000^ x 45% = $2,250 in tax

    ^ ($20,000 - $15,000 CCs) = $5,000 taxable as NALI
- **The SMSF would pay $4,500 in tax (vs. up to $6,750) for the 2023-24 financial year, as would occur under the current NALI provisions (2), being NALI of $2,250 + contributions tax of $2,250.**

Missed the target?

- The measure excludes APRA-regulated funds from the NALI provisions for general expenses (fairness?)
  - Treasury initially highlighted the importance of this measure for SMSFs due to tax integrity risks to influence the general expense arrangement.
- Does the problem still actually exist?
  - Geneses of issue (LRBAs) now resolved through PCG 2016/5
  - ‘Trang’ issue (Example 9, LCR 2021/2) remains unresolved – TR 2010/1?
- SMSFA previously proposed a solution to incorporate within s.109 – Arm’s length dealings
  - SMSF NALE – would be subject to annual audit and ‘materiality’ as an operating standard.

What do you need to understand?

- Capacity in which the services are being performed?
  - s.17A (trustee) vs s.17B (individual capacity)
- Discount policies?
  - LCR 2021/2 confirms as ok where consistent with normal commercial practices (i.e. firm-wide policy)
- If arm’s length charges are paid – NALE provisions do not apply
  - Look for commercial pricing policy to support the amount being charged
  - Auditors will be looking for ‘gaps’ in the P&L to ask questions? e.g. no accounting fees

What else is ahead for 2023-24?

Rates & threshold changes

Published CPI and AWOTE figures have seen several superannuation thresholds adjusted for the 2023-24 financial year:

Item	Threshold 2023-24
General Transfer Balance Cap	$1.9 million (up from $1.7m)
Concessional contributions	$27,500 (remains unchanged)
Non-concessional contributions (NCC)	$110,000 (remains unchanged)
TSB thresholds for NCCs	• $1.9m and above – ineligible • $1.79m - $1.9m - $110,000 (1x NCC cap) • $1.68m - $1.79m - $220,000 (2x NCC cap) • Below $1.68m - $330,000 (3x NCC cap)

Some important considerations

TSB moves whilst member within a bring-forward period?

Where a member has triggered a bring-forward period and is eligible to make NCC amounts in either year 2 or 3, the member must be eligible to contribute in that income year.

Example - Indexation of the general cap

- Mary (62) has a TSB of $1.42m at 30 June 2021. She makes a NCC of $180,000 during 2021-22, triggering a 3 year bring-forward period.
- At 30 June 2022, Mary's TSB had increased to $1.74m, meaning that she is ineligible to make any further NCCs during 2022-23.
- Due to indexation, the general cap increases to $1.9m from 1 July 2023. Mary's balance at 30 June 2023 increased to $1.85m.
- As a result of the increase in the general cap, Mary is eligible in year 3 to make an NCC of $150,000, being the difference between the $330,000 bring-forward triggered and the amount made in Year 1.

TBAR changes from 1 July 2023

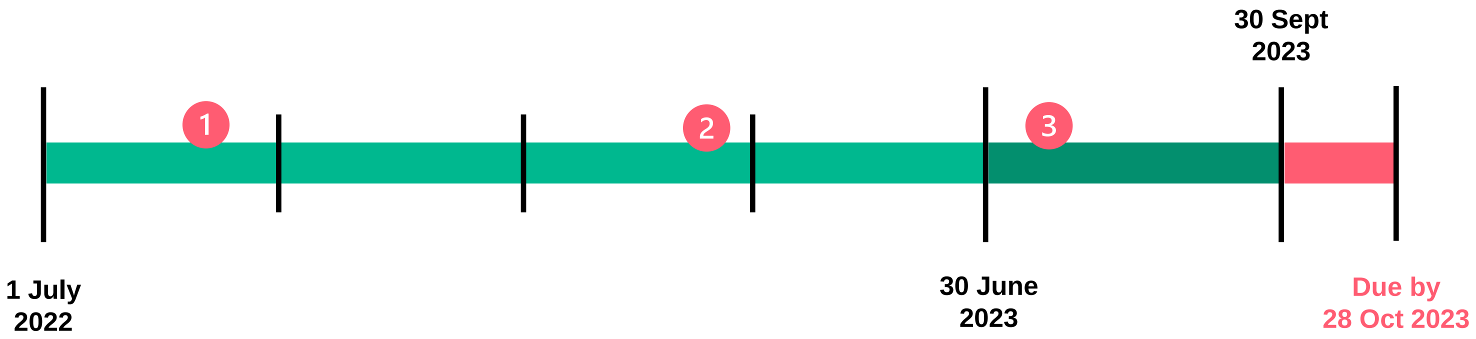
- From 1 July 2023, **<u>all</u>** SMSFs are required to report transfer balance events on a quarterly basis.
- Other reporting timeframes will remain in existence – commutation for ETB determination (10 days), commutation authorities (by legislated due date on notice).
- Outcome will deliver:
    - More up-to-date and accurate TBA information via online services
    - Reduction in period of TBA in excess
    - Reduce ‘reverse’ workload with incomplete information where excess determinations issued.

TBAR amendments

As a result of the streamlining of the TBAR requirements for SMSFs:

- The $1 million total super balance (TSB) threshold is **<u>removed</u>**; and
- will require all SMSFs to report 28 days after the end of the quarter in which the event occurred (even where they were previously allowed to report annually).

Timing of event reporting



- As part of the **transition** to quarterly TBAR reporting, certain 'annual' reporter events will be due by 28 October 2023, not the due date of the SMSF Annual Return.
- Events (1), (2) & (3) for a current 'annual' TBAR purposes are **all** due by 28 October 2023.
- If current 'quarterly' TBAR, no change to existing requirements of 28 days after the end of the quarter to report the event.

Starting a 1 July pension?

Starting an income stream

- Definition of a superannuation income stream (TR 2013/5)
  - a trustee has a liability to make a "*... series of periodic benefit payments that relate to each other over an identifiable period of time.*"
- Member's request to commence before first payment
  - How do you acknowledge a 1 July start date? Backdate/Hindsight?
  - How do you meet the TBAR reporting timeframe by 28 October 2023?
  - Acknowledgement of previous request (oral or written), but what about the account balance?

50% reduced temporary minimum pension ceases from 1 July 2023

Starting a pension during the income year

Valuation guidelines

- Where income streams commences partway through an income year, SMSFs should continue to apply the ATO's valuation guidelines
    - i.e. market value on commencement day of pension using objective and supportable data.
- The valuation guidelines (QC 26343) specify that:
    - It is accepted that a ***reasonable estimate*** of the value of the account balance can be used when a pension is started part way through the year.
    - It is also accepted that a ***reasonable estimate*** value of the account balance can be used when calculating the value of a pension for ***transfer balance cap purposes*** when the ***member commences a pension on 1 July***, but a full valuation of the assets supporting the pension is not possible by 28 October, and:
        - the SMSF has an obligation to report events no later than 28 days after the end of the quarter.
        - the SMSF does not have an obligation to report events until they lodge the SAR for the year but choose to report the event to the ATO no later than 28 days after the end of the quarter.

Starting a pension during the income year

General approach to valuations

- In making the estimate, the general valuation principles would apply.
- A valuation is generally considered fair and reasonable when:
    - It takes into account all relevant factors and considerations likely to affect the value of the asset(s)
    - It has been undertaken in good faith
    - It uses a rational and reasoned process
    - It is capable of explanation to a third party

Starting a pension during the income year

With the changes from 1 July 2023 for TBAR requirements, it is important to note:

- You can utilise a 'reasonable estimate' for the starting value of retirement phase super income streams that **may not** equal the audited financial statements.
- The fund should record this value for documentation purposes with the commencement of the pension, supported by the reported TBAR value.
- Will the ATO's stance change with failure to lodge (FTL) penalties?

ECPI calculation

Although a reasonable estimate of the value of a pension can be used for TBAR purposes, the reasonable estimate cannot be relied upon when preparing the SMSF's financial accounts and calculating ECPI in the fund for an income year.

LRBAs - benchmark adjustments (related party)

<table>
<tr><th>PCG 2016/5</th><th>Details</th></tr>
<tr><td rowspan="2">Interest Rate</td><td><u>Real Property</u>
• 2022-23: 5.35%
• 2023-24: 24: RBA published rate in May 2023 for standard variable housing loans for investors (NB. April 2023 = 8.6%!)</td></tr>
<tr><td><u>Listed Shares/Units</u>
• 2022-23: 7.35%
• 2023-24: RBA published rate in May 2023 for standard variable housing loans for investors (plus 2%)</td></tr>
</table>

- Need to ensure that any related party borrowing (non-bank lender) benchmarks to the ATO’s safe harbour terms (PCG 2016/5)
- COVID-19 relief ramifications (ABA guidance & Div7a repayment relief)
- Ensure documenting the Loan Notice to vary interest rate, and investment strategy considerations

SuperStream rollover – SMSF windup

- ATO have extended the time before ABN is cancelled following the wind up of a SMSF to 28 days.
- This provides additional time to ensure fund can perform final rollover under SuperStream requirements following the receipt of final tax refund.
- Previously funds would need to request the ATO to reinstate the ABN which further delayed the rollover.
- **NB.** On 12 April 2023, the ATO announced (QC 72223) temporary relief to use paper rollover forms ceases on 30 June 2023
    - Currently applies to funds experiencing issues getting ESA who apply to the ATO
    - Number of ESAs has increased, and number of applications decreased

Key takeaways

- Make sure that you are reviewing NALE ‘general expense’ arrangements to ensure compliance from 1 July 2023 – amendments to the law expected to follow shortly.
- Be aware of the impact of the various super rates & thresholds for the year ahead
- Changes to the TBAR requirements may pose some additional challenges for professionals in the timing of your SMSF client’s work
- Interest rate changes are playing a big role in the structuring of LRBAs – both related party and with various financial institutions
- The nuances of SuperStream will continue to create problems throughout the 2023-24 financial year

Disclaimer

Changes in circumstances may occur at any time and may impact on the accuracy, reliability or completeness of the information and we exclude liability for any decision taken based on the information shown in or omitted from this presentation. We have taken reasonable care in producing the information found in this presentation at the time of writing.

Prepared as of 5 June 2023

Thank you

T 1300 95 94 76

team**@smartersmsf.com**