

Gnarly about NALI - the changes and impacts on SMSFs

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Nicholas Ali is the Executive Manager – SMSF Technical Support, at SuperConcepts, Australia's leading innovator in SMSF services. He has over 10 years experience as an SMSF technical specialist, taking a pragmatic approach to enhancing SMSF Client Value Propositions.

In his current role he provides technical support to SMSF intermediaries and trustees on a range of matters, as well as being involved in adviser and trustee training and education through seminars, masterclasses and workshops.

Nicholas has extensive knowledge and experience having worked as a Financial Planner for 14 years, with emphasis on strategic advice to trustees and members of SMSFs. He been an SMSF Association Specialist Adviser for more than a decade.



Nicholas has a Bachelor of Arts, Bachelor of Commerce, Advanced Diploma of Financial Planning and is currently studying a Masters in Taxation. His interests include competitive target pistol shooting, Rugby Union, Boxing and Motorsport. He is also an exceptional cook!




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NALI – Session Overview

- What is NALI?
- What is treated as NALI?
- Proposed changes
- The "Conundrum"
- The "Clarification"
- What is still unclear.

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What is NALI?

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- Purpose explained in EM to SLAB (No. 2) 1999:
- *“.....to prevent income from being diverted into superannuation entities as a means of sheltering that income from the normal rates of tax applying to other entities, particularly rates applying to individual taxpayers.”*



NALI – A brief history

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- TR 2006/7
- TA 2003/1
- TA 2008/4
- Allen's Asphalt Staff Superannuation Fund
 - Interposed fixed trust between SMSF and discretionary trust
- MH Ghali Superannuation Fund
 - Income from fixed trust, dealing not at arm's length
- Henfam Super Fund (Darrelen Pty Ltd)
 - Includes income from assets acquired at less than market value.



What is treated as NALI?

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- All income from discretionary trusts
- Private company dividends unless satisfy requirements in s.295-550(3)
- Scheme where parties are not at arm's length and income is > arm's length
- Income from fixed trusts where parties are not at arm's length and income is > arm's length
- Cannot claim NALI as exempt pension income.



The impact of NALI

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- Complying funds enjoy concessional rates of tax
- NALI at top marginal rate (45%)
- Top marginal rate applies even if ECPI is 100%
- May be reduced by deductions attributable to the NALI
- NALI can be ordinary/statutory income
- Must be identified as a specific amount.



The Good Life Super Fund

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- Good Life Super Fund owns commercial property which is leased to Better Than Gold Financial Services
- The market rent for the property has been determined as \$60,000 per annum
- However, the amount of rent actually paid is \$80,000
- The fund also received income from other arm's length investments of \$30,000 and concessional contributions of \$50,000.



What is treated as NALI?

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- a) \$20,000
- b) \$110,000
- c) \$80,000
- d) \$160,000
- e) Nil.



Proposed changes to NALI provisions

#NC2018

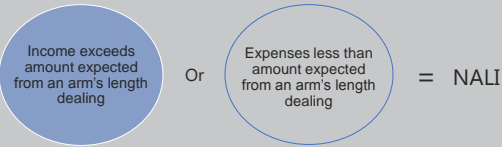


- TLA (Fair and Sustainable Superannuation) Act 2016
- Lowered contribution caps
- Division 293 on concessional contributions
- Treasury in the EM to TLA (2018 Superannuation measures No.1) Bill 2018:
- *"This increases the incentive to engage in arrangements that have the effect of circumventing these restrictions upon the transfer of wealth into superannuation".*



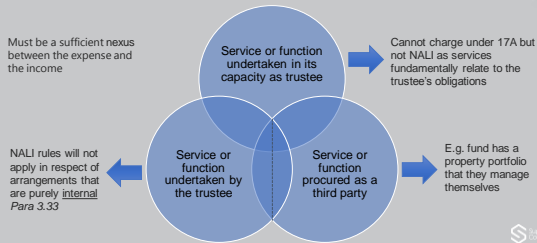
Proposed NALI changes

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The "Conundrum" - It's Gnarly!

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What is treated as NALI?

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- From the EM (TLA (2018 Superannuation Measures No.1) Bill 2018):
- *"A new provision is added to ensure that a superannuation entity's non-arm's length income includes income where expenditure incurred in gaining or producing it was not an arm's length expense...includes where no expense was incurred (but might have been expected to have been incurred..."*
- Concern this would be (very) broadly administered.



Does NALI apply?

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- Marilyn is a chartered accountant and runs a small accounting business
- In her capacity as Trustee of the Good Life Super Fund, she prepares the accounts and annual return of the fund
- She does not charge the fund for this work
- Do the NALI provisions apply?



Does NALI apply?

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- a) NALI definitely applies
- b) NALI definitely does not apply
- c) It depends – we need more information!



Does NALI apply?

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- The EM states NALI rules do not apply in respect of arrangements that are purely internal
- The internal functions are not taken with another party on any terms – non-arm's length or otherwise
- *"Such internal arrangements are outside of the scope of the non-arm's length income rules as they do not constitute a scheme between the parties dealing with one another on a arm's-length basis".*



Does NALI apply?

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- Joe & Rosie own residential real estate through the JR Super Fund
- The property has a good long-term tenant
- However Real Estate Agents charge a fortune in commission to 'manage' the property
- Joe will liaise with the tenant, arrange for any repairs/maintenance and negotiate rent collection
- He will not charge the SMSF a fee for this service.



Does NALI apply?

#INC2019



- a) NALI definitely applies
- b) NALI definitely does not apply
- c) It depends
- d) Who cares? No-one is going to know!



This is the conundrum!

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- In this scenario the SMSF trustee charges a less-than-commercial fee for managing the rental property
- There appears in the EM a greater focus on whether expenses can be allocated to a source of income
- With the accounting work, the expenses cannot be specifically allocated to a source of income
- However the property management costs can be specifically linked to the income of that property.



NALI – SIS Act v Tax Act

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- SMSF must comply with SIS Act & EM acknowledges:
- "...the trustee of an SMSF is prevented from charging for the services it undertakes in its capacity as trustee by para 17A(1)(f) of the SIS Act"
- However the EM goes onto say s17B of the SIS Act:
- "...permits a trustee to charge up to an arm's length amount for duties or services performed other than in the capacity as trustee."
- But that's not the whole story!



NALI – SIS Act v Tax Act

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S.17B "permits a trustee to charge up to an arm's length amount for duties or services performed other than in the capacity as trustee"...provided:

1. the trustee is appropriately qualified, and holds all necessary licences, to perform the duties or services; **and**
2. the trustee performs the duties or services in the ordinary course of a business, carried on by the trustee, of performing similar duties or services for the public; **and**
3. the remuneration is no more favourable to the trustee than that which it is reasonable to expect would apply if the trustee were dealing with the relevant other party at arm's length in the same circumstances.



NALI – SIS Act v Tax Act

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- Can the SMSF trustee:
 1. Show they are appropriately qualified?
 2. Hold the necessary licenses to be a property manager?
 3. Are carrying on a business of property management?
- If not, they do not comply with s17B
- How many SMSF trustees will comply with all the requirements of s17B?
- *Breach SIS, or incur NALI?*



The Clarity - LCR 2018/D10

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- Released for comment 19 December 2018
- Appears to provide a more narrow application than EM
- But interesting the ATO released a draft ruling of how it will administer changes
- If the Bill has not passed prior to Federal Election being called – it will lapse
- *Will Labor resurrect the Bill?*



The Clarity - LCR 2018/D10

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- When the Bill and EM was first released, there was concern NALI changes would capture virtually all services trustees provide to their SMSFs on a non-arm's length basis
- However, the LCR appears to be saying that if the trustee provides a service to their SMSF and they are not able to charge their fund because they are not licensed, the non-charging won't invoke the new NALI rules.



The Clarity – LCR 2018/D10

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- So in our view, Joe providing management services to the SMSF regarding the property and not charging would not be NALI
- The trustee is performing their duties in their capacity as trustee
- That is, maintaining the assets of the fund and maximising member benefits
- HOWEVER....



Does NALI apply?

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- Joe & Rosie also have a substantial equity portfolio in the JR Super Fund
- Joe has maintained his accreditation and, at 85, is still a qualified financial adviser
- He provides portfolio recommendations to the SMSF in his personal capacity
- He charges the fund a fee that covers the cost of using the company research software, which is what he does with the select clients he maintains.



Does NALI apply?

#MC2019



- a) NALI definitely applies
- b) NALI definitely does not apply
- c) It depends...on whether Joe maintains sufficient documentation!!
- d) Don't charge anything!! Then NALI will not apply!!!



Does NALI apply?

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- It appears the NALI rules will only apply where a service is provided to an SMSF by the trustee or a related party and the trustee or related party is:
 - Qualified and holds the necessary licence to provide the service; and
 - Provides the services as part of a business that they conduct; and
 - A fee less than what would be considered commercial is charged to the SMSF
- Is the JR Super Fund situation commercial?



What is still unclear

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- What services provided by the trustee at low or no cost will be caught by NALI?
- The draft ruling and EM are unclear when (if) NALI applies where the trustee provides a service and doesn't charge but are licensed to provide the service
- What if provide the service, but do not use the resources of the company?
- Documentation is the key – the provisions work on a "prove you are right" basis.



What you need to know

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