ALL THINGS SMSF TAX ADMINISTRATION

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#NC2020

Brooke Hepburn-Rogers

Director, Stellar Super

Brooke Hepburn-Rogers has over 20 years' specialist experience within the Self-Managed Super Fund industry. Brooke established her career as an SMSF Association Specialist Advisor (SSA™) and SMSF Specialist Auditor (SSAUD®) in Queensland and New South Wales. Brooke is a Member of the Institute of Public Accountants, Registered Tax Agent, SMSF Specialist Auditor™ and SMSF Specialist Advisor™, with over 19 years' experience in the SMSF industry. Currently part of the ACT Committee for the SMSF Association. Brooke recently graduated with the Graduate Certificate in Self-Managed Superannuation Funds, at the University of Adelaide. She consults with various professional peers and governing bodies as well as other accounting bodies and presents at various events. She has been honoured to have been a National finalist in both the Women in Finance and Accountants Daily Australian Accounting awards, in 2019. Brooke has been a qualified volunteer Bush Firefighter since 2014, with the NSW Rural Fire Service, and is in her fourth year of Marathon events for charity, her favourite being the Honolulu Marathon.

Areas being covered

- NALI/NALE Implications
- LRBA Inclusions in Total Super Balance Calculations
- GST and SMSFs
- Tax Exemption for Retirement Phase
- Practical impact of SuperStream changes for SMSFs
- Potential Tax Changes Ahead

NALI/NALE Implications

- NALI – Non Arm's Length Income
- NALE – Non Arm's Length Expenses

1st July 2018 the definition of NALI was expanded to say ALL income will be NALI, when the parties are not dealing with each other at arm's length:

- In gaining, or producing the income, that is less than what would be expected had the parties dealt with each other at arm's length in relation to the scheme; and
- In acquiring a fixed entitlement to the income of a trust or in gaining or producing the income from a fixed entitlement that is less than would be expected had the parties dealt with each other at arm's length in relation to the scheme.

NALI/NALE Implications

ATO draft Law Companion Ruling LCR 2019/D3 gives guidance and feedback on this change

(https://www.ato.gov.au/law/view/document?docid=COD/LCR2019D3/NAT/ATO/00001)

Practical Compliance Guideline PCG 2019/D6 provides a compliance approach to this new law.

https://www.ato.gov.au/law/view/document?docid=DPC/PCG2019D6/NAT/ATO/00001

NALI/NALE Implications

- The amendment could affect trustees who do their own accounts or improve their own assets
- NALI principles will apply regardless of whether the asset or activity has been acquired in line with s66 SIS – acquisition of assets from a related party
- When no link is found between an asset and the undertaken activity – NALI will apply to ALL income in that financial year.

NALI/NALE Implications

LCR 2019/D3 - EXAMPLES

Asset Purchased Less Than Market Value

During the 2019-2020 income year, the SMSF purchases commercial property, with a market value of $800,000, off the member for $200,000. This provides sufficient connection between the NALE incurred in acquiring the property such that all rental income is NALI and any capital gain from the disposal of the property is also NALI.

NALI/NALE Implications

LCR 2019/D3 - EXAMPLES

Trustee Uses Their Professional Services Firm (Non-Asset Linked)

A director of an accounting firm, who is the trustee of their SMSF, uses the firm to provide accounting services to the fund, no fee is charged. This scheme involves the SMSF acquiring the accounting services under a non arm's length basis.

As a result, of the NALE, ALL income of the Fund, in that financial year is classified as NALI.

NALI/NALE Implications

LCR 2019/D3 - EXAMPLES

Trustee Uses Their Professional Services (Asset Linked)

The Trustee of the Fund is a licensed property manager, and provides property management services to their SMSF as a licenced real estate agent.

The Fund pays reduced fees than would be normally charged to non-related clients. There is a sufficient link between the NALE and rental income derived from the residential property such that all rental income will be NALI as long as the non-arm's length deal remains in place.

NALI/NALE Implications

LCR 2019/D3 - EXAMPLES

Related Party LRBA Financed on Non-Arm's Length Terms

A Trustee of the SMSF entered into a related party LRBA, with themselves. The SMSF borrowed 100% of the purchase price and the terms of the loan were:

- 25-year term
- 1.5% interest rate
- Interest only repayments, one per annum

All rental income is NALI, and any capital gain that may arise is also NALI.

NALI/NALE Implications

POLL

Time for Voting

The Trustee, of a SMSF is also a registered tax agent and Director of an accounting firm. Outside of business hours, the prepare their own financials and Tax return, on their work computer, using their own tax software. Once audited the Trustee lodges their tax return, again using their own software, and after business hours, however, using their work computer. No fee is charged.

NALI/NALE Implications

Audit Implications

- Not a compliance breach
- Tax Issue
- Should be noted in the Management Letter
- If material will cause breach of Part A of the audit report, which is now reported in the Fund's annual return
- ATO are being lenient for the 2019 and 2020 FYs – However <u>NOT</u> for all other fund activities and assets that are not undertaken on commercial terms from the 2019 financial year onwards, regardless of whether the scheme was entered into before 1 July 2018.

NALI/NALE Implications

Audit Implications

- With the ATO's high-level data matching capabilities, there is no doubt that the new NALE legislation will catch out those SMSF trustees who ignore non-arm's length dealings
- Simple NALE confusion can cause significant tax concerns
- It is argued that expenses, like accounting fees, occur too late to produce any effect on income, in the same way, that legal/financial planning occur too soon to be a part of the income-producing process
- The new law is backdated 1 July 2018 but the ATO said it will be lenient on compliance and tax breaks until the end of this financial year.

LRBA Inclusion in TSB Calculations

An individual's total superannuation balance (TSB) will include, in certain circumstances, the outstanding Limited Recourse Borrowing Arrangement (LRBA) amount attributable to each member's interest where the SMSF has an LRBA that was made under a contract entered into, on, or after 1st July 2018.

LRBA Inclusion in TSB Calculations

A share of the outstanding amount of a borrowing under an LRBA will be added to an SMSF member's 'total superannuation balance', increasing it beyond the ordinary calculations where:

- there is an amount outstanding under an LRBA that complies with section 67A;
- the assets secured by that debt support the member's superannuation interest; and
- either:
  - the borrowing is a related party of the Fund; or
  - the member has satisfied one of the retirement, terminal medical condition, permanent incapacity or turning 65 conditions of release.

LRBA Inclusion in TSB Calculations

Multiple Member Funds and Total Super Balance:

- Outstanding loan amount is prorated
- Condition of release only applies to that member, however, for related party loans it applies to ALL members.

Outstanding Balance x $\frac{\text{value of each member's super interest}}{\text{value of all supported super interests}}$

LRBA Inclusion in TSB Calculations

Commencement

- The rules apply to a borrowing 'that arises under a contract entered into on or after 1 July 2018
- Property contract date or loan agreement date?

A refinancing of a pre-1 July 2018 borrowing does not trigger the new rules. Where all of the following are present:

- Original borrowing arose 'under a contract entered into before 1 July 2018
- The refinancing itself complies with the LRBA rules
- The refinancing is secured by the same asset
- The refinanced amount is equal to or less than the amount outstanding under the old borrowing at the time of refinancing.

LRBA Inclusion in TSB Calculations

Example -

William, aged 54

	Acquisition	30th June 2019
Property	$1,000,000	$1,000,000
Shares	$ 400,000	$ 430,000
Other	$ 200,000	$ 270,000
	$1,600,000	$1,700,000
LRBA Loan	$(800,000)	$(780,000)
Net Assets	$1,600,000	$1,700,000
William's Account Balance	$ 800,000	$ 920,000

Lender **Non-Related** – William's balance is $920,00 – Therefore can contribute the $100,000 NCC and utilise BFP - $300,000

Lender **Related Party** – William's balance is $1,700,000 ($920,000 + LRBA $780,000) – NIL NCC Caps

LRBA Inclusion in TSB Calculations

Example -

As you can see – the source of the lender is incredibly important as additional NCCs may be required for LRBA payments and other expenses of the Fund.

LRBA Inclusion in TSB Calculations

Consequences

- Member could end up having NIL NCC caps
- If you have already lodged your clients 2019 annual return and reported an amount in sections F or G, label Y (Outstanding LRBA amount) the ATO may contact you to discuss
- If clients are members of an SMSF with an LRBA affected their TSB on myGov may be incorrect
- Incorrect TSBs may also be shown on tax agent online services
- ATO systems should be updated after March 2020 – Until then, ensure you review and potentially re-calculate your clients TSB.

GST in SMSF

- GST is treated differently inside an SMSF, than outside
- If your clients or their bookkeepers prepare the SMSF BAS then there potentially may have to be adjustments when you do the year end financials

GST in SMSF

Does my client need to register for SMSF?

Most SMSFs do not need to register for GST, however, where the annual turnover exceeds $75,000 an SMSF is required to register. An SMSF also has the ability to voluntarily register, when the turnover is below the threshold.

The turnover counted to assess whether a business must register for GST is its total sales, and it is not the net turnover after deducting all allowable expenses.

GST in SMSF

Input Tax Credits

The claiming of GST (input tax credits) falls into 3 groups:

- Fully claimable – You can claim 100% of the GST
- Reduced Input Tax Credits (RITC) - You can claim 75% of the GST
- Not claimable – No GST can be claimed.

GST in SMSF

Input Tax Credits

Full – 100% Claimable	RITC – 75% Claimable	NO CLAIM – 0% Claimable
Commercial property purchase, including legal fees	Administration fees (except audit and tax return fees)	Audit Fees
Commercial property expenses (exc. Government charges such as water and council rates and land tax. However, where these expenses are charged to the tenant, GST must be added)	Investment management fees	Fees to prepare tax returns
	Actuarial Fees	Fees to prepare activity statements
		Bank charges
		Residential property purchase and expenses

GST in SMSF

Commercial Property

When buying commercial property there generally the following scenarios:

- **The seller is registered for GST/Buyer is not** – GST will need to be added to the purchase price, but the buyer is not able to claim this GST
- **The seller is not registered for GST/Buyer is –** GST is not added to the sale price, and therefore the buyer is not able to claim GST
- **Both seller and buyer are registered for GST** – Seller is required to add GST to the purchase price and the buyer is able to claim the GST

GST in SMSF

Commercial Property

- **Both seller and buyer are registered for GST and the property is sold as a going concern -** One common mistake that we see with GST in SMSFs, besides the incorrect allocation of full and reduced imputed tax credits, is to do with commercial property and the purchase being GST-free. This mistake often happens when the property is a going concern where it requires that both seller and buyer have to agree that the property was under the section of 38-325 of the GST Act, and both parties will need to be registered for GST
- This information can be easily missed on the contract – So ensure a full review before finalisation
- In your software, it will try and include the GST in the transaction – You may have to manually amend.

GST in SMSF

Residential Property

As a general rule GST cannot be claimed back on residential property transactions and is not added to the sale price of the property.

<u>However</u>, where the SMSF develops a new residential property, with intention to sell it and the following conditions are met:

- It has not been sold as a residential property prior
- They have been created through substantial renovations
- New buildings replace demolished buildings on the same land

GST in SMSF

Cancelling SMSF GST Registration

- Under turnover – Yes
- However, if GST claimed back there may be an adjustment period (maximum 10 years)

Table A: Assets not used for business finance	
Purchase or importation value (less GST)	Number of adjustment periods for assets
$1,001 to $5,000	2
$5,001 to $499,999	5
$500,000 or more	10

https://www.ato.gov.au/Business/GST/In-detail/Managing-GST-in-your-business/Ceasing-business/Adjusting-for-assets-retained-after-cancelling-GST-registration/?page=2

GST in SMSF

Cancelling SMSF GST Registration

- Calculating adjustments

https://www.ato.gov.au/Business/GST/In-detail/Managing-GST-in-your-business/Ceasing-business/Adjusting-for-assets-retained-after-cancelling-GST-registration/?anchor=Calculatingadjustments#Calculatingadjustments

GST in SMSF

GST Notes

- Before registering – Discuss with your client/their accountant the pros and cons, do they need to register? Additional accounting/administration costs etc
- Before cancelling – Best to talk to the client/accountant/tax specialist – Especially if GST has been claimed on a property purchase. Review the GST adjustments.

Tax exemption for retirement phase

- SMSFs enter Retirement Phase when a member commences an income stream (pension). Currently the cap is $1.6m (Transfer Balance Cap)
- Fund earnings on assets attached to the retirement phase are tax-free, known as Exempt Current Pension Income (ECPI)
- Concessional contributions and fund earnings in accumulation phase are taxed at 15% (unless you are a high-income earner and your concessional contribution tax rate is 30%)
- The retirement phase used to be called the pension phase prior to 1st July 2017 – As a result of TRIS tax treatment changes.

Tax exemption for retirement phase

When TRIS enters retirement phase

TRIS will move into the retirement phase when the member meets one of the following conditions of release:

- Age 65
- Retirement
- Permanent incapacity
- Terminal medical condition.

Tax exemption for retirement phase

When TRIS enters retirement phase

- Also, a TRIS will move into retirement phase when it commences being paid to a reversionary beneficiary, after the death of the member. Regardless of age of beneficiary, ATO Guidance Note 2019/1 & Treasury Laws amendment (2018 measures No 4) Act 2019:
  - Reversionary TRIS, paid as a death benefit, is always a retirement phase pension, even if the beneficiary has not met a condition of release.
- With all other conditions the TRIS will move into retirement phase on the date the super provider has been notified
- Once the condition of release is met, NIL cashing restrictions, means that restrictions usually put on TRIS' are removed.

Tax exemption for retirement phase

When TRIS enters retirement phase

- The nature of the pension stays a TRIS
- The pension does not cease
- The maximum annual pension limit no longer applies
- Some of the payment and commutation restrictions that affect a TRIS will cease to apply
- The value of the pension at that date is counted towards the member's transfer balance cap, that is, it is a transfer balance credit
- Some or all of the fund's income and capital gains may be treated as exempt current pension income and exempt from tax from the date the TRIS moves into the retirement phase.

Tax exemption for retirement phase

Tax implications when paying a TRIS

From 1 July 2017, whether or not you are eligible to treat some of the fund's income from the assets supporting the payment of a TRIS as ECPI income will depend on if the TRIS is in the retirement phase.

Earnings from assets supporting a TRIS that is not in the retirement phase will be taxed at 15%.

Tax exemption for retirement phase

Beware of failing minimum pension

Under the meeting pension standards for an account-based pension there are three essential points that must be satisfied.

- Ensure the pension meets the minimum payment requirements published in Schedule 7 of the SIS Regs
- The pension can only be transferred to another only on the death of the primary or reversionary beneficiary
- Ensure the capital value of the pension and income earned from it are not used as security for a borrowing.

Tax exemption for retirement phase

Beware of failing minimum pension

Point 1 is the one we see most common. There is a slight leniency where:

- The Commissioner may overlook the underpayment of the account-based pension where an honest mistake has been made that has resulted in a small underpayment or the reason for the underpayment was outside the control of the fund trustees
- In these cases, a payment is required to be made as soon as possible. A small underpayment of the minimum is where it is no greater than a 1/12th of the minimum pension required to be paid
- Circumstances beyond the control of the trustees would include genuine errors in calculation that resulted in the underpayment or an error by a third party such as a financial institution

Tax exemption for retirement phase

Beware of failing minimum pension

Please also note that the SMSF can only utilise this 'assistance' once, so if it happens again the pension would have ceased per TR 2013/5 and the Fund will not be entitled to ECPI.

Tax exemption for retirement phase

Example

- Camilla, aged 63
- Sole member of the SMSF
- Commenced a pension of $900,000, her whole member balance
- Required to draw at least 4% of her account balance from the fund calculated at the time the pension began (pro-rated daily if commenced throughout the year)
- If the pension began on the 1st July in the financial year the minimum drawdown amount will be $36,000. If only $20,000 was drawn as a pension from the fund it would not meet the minimum requirements.

Tax exemption for retirement phase

Example

- If the pension balance of $900,000 earned $82,000 for the year it now would be taxed at 15% and tax of $12,300 would be payable rather than being tax free if the minimum pension requirements had been met
- In addition, the drawdowns received by Camilla will be treated as lump sums
- On 1st July 2019, if she wishes to continue to receive a pension from the previous balance, new calculations will need to be made as the tax commissioner treats it as an entirely new pension from the start of the next financial year.

Important to remind your clients of their minimum pension requirements, not just when the financials have been completed for the FY, but also before year end.

Practical Impact of SuperStream Changes

SuperStream

- From 30th November 2019 all rollovers to or from SMSFs will be required to be conducted via SuperStream
- SuperStream is a standard processing for superannuation data and payments electronically
- To date SMSFs have only been required to be registered for SuperStream where contributions were received on behalf of a member from an unrelated employer
- APRA funds have been using SuperStream for rollovers between other APRA funds since 2013 and for contributions from 2014 when the contribution protocols were introduced.

Practical Impact of SuperStream Changes

Poll

Time for Voting

Practical Impact of SuperStream Changes

SuperStream and Rollovers

- Historically rollovers from APRA funds to SMSFs have taken a long time
- Rollovers will now finalise in days, instead of weeks, as processing must occur within 3 business days
- Rollover reports are transmitted electronically
- This information is received, or transmitted, through your SMSF software
- Paper rollover forms are not required
- Rollover payment will be directed to fund bank account.

Practical Impact of SuperStream Changes

Reporting to ATO – Changes

- From 30th November 2019, SMSF Trustees will be required to notify ATO of their SuperStream providers Electronic Service Address (ESA), and bank account details, no later than 10 days prior to the first reportable transaction
- Therefore, all Funds currently receiving contributions will need to report their SuperStream details to ATO
- There is a list of SuperStream ESA providers on the ATO website: https://www.ato.gov.au/Super/Superstream/Self-managed-super-funds/electronic-service-address/register-of-SMSF-messaging-providers/.

Practical Impact of SuperStream Changes

Reporting to ATO – Changes

- Accountants and Administrators should update their procedures to include these new requirements
- Existing Funds:
  - ESA and bank details can be reported through lodging the annual return
  - If you need to notify earlier, use *Change of Details for Superannuation Entities* form (NAT 3036)
- New Funds:
  - The ABR applications now allows for the ESA to be recorded, if this is not known at the time, you can use the same form as above.

Practical Impact of SuperStream Changes

Rollover process - So what can you do?

- Check the SMSFs complying fund status on the Super Fund Look Up service. Funds with a status other than 'Complying' or 'Registered – Status Not Determined' will be ineligible to receive rollovers or register for SuperStream.
- Tax Agents should confirm that all fund details are correct via www.abr.gov.au including:
  - Fund name
  - Fund address
  - Member and Trustee/Director names, and particulars are recorded and correct
- Notify the ATO of any changes to the SMSF details via a Change of Details Form (NAT 3036)
- Ensure that the SMSFs bank account and SuperStream details have been reported to the ATO.

Practical Impact of SuperStream Changes

Information – SMSF Members

SMSF members will require their SMSFs SuperStream details to provide to employers or other superannuation providers in order to direct their benefits to their SMSF account.

Members will require the SMSF's:

- ABN
- Electronic service address ("ESA")
- Bank account details

Please note that SMSFs are not issued with a unique superannuation identifier or USI. These apply to APRA funds only.

Practical Impact of SuperStream Changes

Exclusions

- The ATO will consider hardship cases on an individual bases if a SuperStream solutions isn't available. The ATO can assist with practical options, the employer may even be able to still pay by cheque if their agent (bookkeeper/tax agent) manages the electronic transfer of the SuperStream information on their behalf
- The ATO has previously confirmed that any internal rollovers and in-specie rollovers or contributions are excluded from SuperStream
- In-specie rollovers and contributions are to be undertaken in manner agreed to by both parties.

Practical Impact of SuperStream Changes

Exclusions

SuperStream registration is not compulsorily required where the following circumstances apply:

- No contributions are being received
- Contributions are from a member or a related business only
- There will be no rollovers or transfers

Practical Impact of SuperStream Changes

Benefits

- Currently it is estimated that SuperStream is saving employers approx. $400 million per year on administration and further $400 million per year for superannuation funds in mis-matched data
- Estimated savings for members is estimated $2.4 billion p.a.
- Replacement of 30 day-rule for Funds to process contributions and rollovers with 3 day
- Streamlining information / Ease of getting and receiving information

https://www.ato.gov.au/Super/SuperStream/In-detail/SuperStream-benefits-report/

Practical Impact of SuperStream Changes

Late lodgement - Impact

- From 1st October 2019, if an SMSF is more than 2 weeks late on lodging its annual return the super fund lookup register status will be changed to 'regulation details removed'
- This will mean that the employer, or clearing house, when they check to see if the SMSF is eligible to receive SG contributions, will note that they are not able too
- Not only would the Fund not be eligible to receive contributions, it will not be able to transmit or received rollovers
- Status changes for Funds will be made by the ATO on the 1st business day of each month.

Potential Tax Changes Ahead

- Deemed Segregation – It is likely that this will be removed from 1st July 2020 and the calculations for claiming ECPI will revert to pre-1st July 2017. It looks like that instead of the segregated periods throughout the year that the fund will default be considered unsegregated
- Several super bills lapsed as a result of the last election:
  - 3-year audit cycle – Hopefully after all the submissions and consultations that will not resurface
  - Increasing members four to six
  - There is an amendment to address the loophole of the ability for employers to offset salary sacrifice super contributions against the employers super guarantee (SG) charge. This amendment is contained in a bill with 6 non-super integrity measures and will not come into effect until the 1st July 2020.

Potential Tax Changes Ahead

- Potential reduction of annual non-concessional cap to $75,000, which will also reduce the bring forward provision cap to $225,000
- A further reduction of the high-income super contributions threshold from $250,000 to $200,000
- Potential removal of the unused concessional contribution cap amounts
- Indexation of the general transfer balance cap won't occur on the 1st July 2020 (likely 2021)
- From 3rd February – There will be an SMS/Email alert issued when changes are made to an SMSF

Questions?

Should you have any questions please feel free to email myself at:

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