Nexia Australia

Superannuation Solutions

Edition 7

Welcome

Welcome to the latest edition of our Superannuation Solution Newsletter.

In this edition, we take the opportunity to provide details on the SGC amnesty deadline as well as a number of upcoming super changes which have been delayed due to COVID-19. In particular, we consider:

- SGC Amnesty Deadline is Coming
- Changes to Testamentary Trusts may Affect Super Arrangements
- Delayed Start to Super Changes
- COVID-19 Concessions

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

24 September 2020
Initial due date for COVID-19 early release applications for up to $10,000 of Super for the 2021 financial year

The government has announced that they will extend the application period to 31 December 2020

28 October 2020
September Quarter Superannuation Guarantee Charge Contributions due for employers

31 October 2020
June Quarter Superannuation Guarantee Charge Contributions due for employers

SGC Amnesty Deadline is Coming

Time is running out

In the midst of dealing with the government restrictions imposed on businesses, the Jobkeeper scheme and health concerns for family, staff and customers as well as clients there is a lot to consider with ongoing changes. Those who plan to take advantage of the Federal Government's Superannuation Guarantee Charge (SGC) amnesty might have forgotten that they only have until 12.59 pm on Monday 7 September 2020 to calculate their SGC shortfalls and lodge their amnesty disclosure form with the ATO.

The amnesty

The amnesty is intended to be a once only opportunity for employers who have undeclared SGC obligations to "wipe the slate clean" on a concessional basis.

An employer will qualify for the amnesty in relation to the employer's SG shortfall for a quarter if:

- during the amnesty period, the employer discloses to the ATO, in the approved form (which is basically a special SG statement), the information required by the ATO,
- the SG shortfall is in respect of any quarter from 1 July 1992 to 31 March 2018, and
- the employer has not been previously informed by the ATO that it is examining (or intends to examine) the employer's SG compliance for the relevant quarter.

The amnesty is not available in relation to SG shortfall amounts that have been previously disclosed to the ATO before the amnesty period (but can apply to the disclosure of additional amounts of SG shortfall in the same quarter).

If an employer qualifies for and takes advantage of the amnesty:

- the SG shortfall will still be payable, but payments made in the amnesty period will be tax-deductible,
- to the extent that contributions are offset against SGC imposed in relation to SG shortfalls qualifying for the amnesty, contributions made during the amnesty period will be tax-deductible,
- the threat of the 200% administrative penalty for late lodgement is removed, and
- the $20 per employee per quarter administrative component will not be payable.

The notional interest component and any general interest charge will still be payable.

Employers who wish to take advantage of the amnesty but have difficulty paying the SGC by the due date can negotiate with the ATO to pay the amount under a payment arrangement, but payments must be made during the amnesty period in order to be tax deductible.

As an additional incentive to take advantage of the amnesty, if the ATO later finds an unpaid SGC obligation which could have been subject to the amnesty, an administrative penalty of at least 100% will be imposed.

Clients should also remember that while calculation of the minimum contributions required to escape an SG shortfall are based on "ordinary time earnings" (OTE), calculation of the shortfall itself is based on "wages or salary", and there are items included in wages or salary which are not included in OTE. The most important of these are payments for overtime hours, annual leave loading which is demonstrably referable to a loss of opportunity to work overtime, and termination payments for unused annual leave, long service leave or sick leave.

Bearing in mind that it often takes longer than anticipated to put together the disclosures required and payment must be made within the amnesty period to be tax deductible, we recommend you contact your Nexia Advisor promptly if you wish to take advantage of the amnesty.

Changes to Testamentary Trusts may Affect Super Arrangements

A recent change to the taxation of trust income distributed to minors (people under 18) means that some clients may need to review their estate planning arrangements in relation to superannuation and life insurance benefits.

The current position

Special rules were enacted in 1980 to prevent family trusts from using the tax free thresholds of minor beneficiaries to reduce the total tax payable on the trust income by distributing trust income to children up to the limit of their tax free thresholds. The rules operate by imposing a penalty rate of tax on the trust income of minors unless the income falls into a number of categories of "excepted trust income". These include employment income and trust income arising from the investment of property transferred to the trustee for the benefit of the minor beneficiary arising from events such as personal injury claims or family breakdown.

One significant class of excepted trust income is the income of a trust where the trust resulted from a person's will or a court order relating to intestacy. Such trusts are often referred to as "testamentary trusts", and it is common for parents to provide in their wills for a testamentary trust in favour of their minor children. Usually a reliable family friend or advisor is nominated to be the trustee. The intention is that, should both parents die while their children are still minors, the nominated trustee will have the duty of providing for them from the assets left by their parents until the children are old enough to take charge themselves.

Under the current law it is the origin of the trust, not the source of the trust assets, which determines if the trust income is excepted trust income. This has led to a tax planning strategy of transferring other assets to a testamentary trust after its creation, with the aim of reducing tax by generating excepted trust income from the additional assets. The recent amendments are aimed at removing this tax benefit.

Under the changes, the income from assets of a testamentary trust will only be excepted trust income if the assets were transferred to the trust from the deceased estate, or represent the accumulation of such income. These amendments were originally announced in the 2018-19 Federal Budget, and apply to assets transferred to a testamentary trust on or after 1 July 2019. Income from assets transferred before that date continues to be treated as excepted trust income.

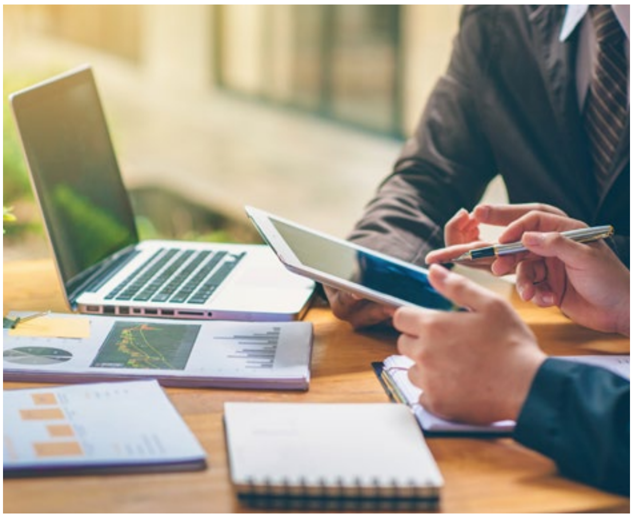
Here is an example of how the new rules will work (from the Explanatory Memorandum):

> *"On 1 July 2019, testamentary trust ABC is established under a will of which a minor is a beneficiary. Pursuant to the will, $100,000 is transferred to the trustee from the estate of the deceased. Shortly after the testamentary trust is established, a related family trust makes a capital distribution of $1,000,000 to the testamentary trust. The resulting $1,100,000 is invested in ASX-listed shares on the same day. Dividend income of $110,000 is derived for the 2019–20 income year. The net income of the trust is $110,000 and the minor is presently entitled to 50 per cent of the amount of net income.*
>
> *The minor's share of the net income of the trust is $55,000. $50,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. $5,000 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from property transferred from the deceased estate."*

The changes may create unintended consequences for superannuation death benefits and life insurance benefits. It appears that where such benefits are intended to be part of a testamentary trust in favour of minor children, they should first be directed to the deceased's estate and then flow to a testamentary trust through the provisions of the will. Otherwise there is a danger that income on the assets from such benefits will not be regarded as excepted trust income, and taxed at penalty rates in the hands of the minor children.

These changes are yet another reason why it is important to periodically review estate planning arrangements, to ensure they are appropriate to current law and conditions.

Please contact your Nexia advisor if you wish to obtain any further advice in this area.



Delayed Start to Super Changes

Due to a backlog of legislation and the effects of COVID-19, the Federal Government has announced delayed starting dates for a number of super changes.

Maximum number of SMSF members

The maximum number of members in an SMSF was to be increased from 4 to 6 from 1 July 2019. The legislation to implement this was introduced in the 2019 Federal Budget, but lapsed with last year's Federal Election. The change is now to be effective from the day the relevant amending legislation receives Royal Assent. There is currently no draft legislation before Parliament.

Calculation of exempt pension income

The issue of segregated assets in SMSFs has been made more complex since 1 July 2017 by amendments to the law and a change in interpretation by the Australian Taxation Office.

It had been longstanding industry practice that a fund could use either the segregated method or non-segregated method (obtaining an actuarial certificate) to calculate its exempt current pension income (ECPI), unless the fund was entirely in pension mode throughout the year. However, with effect from 1 July 2017, the ATO ruled that during any period when a fund is fully in pension mode, the fund would be deemed to have segregated pension assets, with the result that it cannot use the non-segregated method in those periods. This made the calculation of ECPI more complicated and left the fund potentially needing a separate actuarial certificate for each period during the year when the fund was not wholly in pension mode.

The unintended consequence of another change in the law from 1 July 2017 was that an SMSF which is wholly in pension mode throughout a year may be prevented from using the segregated method to calculate its ECPI and forced to obtain an actuarial certificate, even though the exempt percentage clearly would be 100%. This can happen when a member of the SMSF had a total super balance of more than $1.6m at the previous 30 June.

Although there is no draft legislation available yet, the Federal Government is expected to remedy these issues with effect from 1 July 2021.

General non-arm's length expenses

In a recent newsletter, we discussed legislative amendments from 1 July 2018 that would result in a Super Fund's income and capital gains being taxed at the non-arm's length income (NALI) rate of 45% instead of the usual 15% if the Fund incurred expenses or losses that were less than arm's length amounts.

This amendment was drafted very widely and created a great deal of uncertainty in the super industry following confirmation from the ATO which confirmed that non-arm's length general expenses, such as discounted accounting fees, could result in all the Fund's income and gains being taxed at the NALI rate. The ATO conceded in Draft Practical Compliance Guideline PCG 2019/D6 that trustees "may not have realised" the impact of these amendments in relation to general expenses, and advised that trustees would be given until 30 June 2020 to alter their arrangements. The ATO has extended this transitional period to 30 June 2021 in its recently released PCG 2020/5.

While the extension is good news, the ATO should provide workable guidance on how funds can steer their way through the new rules. It is important to also note that the deferral only applies to general expenses of the fund, and it does not apply to non-arm's length expenditure that directly relates to deriving particular investment income or gains.

Audits every 3 years

The proposal to allow certain SMSFs with good records to be audited every 3 years instead of annually, fortunately, seems to have been dropped. This change would likely have resulted in errors being picked up later whilst not really providing trustees with any significant savings.

COVID-19 Concessions

The following has been taken from the SMSF Frequently Asked Questions page of the ATO website, and may be useful to clients whose SMSFs have been affected by COVID-19.

In-house asset restrictions

Question

The downturn in the share market may result in the fund's in-house assets being more than 5% of the fund's total assets. The in-house asset rules would be breached. What do I need to do?

Answer

If, at the end of a financial year, the level of in-house assets of a SMSF exceeds 5% of a fund's total assets, the trustees must prepare a written plan to reduce the market ratio of in-house assets to 5% or below. This plan must be prepared before the end of the next following year of income. If an SMSF exceeds the 5% in-house asset threshold as at 30 June 2020, a plan must be prepared and implemented on or before 30 June 2021. However, we will not undertake compliance activity if the rectification plan was unable to be executed because the market has not recovered or it was unnecessary to implement the plan as the market had recovered. This compliance approach also applies where the SMSF exceeded the 5% in-house asset threshold as at 30 June 2019 but has been unable to rectify the breach by 30 June 2020.

Rental relief for a related party tenant

Question

My SMSF owns real property and wants to give my tenant – who is a related party – a reduction in rent because of the financial effects of COVID-19. Charging a related party a price that is less than market value is usually a contravention. Given the effects of COVID-19, will the ATO take action if I do this?

Answer

Some landlords are giving their tenants rent relief as a rent reduction, waiver or deferral because of the financial effects of COVID-19 and we understand that you may wish to do so as well. Our compliance approach for the 2019–20 and 2020–21 financial years is that we will not take action if an SMSF gives a tenant – even one who is also a related party – a temporary rent reduction, waiver or deferral because of the financial effects of COVID-19 during this period.

If your SMSF holds an interest in an interposed entity such as a non-geared company or unit trust and that interposed entity leases property to a tenant, we will not treat the investment in the interposed entity as an in-house asset for the current and future financial years as a result of a deferral of rent being provided to the tenant due to the financial effects of COVID-19.

If there are temporary changes to the terms of the lease agreement in response to COVID-19, it is important that the parties to the agreement document the changes and the reasons for the change. You can do this with a minute or a renewed lease agreement or other contemporaneous document.

Related party limited recourse borrowing arrangement relief

Question

My SMSF has a compliant limited recourse borrowing arrangement (LRBA) in place with a related party. Would the non-arm's length income (NALI) provisions apply if the related party offers repayment relief to the SMSF trustees because of COVID-19?

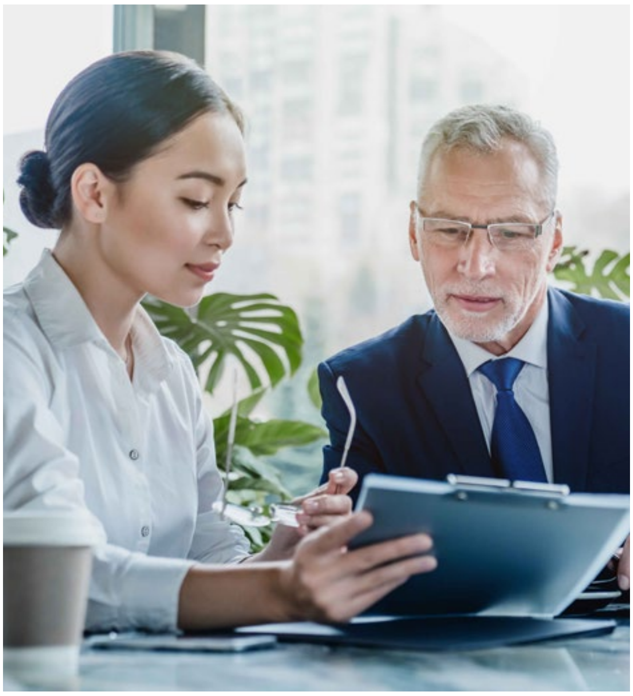
Answer

We understand that temporary repayment relief may be offered in relation to an existing LRBA between an SMSF and a related party due to the financial effects of COVID-19.

If the repayment relief reflects similar terms to what commercial banks are currently offering for real estate investment loans as a result of COVID-19, we will accept the parties are dealing at arm's length and the NALI provisions do not apply. For example, these terms currently include temporary repayment deferrals for most businesses of up to 6 months, with unpaid interest being capitalised on the loan.

The parties to the arrangement must also document the change in terms to the loan agreement and the reasons why those terms have changed. It is also expected that there is evidence that interest continues to accrue on the loan and that the SMSF trustee will catch up any outstanding principal and interest repayments as soon as possible.

Any further repayment relief needed due to the continued effects of COVID-19 should be reviewed at the end of the agreed deferral period and remain in line with what the commercial banks are offering at that time.



Investment strategies

Question

The downturn in the market has affected my SMSF's investment strategy. What do I need to do?

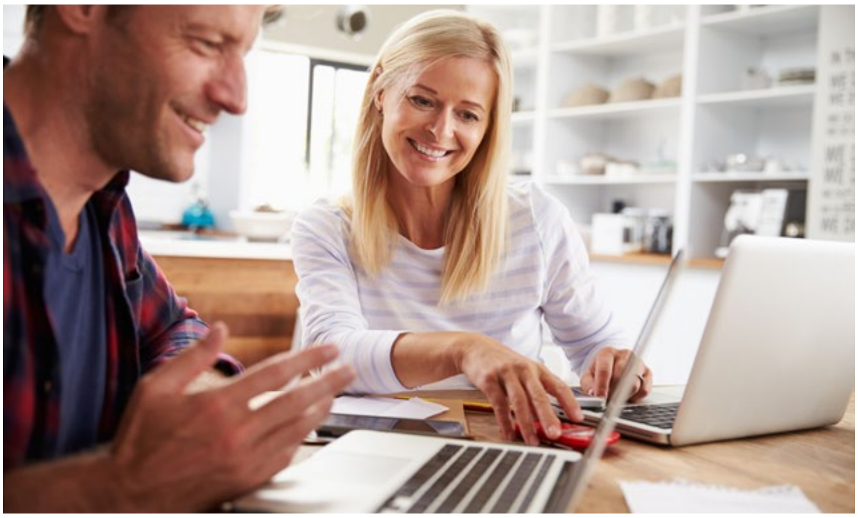
Answer

Trustees must prepare and implement an investment strategy for their SMSF, which they must then give effect to and review regularly. The strategy should be reviewed at least annually, and you should document that you've undertaken this review and any decisions arising from the review. Certain significant events, such as a market correction, should also prompt a review of your strategy and may require updating your investment strategy.

If the assets of an SMSF or the level of investment in those assets fall outside of the scope of your investment strategy, you should take action to address that situation, which could involve adjustments to investments or updating your investment strategy. We don't consider that short term variations to your articulated investment approach, including to specified asset allocations whilst you adjust your investments, constitute a variation from your investment strategy.

All investment decisions must be made in accordance with the investment strategy of the fund. If in doubt, trustees should seek investment advice.

Please contact your Nexia adviser if you wish to discuss any of these issues.



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