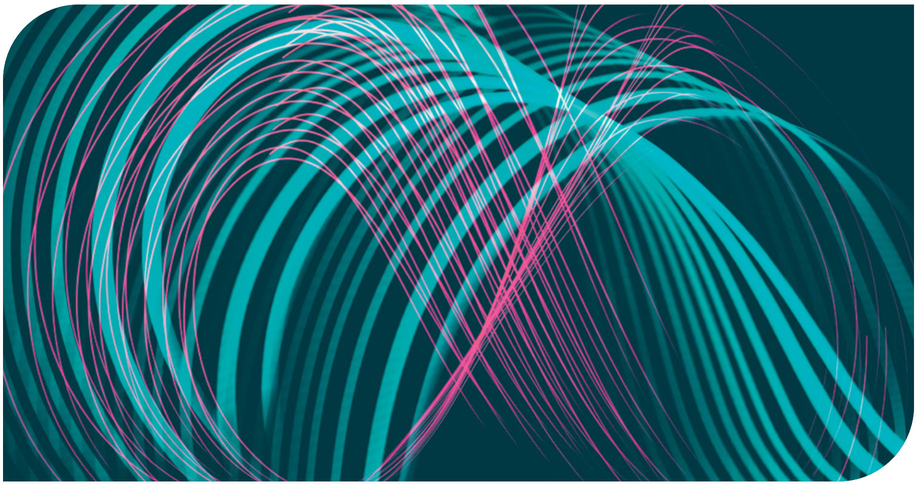
Nexia Australia

Superannuation Solutions

Edition 17



Welcome

Welcome to the latest edition of our Superannuation Solutions Newsletter.

In this edition we discuss the federal budget announcements on 9 May, additional tax on your $3m super balances, compulsory super contributions by employers from 2026, the continued debate over the treatment of non-arm's length expenses in super funds and when workers are considered as employees in a workplace setting.

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

26 May 2023
March quarter activity statements due if lodged electronically.

28 May 2023
Lodge and pay quarter super guarantee charge statement if an employer has not paid enough SCG super contributions in the March quarter.

30 June 2023
Super contributions must be paid by this date to qualify for a tax deduction in the 2022–23 financial year.

28 July 2023
June quarter super guarantee contributions to be paid to super funds by employers.

Federal Budget Announcements

The Federal Treasurer, Dr Jim Chalmers, brought down the 2023-24 Federal Budget on 9 May. In this issue we look at three announcements which directly affect our superannuation clients:

- A new additional 15% tax on fund "earnings" starting in the 2025-26 tax year where a member's total super balance on 30 June exceeds $3m (first announced 28 February);
- Bringing forward the deadline for the payment of compulsory SCG super contributions, so they must be paid at the same time as salary and wages (first announced 2 May), and
- Clarification on the tax consequences of a super fund incurring general expenses of less than an arm's length amount.

We also note that there was **no** announcement on:

Indexation of the General Transfer Balance Cap

The general transfer balance cap is indexed in multiples of $100,000 by movements in the CPI. It is due to increase from $1.7m to $1.9m on 1 July 2023. There has been some speculation on whether the Federal Government would act to stop the increase. In the absence of any announcement to the contrary, the expected increase is likely to go ahead.

Minimum Pension Payment Factors

Super law requires that a minimum annual amount be withdrawn from an account based pension, based on the size of the pension account at the beginning of the financial year and the age of the member. Since the 2019-20 year these factors have been reduced by 50%, to take account of various economic factors and the effect of COVID-19. There has been no announcement that the factors will be reduced again in the 2023-24 year, so they are likely to return to their original percentages, as below:

Age at previous 30 June	Minimum % in 2022-23	Expected minimum % in 2022-23
Under 65	2%	4%
65-74	2.5%	5%
75-79	3%	6%
80-84	3.5%	7%
85-89	4.5%	9%
90-94	5.5%	11%
95 or more	7%	14%

Additional tax on super balances over $3 million

The Budget confirms the Federal Government's intention (see Super Solutions Newsletter 16) to introduce an additional 15% tax on a proportion of the super "earnings" of a member where the member's total super balance is greater than $3m at the end of a financial year. The new tax will be first levied in the 2025-26 financial year.

It is important to understand that this is not a flat 15% tax on "earnings", but on a proportion of "earnings", calculated as the proportion of total super balance (TSB) greater than $3m at the end of the financial year.

Perhaps the most controversial aspect of the new tax is that "Earnings" is not based on a fund's taxable income, but is to be calculated using the formula:

> Closing TSB – Opening TSB + Withdrawals – Contributions (net of contributions tax)

If the closing TSB is greater than $3m but the opening TSB is less than $3m, $3m is used as the opening figure to ensure that only balances over $3m will be caught in the tax.

As total super balance includes unrealised gains, these will be included in "earnings", but there is still a great deal of uncertainty around precisely what will be included in "withdrawals" and "contributions". For example, will the formula be adjusted to take account of the fund receiving a reversionary pension, insurance payouts for death or disability, or a payment split on the break-up of a relationship? Note also that TSB includes any retirement phase pensions, so "earnings" on these will be included in the new tax, even though the income on retirement phase pensions is exempt from ordinary income tax.

If an individual makes an earnings loss in a financial year, this will be able to be carried forward to reduce the tax liability in future years, but losses will not be able to be carried back to offset against gains of earlier years. Individuals will have the choice of either paying the tax out-of-pocket or from their superannuation funds. Of course, this raises the issue of whether the fund has sufficient cash reserves to pay the tax for the member.

The Federal Government has confirmed that the $3m threshold will not be indexed, and no new condition of release will be introduced to allow members to reduce their total super balances before the tax commences.

Example

Ron has only one super fund, so the balance in the fund is his total super balance. In the year ended 30 June 2026, the transactions in Ron's super fund were:

Fund balance at 30 June 2025	$2,900,000
Concessional Contributions	$27,500
Contributions tax	($4,125)
Non-concessional contributions	$110,000
Fund net investment income	$145,000
Tax payable	($21, 750)
Fund balance at 30 June 2026	$3,156,625

The proportion of "earnings" subject to the tax would be:

> (Closing TSB - $3 million) / Closing TSB, but $3m is used as the opening TSB because it was less than $3m:
>
> ($3,156,625 - $3,000,000) / $3,000,000 = 5.2208%

"Earnings" would be calculated as:

> Closing TSB – Opening TSB + Withdrawals – Contributions (net of contributions tax):
>
> $3,156,625 - $3,000,000 + 0 – ($27,500 - $4,125) -$110,000 = $23,250

And the amount of tax to be paid would be calculated as:

> $23,250 x 5.2208% x 15% = $182.07.

In the year ended 30 June 2027, the transactions in Ron's super fund were:

Fund balance at 30 June 2026	$3,156,625
Concessional Contributions	$10,000
Contributions tax	($1,500)
Fund net investment losses	($170,000)
Fund balance at 30 June 2027	$2,995,125

As Ron's closing TSB is less than $3m, he will not pay tax in the 2026-27 year.

His fund "earnings" would be calculated as:

> Closing TSB – Opening TSB + Withdrawals – Contributions (net of contributions tax)
>
> $2,995,125 - $3,156,625 +0 – ($10,000 - $1,500) = ($170,000)

His negative fund earnings in 2026-07 can be carried forward and offset against positive earnings of later years, but cannot be carried back to obtain a refund of tax paid in 2025-26.

Even though the Federal Government has announced that the new tax will affect a small number of super fund members, the non-indexation of the $3m threshold guarantees that its impact will increase over time.

The change has been deliberately planned to commence after the next Federal election is due (in 2025). It is likely that the Federal Government will legislate the change now in order to allow it to campaign on the issue of "Better Targeted Superannuation Concessions" should the Opposition seek to repeal the tax.

Please contact your Nexia advisor if you wish to discuss this or any other superannuation issue.

Superannuation to be paid at the same time as salary and wages from 1 July 2026

Currently, compulsory superannuation contributions must be paid by employers by the 28th day after the end of the quarter in which an employee is paid salary or wages. In a statement released on 2 May, the Federal Treasurer Dr Jim Chalmers announced that from 1 July 2026, compulsory superannuation contributions will have to be paid at the same time as the related salary and wages. The delay to 1 July 2026 is to allow employers, superannuation funds, payroll providers and other parts of the superannuation system with sufficient time to prepare for the change.

Once implemented, this change will probably simplify payroll administration for employers, as the payment of salary, wages and super will involve one action rather than two, but the earlier payment of super contributions may have an adverse effect on cash flow. For employees, the earlier payment of super contributions will probably result in a modest increase in total super earnings. In his statement, Dr Chalmers estimated that a 25-year-old median income earner currently receiving their super quarterly and wages fortnightly could be around $6,000 or 1.5% better off at retirement.

But the main reason for the change must surely be to make it easier to identify employers who fail to make compulsory super contributions. According to Dr Chalmers, the ATO estimates that $3.4m worth of super contributions went unpaid in 2019-20. Under the Budget proposal the Federal Government will also provide $40.2 million to the ATO in 2023–24, which includes $27.0 million for the ATO to improve data matching capabilities to identify and act on cases of SG underpayment by employers and $13.2 million for consultation and co-design. Presumably employers will be required to report the payment of super along with the payment of salary and wages through single touch payroll. The next step might be to require super funds to report the receipt of contributions, with the ATO querying employers if a reported payment is not matched by a reported receipt.

Please contact your Nexia advisor if you need assistance in relation to outstanding SGC contributions, or have any queries in relation to this change.

The continuing saga of non-arm's length expenses in super funds

The Budget included a disappointing announcement in relation to the long-running debate over the treatment of non-arm's length expenses in super funds.

Readers may have seen our earlier article (Super Solutions Edition 9) about the non-arm's length expenses (NALE) provisions that have been effective from 1 July 2018. These are intended to ensure that expenses incurred by funds in deriving income are commercial and not artificially reduced in order to shelter net income in the tax-advantaged environment of a super fund. Broadly, when expenditure incurred in deriving income is less than would be expected in an arm's length dealing, the income related to the expenditure will be treated as non-arm's length income and taxed at the penalty rate of 45% instead of the usual rate of 15% for a super fund.

The provisions can potentially apply to any expenses incurred by super funds. The issue of "general expenses" is 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).

In our Super Solutions Edition 16 we reported the issue by Treasury of a consultation paper ***Non-arm's length expense rules for superannuation funds***, in which Treasury puts forward a proposal to amend the legislation and seeks feedback on the proposals. The proposed changes apply differently to SMSFs and small APRA-regulated funds (SAFs) on the one hand and large APRA-regulated funds (basically retail and industry funds) on the other.

Under the consultation paper proposals, the maximum amount of fund income that could be treated as NALI for SMSFs and SAFs was to be five times 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. So, in the example of free accounting services, if we assume the arm's length charge for the accounting services was $5,000, the maximum amount of fund income that could be treated as NALI would be ($5,000 - $0) x 5 = $25,000. It is of course still possible that this could represent the entire income of the fund in the given year. In contrast, large APRA-regulated funds would be exempted from the NALI provisions for general expenses.

In the Budget, the Federal Government has announced that it intends to implement a **modified version** of the consultation proposals. In particular:

- The NALE rules will only apply to SMSFs and SAFs. Large APRA funds will be completely exempted from the NALE rules for **both general and specific expenses**;
- The maximum amount of fund income that can be treated as NALI for SMSFs and SAFs will be twice (rather than five times) 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, and
- Contributions will not be taxed at penalty rates as NALI in this calculation.

While it is good to see the level of NALI reduced from a multiple of five to a multiple of two, many will be disappointed by the Government's decision. On 22 February seven tax and accounting bodies including CA ANZ, the Tax Institute and the SMSF Association released a ***Joint Submission to Treasury on NALE Rules for Superannuation***, which argued cogently for a different approach to the issue. The joint submission makes the following perfectly reasonable points:

- The difference between general and specific expenses is often not straightforward, and the approach of the consultation paper will be costly for SMSF trustees to administer;
- Professionals (eg. tax agents, accountants and solicitors) performing general everyday tasks for their SMSF are not performing these tasks to circumvent rules as suggested by the consultation paper. These tasks are completed personally by fund trustees, members, or by colleagues, because this is easier and is commercially sensible;
- The superannuation sector is a dynamic market and there are often significant variations in the type and scope of services provided. Therefore, determining what is an arm's length commercial expense is not always a simple task, and
- The NALE rules conflict with the trustees' duty to act in the best financial interests of their members by choosing a lower cost option.

The submission suggests that any significant NALE activity could be dealt with by the ATO by applying existing law and tax rulings.

Nor is it reasonable to focus the NALE penalties on only SMSFs and SAFs. It is tempting to think that they have been selected by the Federal Government as easy targets.

Indications are that this debate is still far from over.

Please contact your Nexia advisor if you have any questions on this or any other super related matter.

When is a worker an employee?

Although not part of the Budget, it is worth noting a recent case on the extended definition of "employee" in the super guarantee legislation.

An employer's obligation to make super contributions is governed by the Superannuation Guarantee (Administration) Act 1992. In some situations the Act extends this obligation to workers who would not normally be considered employees, so it is important to understand where this may happen.

In particular, sec 12(3) of the Act extends the requirement to make super contributions beyond common law employees to a person who "works under a contract that is wholly or principally for the labour of the person". The two key elements that will result in an obligation to make super contributions are that the contract with the worker:

- Is at least principally for labour (and not, for example, principally for the provision of equipment), and
- Must be for the labour of that person (the worker must not have the ability under the contract to substitute someone else to do the work).

A recent case involved truck drivers who provided their own trucks and operated partnerships with their respective wives to provide delivery services to a company, ZG Operations Australia Pty Ltd. The truck drivers had hoped to be entitled to super contributions, either as common law employees or under the extended definition of sec 12(3).

In 2022 the High Court ruled that the truck drivers were not common law employees, and the Federal Court in *Jamsek v ZG Operations Australia Pty Ltd (No 3)* [2023] FCAFC 48 recently ruled that neither are they employees under the extended definition of sec 12(3).

In particular, the Federal Court considered that in this situation:

- The contract was for labour and a substantial element of non-labour (the provision of the truck), and that the non-labour element predominated;
- The contract permitted the worker to delegate the performance of work under the contract, and
- The workers were engaged under the contract for a result.

There may be situations where a detailed examination of the terms of the contract and a quantitative analysis of the components being provided are necessary to determine if there is an obligation to make super contributions for a worker.

Please contact your Nexia advisor if you would like any assistance or advice on this issue.

Nexia Australia

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Contact us

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