

Superannuation update for fund auditors – October 2023

Key thresholds:	2023/24	2022/23	2021/22
Concessional Contributions (CC)	\$ 27,500	\$ 27,500	\$ 27,500
Non-Concessional Contributions (NCC)	\$ 110,000	\$ 110,000	\$ 110,000
NCC bring forward	\$ 330,000	\$ 330,000	\$ 330,000
Downsizer contributions (from age 55 1/1/2023)	\$ 300,000	\$ 300,000	\$ 300,000
Spouse contributions	\$ 3,000	\$ 3,000	\$ 3,000
Total super balance (TSB)	\$ 1,900,000	\$ 1,700,000	\$ 1,700,000
Transfer balance cap (TBC)	\$ 1,900,000	\$ 1,700,000	\$ 1,700,000
Unused CC carry forward cap (from 1/7/18)	\$ 500,000	\$ 500,000	\$ 500,000
Bring forward arrangements			
Total Super Balance (TSB):			
Less than \$1,680,000 (3 years)	\$ 330,000		
\$1,680,000 to less than \$1,790,000 (2 years)	\$ 220,000		
\$1,790,000 to less than \$1,900,000 (1 year)	\$ 110,000		
Greater than or = to \$1,900,000	\$ -		
Less than \$1,480,000 (3 years)		\$ 330,000	\$ 330,000
\$1,480,000 to less than \$1,590,000 (2 years)		\$ 220,000	\$ 220,000
\$1,590,000 to less than \$1,700,000 (1 year)		\$ 110,000	\$ 110,000
Greater than or = to \$1,700,000		\$ -	\$ -
Division 293 tax - assessable income threshold	\$ 250,000	\$ 250,000	\$ 250,000
Low rate cap (lump sum)	\$ 235,000	\$ 230,000	\$ 225,000
Super Guarantee	11.0%	10.5%	10.0%
Quarterly SG cap	\$ 62,270	\$ 60,220	\$ 58,902
Co-contribution			
- Entitlement	\$ 500	\$ 500	\$ 500
- lower income threshold	\$ 43,445	\$ 42,016	\$ 41,112
- higher income threshold	\$ 58,445	\$ 57,016	\$ 56,112
Spouse contributions			
- maximum tax rebate, to contributing spouse	\$ 540	\$ 540	\$ 540
- lower income threshold	\$ 37,000	\$ 37,000	\$ 37,000
- higher income threshold	\$ 40,000	\$ 40,000	\$ 40,000
Defined Benefit income cap	\$ 118,750	\$ 106,250	\$ 106,250
Small Business CGT contribution cap	\$ 1,705,000	\$ 1,650,000	\$ 1,615,000

1. Contributions update

It is essential that SMSF auditors stay on top of the recent changes to the superannuation contribution rules.

What taxable contributions can be made for the year ended 30 June 2024?

The Concessional Contribution (CC) cap is \$27,500 per member for the 2023/24 year. The CC cap has been set at \$27,500 since the 2021/22 year and for the 2020/21 CC cap was \$25,000. Any excess over the CC cap is taxed at the individual's marginal tax rate.

CC's are contributions that somebody is claiming a tax deduction for (employer / individual).

CC's include:

- Superannuation Guarantee Contributions (SGC)
- Employer voluntary / extra contributions (eg. salary sacrifice)
- Member taxable contributions (claimed as a deduction in personal ITR)

What tax free contributions can be made for 2023/24?

Non-Concessional Contributions (NCC's) are contributions that an individual is not claiming a tax deduction for.

The Non-Concessional contribution (NCC) cap is \$110,000 for the 2023/24 year. The 2022/23 NCC cap was also \$110,000.

For 2023/24 members aged under 75 have the option to contribute up to \$330,000 over a 3 year period (depending on their Total Superannuation Balance (TSB)).

The rule works as follows for 2023/24 onwards:

Total super balance	NCC & bring forward \$
< \$1,680,000	\$330,000 over 3 years
> \$1,680,000 & < \$1,790,000	\$220,000 over 2 years
> \$1,790,000 < \$1,900,000	\$110,000 over 1 years
> \$1,900,000	\$0 (nil)

The NCC rules worked as follows for 2021/22 year until the 2022/23 year for members having an option to contribute up to \$300,000 over a 3 year period (depending on their Total Superannuation Balance (TSB) and meeting the relevant age requirement).

Total super balance	NCC & bring forward \$
< \$1,480,000	\$330,000 over 3 years
> \$1,480,000 & < \$1,590,000	\$220,000 over 2 years
> \$1,590,000 & < \$1,700,000	\$110,000 over 1 years
> \$1,700,000	\$0 (nil)

It is essential that making a NCC be carefully reviewed by members in terms of the cap rules prior to a contribution being made.

2. Audit Report Matters

There are no changes to the year ended 30 June 2023 audit report.

As a reminder the audit report has a footnote that states:

“Delete the option that is not applicable. ASQC1 can be applied until ASQM1 becomes operative on 15 December 2022.”

As a result of ASQM 1 having an operative date of 15 December 2022 auditors will need to ensure that they are referring to ASQM 1 from 15 December 2022.

3. Transfer Balance Cap Indexation

A significant change for the 2023/24 income year has been the increase in Transfer Balance Cap, due to Consumer Price Index increases, from \$1,700,000 to \$1,900,000.

Where a fund member has not commenced a pension prior to 1 July 2023, they will have the full benefit of the \$1,900,000 Transfer Balance Cap, meaning that if they happen to have an accumulation interest of greater than \$1,900,000, that they can commit a maximum of \$1,900,000 worth of fund assets to support a pension interest.

Where a fund member has already commenced a pension prior to 1 July 2023 and had already utilised 100% of the then applicable Transfer Balance Cap (either \$1,600,000 or \$1,700,000), broadly speaking, there is no ability to increase the amount of their superannuation interest committed to pension phase.

However, if a fund member had commenced a pension prior to 1 July 2023, but had not fully utilised their Transfer Balance Cap, their Transfer Balance Cap is increased inline with the following formula:

Unused cap percentage x Amount of indexation increase to general transfer balance cap

Where the **unused cap percentage** is the percentage of the member's transfer balance cap that has not been utilised. It is equal to 100% less (the highest (credit) balance in the member's transfer balance account at the earliest time before 1 July 2023, expressed as a percentage of the member's transfer balance cap at that time, rounded down to the nearest whole number.

Note that the same formula noted above was also used to determine proportional indexation of a fund member's transfer balance cap on 1 July 2021 (for a pension commenced before 1 July 2021), when the general transfer balance cap was indexed from \$1.6 million to \$1.7 million.

For example, if Amy had commenced an Account Based Pension on 1 August 2021 with a balance of \$1,100,000, she would have an unused cap percentage (rounded down to the nearest whole number) of 35% (100% - (\$1,100,000/\$1,700,000)).

Accordingly, Amy's \$1,700,000 Transfer Balance Cap is increased by \$70,000 on 1 July 2023 (35% x \$200,000) to \$1,770,000.

Auditors should play careful attention to fund members that had already commenced a pension before 1 July 2023, who commence a new pension on or after this date. Ensure that the fund member correctly calculates their adjusted Transfer Balance Cap.

4. Latest developments regarding benefits after death

A recent Full Federal Court case has considered the meaning of the terms "spouse" and "interdependency relationship" in the context of the payment of death benefits.

The case is referred to as Wan's case (*Wan v BT Funds Management Limited* [2022] FCAFC 1890) and involved a dispute about a trustee's decision to distribute the entirety of a death benefit to the deceased's estate.

In Wan's case the Full Federal Court ultimately upheld the decision of the trustee of the super fund, as well as the subsequent decisions of Australian Financial Complaints Authority and the Federal Court.

The deceased, Mr Maxwell Walker, died in May 2017, without a Binding Death Benefit Nomination in place. His will provided that his estate was to be distributed in three equal shares to Ms Wan, his former de facto partner, and the son of his former de facto partner.

The applicant, Ms Wan, challenged the decision of BT Funds Management Limited (the trustee of the relevant fund) to pay the death benefit to the deceased estate (where she would ultimately get a one-third interest) on the basis that she was either a "spouse" of the deceased, or if not the spouse, in an "interdependency relationship" with the deceased.

If either of these two arguments were correct at law, Ms Wan would be a "dependant" for the purpose of section 10 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

It was found that Ms Wan, although a friend of the deceased, was not a de facto partner of the deceased (meaning that she was not the "spouse" of the deceased) and she was not a financial dependent of the deceased, given that at all relevant times she had an income from Centrelink and maintained her own residence.

This was even though Ms Wan did stay overnight at the deceased's residence on occasion and with increasing regularity as the deceased's health declined, in order to assist with the deceased with the provision of medical care.

Ultimately, Ms Wan was not able to prove that her relationship with Mr Walker extended beyond that of a close friendship.

One of the key takeaways from this case is that "dependency" for the purposes of the SIS Act is primarily a test of financial dependency and not a broader emotional or personal dependency.

Whilst “personal care” and a “close personal relationship” are two of the limbs of the legislative definition of “interdependency” for the purposes of being a “dependant”, the definition also includes the requirement that one or each of the parties provides the other “financial support”.

Crucially, Ms Wan was not able to demonstrate that she was financially dependent on Mr Walker.

5. Limited Recourse Borrowing Arrangements and related party lenders

Where a Self-Managed Superannuation Fund has entered into a Limited Recourse Borrowing Arrangement (LRBA) with a related party lender, it is recommended that the interest rate charged is consistent with the interest rate suggested by the Australian Taxation Office (ATO) in PCG 2016/5 and as updated yearly.

If the interest rate on a related party LRBA is set at a rate below what the ATO considers to be market value, there is a risk that the ATO can treat the arrangement as one that triggers the non-arm's length income (NALI) rules as per section 295-550 of the *Income Tax Assessment Act 1997*.

If income is deemed to be NALI, it is taxed at the top marginal rate of 45% rather than 15% (or 0% to the extent the Fund is in retirement phase).

Conversely, if the interest rate is set at a rate this is above what the ATO considers to be market value, there is a risk that the ATO considers the arrangement to be one which would be a breach of section 109 of the *Superannuation Industry (Supervision) Act 1993* applies. Broadly, section 109 requires that an investment of a fund is maintained on an arm's length basis.

For the purposes of the ATO's safe harbour interest rates for related party LRBAs used to fund investments in **real property**, where a **variable rate** is used, the applicable interest rate for the 2024 income year is 8.85% (a change from 5.35% for the 2023 income year).

Where a **fixed rate** is used, the ATO's safe harbour interest rate for related party LRBAs used to invest in **real property**, is also 8.85% for a loan that commenced in the 2024 income year (it was 5.35% for a loan that commenced in the 2023 income year).

Where an LRBA is used to fund the purchase of real property, the interest rate can be fixed for a maximum period of five years, after which it must be converted to a variable interest rate.

Where a related party LRBA was used to fund investments in **listed shares or listed units**, where a **variable rate** is used, the applicable interest rate for the 2024 income year is 10.85% (a change from 7.35% for the 2023 income year).

Where a **fixed rate** is used, the ATO's safe harbour interest rate for related party LRBAs used to invest in **listed shares or listed units**, is also 10.85% for a loan that commenced in the 2024 income year (it was 7.35% for a loan that commenced in the 2023 income year).

Where an LRBA is used to fund the purchase of listed shares or listed units, the interest rate can be fixed for a maximum period of three years, after which it must be converted to a variable interest rate.

PCG 2016/5 stipulates the terms of a related party borrowing which need to be met to access the ATO's safe harbour where there is a related party lender. The interest rate is but one of several terms that need to meet the ATO's requirements. Other terms include the length of the loan and the loan to value ratio.

6. Court case regarding BDBNs

A recent case has highlighted the need for a Binding Death Benefit Nomination (BDBN) made by a member of an SMSF to comply with the requirements of a fund's deed in order to be valid.

SMSF auditors need to be aware of the rules (legislation and case law) in relation to BDBNs and raise matters / concerns with trustees if they become aware of any issues.

The Queensland Supreme Court in *Williams v Williams* [2023] QSC 90, found that a BDBN was invalid because it failed to meet the requirements of the fund's deed.

In particular, the Court was required to decide if it was a requirement under the relevant deed that the fund member had given notice of the BDBN to all the trustees of the fund (an SMSF) or whether the required notice was validly given as the member (who was one of the two individual trustees) had executed the document on his own, acting in his capacity as a trustee.

The deceased, Anthony Williams, died on 28 December 2021, and was survived by his second wife, Gayle, and two adult sons, Paul and Mark. Paul and Mark were sons from the deceased's first wife, who died in 2014.

Paul was also a member of the SMSF, having replaced his mother as both a fund member and trustee, after her death.

The deed of the SMSF provided for a non-lapsing BDBN "if the Trustees are given a written notice by [a] Member...."

The deceased had executed a non-lapsing BDBN in March 2018 that directed the trustees to pay 50% of the deceased's death benefit to his second wife, Gayle, and 50% to the Legal Personal Representative of his deceased estate.

The BDBN also included a "trustee confirmation" document that the deceased had completed in his capacity as a trustee of the fund.

However, the BDBN was never provided to the fund's other trustee and member, the deceased's son, Paul.

The Queensland Supreme Court concluded that the deed required the notice of the BDBN to be given to **all** the trustees of the fund in order to be valid.

Accordingly, giving the notice to one of the two individual trustees did not constitute the provision of notice to all the trustees.

The SMSF's deed contained a clause stating **“unless the context requires words importing gender include any gender and words importing number include the singular number and the plural number...” [Emphasis added]**

However, the deed also defined “Trustees” to mean “the Trustees or the Trustee for the time being of the Fund and “Trustee” has the same meaning”.

The Court concluded that where there was more than one trustee, that the term “Trustees” was to be interpreted as referring to all the trustees. Furthermore, this specific definition of trustee in the SMSF's deed meant that the clause in the deed (referred to above) indicating that plural can mean singular, did not apply to the term “trustees”.

The takeaway from this case for auditors is that for BDBNs made by SMSF members to be valid, they must comply with all requirements of the relevant fund's deed.

7. NALE/NALI changes

As a broad proposition, where a super fund has non-arm's length income (NALI), the NALI will be taxed at the penal rate of 45% (rather than at 15% or at 0% to the extent that NALI relates to a retirement phase interest).

Changes were made to Section 295-550 of the *Income Tax Assessment Act 1997* with effect from 1 July 2018, to ensure that an arrangement could attract the NALI rules where a fund incurred a loss, outgoing or expenditure, that was less than the amount that might have reasonably been expected to have been incurred if the fund trustee and the counterparty were dealing with each other on arm's length basis (including where no amount has been incurred).

These rules are referred to the non-arm's length expenditure (or NALE) rules.

A particularly draconian application of the NALE rules occurs where a fund expense that is incurred (or is avoided) on a non-arm's length basis, and the expense does not relate to any specific income of the fund (referred to as “general fund expenses”, such as an accountant's fee for preparing the fund's financial statements).

Where a fund incurs (or avoids incurring) a general fund expense, 100% of the fund's income is treated as NALI and taxed at 45%. This understanding was confirmed by the ATO in Law Companion Ruling LCR 2021/2.

On 19 June 2023, Treasury released a Draft Bill, which proposes a less draconian consequence where an SMSF (or small APRA fund) incurs has a general fund expense that has triggered the NALE rules.

The Draft Bill, assuming it passes through both Houses of Parliament, is scheduled to take effect for expenses incurred (or avoided) from 1 July 2023.

Rather than causing all of a fund's income to be taxed at 45%, an SMSF, or small APRA fund, will only be taxed at the highest marginal rate (45%) on two times the difference between the expense the fund paid and the expense that fund would have paid had it been dealing at arm's length.

For example, an SMSF arranges for its fund return to be lodged through a tax agent who happens to be a mother of a member of the fund.

The tax agent would usually charge \$1,200 to prepare and lodge a fund return for an SMSF client. However, due to the family relationship, the tax agent charges \$200. This arrangement triggers the NALE rules.

In the absence of the proposed legislative changes, this arrangement, given it relates to a general fund expense, could cause 100% of the fund's income to be taxed at 45% as NALI.

Assuming these proposed changes become law, for an expense incurred (or avoided) on or after 1 July 2023, in the example being considered, the difference between the arm's length amount and the actual expense incurred, is \$1,000 (\$1,200 - \$200).

Two times this amount is \$2,000.

The NALI tax liability will be $\$2,000 \times 45\% = \$900$.

The Draft Bill also proposes to limit the application of the NALE rules such that they will no longer apply to APRA regulated funds (excluding small APRA funds) and public sector funds.

Furthermore, there will be another change designed to ensure that the maximum amount of potential income of a fund that can be taxable as NALI will be the fund's taxable income less assessable contributions and related deductions.

8. Proposed new tax on super balances above \$3 million

A significant announcement from the Federal Government, which has a proposed commencement date of 1 July 2025 (that is, for the 2026 income year), is an additional 15% tax on the proportion of earnings attributable to fund member balances over \$3 million.

It is noted that this proposed new tax will be known as Division 296 tax. This was announced as part of a new exposure draft released on the 2nd October 2023. Treasury has invited any responses to the draft legislation by 18 October 2023.

It is estimated this measure will apply initially to approximately 80,000 people.

Earnings, for the purpose of the application of this new tax, is not limited to taxable income and it includes all fund earnings, including unrealised capital gains.

Auditors Institute Ltd along with other professional bodies, have called for the Federal Government not to apply this new tax on unrealised capital gains.

The additional 15% tax is to be levied on the individual rather than the superannuation fund. However, (like Division 293 tax) the individual can elect for the tax to be paid from the superannuation fund.

The Treasury had released a factsheet called “Better Targeted Superannuation Concessions” explaining how the proposed tax is to operate.

Provided below is an example from the factsheet.

Carlos is 69 and retired. His SMSF has a superannuation balance of \$9 million on 30 June 2025, which grows to \$10 million on 30 June 2026. He draws down \$150,000 during the year and makes no additional contributions to the fund.

This means Carlos’s calculated earnings are:
 $\$10 \text{ million} - \$9 \text{ million} + \$150,000 = \$1.15 \text{ million}$

His proportion of earnings corresponding to funds above \$3 million is:
 $(\$10 \text{ million} - \$3 \text{ million}) \div \$10 \text{ million} = 70\%$

Therefore, his tax liability for 2025-26 is: $15\% \times \$1.15 \text{ million} \times 70\% = \$120,750$

Whilst the proposed application date is a few years away, auditors need to be mindful of some of the pressures that trustees might face should these measures be enacted into law.

In particular, there could be asset valuation concerns, especially for funds where a member’s balance is close to the \$3 million threshold. There could also be cash flow issues, especially for funds that have investments in assets such as real estate.

The proposed \$3 million threshold is not indexed. So over time a lot more than 80,000 Australians will ultimately be subject to this additional 15% tax.

Given the additional 15% tax is calculated with reference to a fund member’s Total Superannuation Balance, it is calculated with reference to an individual’s interests in superannuation across all funds they are a member of.

So, ensuring that an individual has no more than \$3 million in any particular fund (when they have more than \$3 million in aggregate across two or more funds) will not prevent this new tax from applying.

9. Account based pensions (ABPs)

Auditors of a Fund that have ABP’s need to make sure that the required minimum pension has been paid prior to 30 June 2024.

If the minimum pension is not paid for the financial year, the Fund could lose its tax-exempt status on investment income.

An important development for auditors to be aware of is that the 50% reduction in minimum payments that applied for the 2019/20, 2020/21, 2021/22 and 2022/23 years (a measure to assist trustees deal with economic uncertainty caused by the pandemic) has now ended.

Funds must pay the required minimum pension by 30 June 2024, which is based on a % of a member's account balance as at 1 July 2023, or when their pension started (if later in the financial year (pro-rated)); as follows:

Age	Standard minimum %
Under 65	4%
65-74	5%
75-79	6%
80-84	7%
85-89	9%
90-94	11%
95 and over	14%

A great reference for auditors is Taxation Ruling 2013/5 "Income Tax: when a superannuation income stream commences and ceases." It can be found at:

<https://www.ato.gov.au/law/view/document?docid=TXR/TR20135/NAT/ATO/00001>

It is also noted that the ATO does allow a small underpayment of a pension and that then the Fund will not lose its tax-exempt status. A small underpayment of a pension is when the underpayment does not exceed 1/12th of the minimum annual payment.

The ATO allows this exception if all of the following apply:

- "failure to meet the minimum pension requirements was an honest mistake or was outside the control of the trustees
- the underpayment is only small (that is, does not exceed one-twelfth of the minimum annual pension payment)
- all of the other conditions have been met
- the trustee has not previously applied the exception for failing to meet the minimum pension payment requirements."

Under the 1/12th rule the underpayment must be paid as a catch up payment as soon as possible in the following income year (being within 28 days of being aware of the underpayment).

The Trustees can also apply to the ATO to treat an underpayment of pension as not having failed the minimum pension requirements, and a good reference re this can be found at:

<https://www.ato.gov.au/super/self-managed-super-funds/in-detail/smsf-resources/smsf-technical/smsfs--minimum-pension-payment-requirements---frequently-asked-questions/>