



## MLC TechConnect

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# Legislation to support changes to non-arm's length expenses

**Legislation** has been introduced supporting amendments to the non-arm's length expenses (NALE) rule applying to self managed super funds (SMSFs) and small APRA funds (SAFs). This measure was originally announced in the 2023/24 Federal Budget.

Non-arm's length income (NALI) is taxed at 45%. Since 1 July 2018, NALI was extended to situations where income was derived as part of an arrangement where expenses incurred were lower than if dealing on an arm's length basis.

Concerns were raised by the industry as to the application, particularly in relation to the general expenses of the super fund which could result in all income of the fund being taxed as NALI. General expenses are costs that are not related to a specific asset, but the general operation of the fund, including fees associated with accounting, audit or actuarial and administration costs of running the fund.

The amendment ensures NALI resulting from the underpayment of general expenses will be limited to twice the difference between the amount expected to be paid on an arm's length basis and the amount incurred.

### Example: Amount taxed as NALI

Howard runs his SMSF and is the only member with an accumulation interest. The primary asset held in the fund is a rental property. Howard is an accountant and provides services at no cost but would ordinarily charge clients \$3,000 for the same service.

The provision of these services is consistent with the legislation allowing the trustee to provide the services, meaning there is no breach of any superannuation rules.

As the accounting fees are general to the operation of the fund, it will be assessed as having \$6,000 of NALI calculated as:

$[\$3,000 \text{ (arm's length costs) less } \$0 \text{ (amount paid)}] \times 2 = \$6000$

This is then compared to the other income of the fund.

Let's assume the fund has income of \$15,000 (rental income less allowable deductions). In this case, \$6,000 is taxed as NALI at 45% and the remaining amount of \$9,000 (\$15,000 - \$6,000) is taxed at 15%.

If an amount is incurred by the fund that is less than the amount paid on an arm's length basis, the expense cannot be claimed as a tax deduction. NALE also cannot exceed the super fund's assessable income less other allowable deductions (excluding assessable contributions and associated deductions).

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SMSFs and SAFs will still need to carefully monitor any discounts for general expenses, such as the provision of tax and accounting services from a related party. Ideally, these funds should ensure all expenses are managed on an arm's length basis and market rates are paid for all services.

Large APRA regulated funds, including exempt public sector superannuation funds, pooled super trusts and approved deposit funds, will be exempt from the NALE provisions for both general expenses and asset specific expenses.

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