

2022–2023

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL
2023: NON-ARM'S LENGTH EXPENSE RULES FOR SUPERANNUATION
FUNDS

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	Definition
The Bill	<i>Treasury Laws Amendment (Measures for Consultation) Bill 2023</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
SMSF	Self managed super fund as defined in section 17A of the <i>Superannuation Industry (Supervision) Act 1993</i>

Chapter 1: Non-Arm’s length expense rules for superannuation funds

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Outline of chapter

- 1.1 Schedule [x] of the Bill makes changes to the rules for non-arm’s length expenses for superannuation funds.
- 1.2 These changes improve the operation of the rules in relation to expenses that are incurred on a non-arm’s length basis, referred to as non-arm’s length expenses (including where expenses are not incurred), introduced by the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019*.
- 1.3 Schedule [x] of the Bill will exempt large APRA-regulated funds, including exempt public sector superannuation funds, from the non-arm’s length income rules related to non-arm’s length expenses, although these funds will still be subject to the remaining non-arm’s length income rules for income derived on a non-arm’s length basis.
- 1.4 For SMSFs and small APRA-regulated funds these amendments will apply different treatment depending on the type of expense that is incurred on a non-arm’s length basis.
- 1.5 Any non-arm’s length expense will be either a specific expense or a general expense. A general expense will be an expense that is not related to gaining or producing income from a particular asset of the fund. A specific expense will be any other expense. An expense incurred in relation to gaining or producing income as a beneficiary of a trust through holding or acquiring a fixed entitlement to the income of a trust will always be a specific expense.

- 1.6 For specific expenses the existing treatment will continue to apply, and the amount of income that will be taxed as non-arm's length income will be the amount of income derived from the scheme in which the parties were not dealing at arm's length.
- 1.7 For general expenses the amount of income that will be taxed as non-arm's length income will be twice the difference between the amount of the expense that might have been expected to be incurred had the parties been dealing at arm's length, and the amount the entity did incur. Where the entity did not incur any expense, the amount of income that will be taxed as non-arm's length income will be twice the amount that might have been expected to be incurred had the parties been dealing at arm's length.
- 1.8 The total amount of a small complying superannuation fund's non-arm's length component will be capped at an entity's taxable income for the year not including any assessable contributions or any deductions against assessable contributions.
- 1.9 These changes will apply to income derived in the 2023-24 income year or a later income year, and expenses incurred or expected to have been incurred on or after 1 July 2023.

Context of amendments

- 1.10 Superannuation industry stakeholders raised a range of concerns with the original 2019 amendments contained in the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019* through consultation in March 2023 on the non-arm's length expense provisions. Stakeholders also raised concerns with potential amendments to the non-arm's length expense provisions released for consultation in January 2023. Stakeholders expressed concerns that the current law can lead to harsh outcomes for relatively minor breaches, related to expenses such as accounting fees that have a sufficient nexus to all income of the fund. In these circumstances, a small advantage obtained by minimising an expense through a non-arm's length transaction can result in all income of the fund for that year being taxed at the highest marginal rate.
- 1.11 When the non-arm's length expense provisions were enacted, they applied to the 2018-19 income year and future income years. Expenses incurred before the provisions were enacted could be covered by the provisions and result in income in later income years being taxed at the highest marginal rate.
- 1.12 The current provisions apply equally to all complying superannuation funds, rather than being tailored to the level of risk. For large funds there is a lower risk that these funds will gain a tax advantage by engaging in schemes with related parties to incur losses or outgoings at less than arm's length. Due to the lower risk, exempting these funds will exempt them from additional compliance burdens to account for this lower tax integrity risk.

Comparison of key features of new law and current law

Table 1.1 Comparison of new law and current law

New law	Current law
Non-arm's length expenses rules don't apply to large APRA-regulated funds and exempt public sector superannuation funds	Non-arm's length expense rules apply to all complying superannuation funds
For SMSFs and SAFs, general non-arm's length expenses result in a maximum of twice the difference between the amount that would have been expected at arm's length and the amount actually incurred being non-arm's length income, with no deductions applying against that amount. The total amount taxed at the highest marginal rate is then capped to income minus deductions, excluding assessable contributions and deductions against them.	General expenses result in all fund income being taxed at the highest marginal rate
Expenses incurred or expected to have been incurred before 1 July 2018 cannot result in the application of the non-arm's length expense rules	Expenses incurred or expected to have been incurred before 1 July 2018 can result in the application of the non-arm's length expense rules in relation to income derived in 2018-19 and/or future income years

Detailed explanation of new law

- 1.13 These amendments make changes to the non-arm's length expense rules for superannuation funds. These changes improve the operation of the non-arm's length expense rules and restrict the operation of the rules.

Different approaches for different funds

- 1.14 These amendments apply different approaches to different funds based on the size of the funds. The non-arm's length expense rules will only apply to small superannuation funds and SMSFs. The existing definition of SMSF in section 995-1 of the ITAA 1997 will be used. A small complying superannuation entity will be any regulated superannuation fund that has 6 or fewer members.

[Schedule xx, item 4, paragraph 295-550(8)(a) of the ITAA 1997]

- 1.15 All other complying superannuation entities will be exempt from the non-arm's length expense rules. These larger entities include APRA-regulated funds with

more than 6 members, pooled superannuation trusts, approved deposit funds, and exempt public sector superannuation funds. The nature of the transactions that these entities engage in means they have less incentive to enter into schemes of the kind which result in tax arbitrage.

[Schedule xx, item 1, subsections 295-545(2) and 295-550(5) of the ITAA 1997]

- 1.16 By contrast, members of smaller funds may have the capacity to control or influence the arrangements of the fund to directly inflate their superannuation balance through non-arm's length expenses to take advantage of lower tax rates. The tax penalty for non-arm's length expenses is a strong disincentive from using non-arm's length arrangements for small funds which cannot be adequately addressed through other provisions such as those related to contributions and trustee responsibilities.
- 1.17 For smaller funds the rules will apply a different approach based on the kind of loss, outgoing or expense that is, or should have been, incurred. Whilst specific expenses will continue to be subject to the existing treatment, the consequences of gaining an advantage through a non-arm's length transaction in relation to general expenses will be lessened.
- 1.18 This is achieved by amending the existing non-arm's length expense provision in paragraph 295-550(1)(b) so that it does not apply to expenses incurred that are covered under subsection 295-550(9), which covers general arm's length expenses where an expense is incurred that is less than what might have been expected to be incurred at arm's length.
- 1.19 Similarly, paragraph 295-550(1)(c) is amended so that it does not apply to expenses covered under subsection 295-550(8), which covers general arm's length expenses where no expense was incurred but might have been expected to be incurred at arm's length.
[Schedule xx, item 2, subsection 295-550(1) of the ITAA 1997]
- 1.20 To implement this approach there will also be amendments to the way that the non-arm's length component is calculated for the 2 types of funds.
- 1.21 Large APRA-regulated funds and exempt public sector superannuation funds will continue to calculate their non-arm's length component in the same way they do now but the rules in relation to non-arm's length expenses will not apply to these entities.
- 1.22 For small funds, there is a change to the deduction rules in relation to general expenses. This is because the new approach for calculating the consequence of a non-arm's length general expense takes into account any amount actually incurred in relation to the general expense, so there is no deduction available to small superannuation funds and SMSFs for the amount actually incurred.
- 1.23 Another change for small funds is that a cap is introduced on their total non-arm's length component to ensure that assessable contributions and related deductions are always part of the low tax component. Assessable contributions are subject to other taxing provisions, and it is not intended they also potentially be subject to higher rates of tax under the non-arm's length income provisions.

- 1.24 These amendments do not alter the existing meaning or definition of 'contribution'. Contribution takes its ordinary meaning as it does in other parts of the ITAA 1997, for example section 285-1 of the ITAA 1997, and nothing in the Schedule disturbs that meaning.
- 1.25 A small fund's non-arm's length component will be calculated as the lesser of:
- The sum of:
 - any non-arm's length income amount (other than non-arm's length income as a result of a general expense) less any deduction attributable to that non-arm's length income amount; plus
 - any non-arm's length income as a result of a general expense; or
 - The total of an entity's taxable income for the year, excluding any contributions that are part of an entity's assessable income (this is achieved by subtracting them from the calculation), and excluding any deductions against those contributions (this is achieved by adding them to the calculation).

[Schedule xx, item 1, subsection 295-545(2A) of the ITAA 1997]

Types of Expenses

- 1.26 When a small superannuation fund or an SMSF incurs a loss, outgoing or expense as a part of a scheme with related parties and that expense is related to earning income from a particular asset of the fund, that will be a specific expense for the purposes of these provisions.
[Schedule xx, item 2, paragraphs 295-550(1)(b) and (c) of the ITAA 1997]
- 1.27 This will also apply where an expense is not incurred but is expected to be incurred, which is referred to as an expected expense.
- 1.28 A general expense is an expense that is incurred otherwise than in gaining or producing income from any particular asset or assets of the fund (including the acquisition of the asset itself).
[Schedule xx, item 4, subsections 295-550(8) and 295-550(9) of the ITAA 1997]
- 1.29 For the purposes of this explanatory memorandum, any other expense incurred as part of a scheme where entities are not dealing with each other at arm's length and where the expense is less that would have been expected to have been incurred had the parties been dealing with each other at arm's length (including not being incurred where it would have been expected to have been incurred) and that expense is in relation to a particular asset or assets it is referred to as a specific expense. This term is not defined in the legislation but is used to differentiate these expenses from general expenses.
- 1.30 Even where the income from the particular asset or assets comprises all of the income of the fund in a particular year, the expense will still be a specific expense if it relates to the particular asset or assets.

- 1.31 To establish which category of expense a loss, outgoing or expense falls into, it will be necessary to examine whether or not the expense is incurred in relation to a particular asset or assets of the fund. Where an expense is incurred in relation to a particular asset or assets of the fund it be a specific expense. In addition to the acquisition of an asset itself, some examples of the types of expenses that would fall within specific expenses would be as follows:
- maintenance expenses for a rental property
 - investment advice fees for a particular pool of investments
 - a limited recourse borrowing arrangement for the purchase of a specific asset
 - the purchase of an asset such as a rental property or shares
- 1.32 Although this list provides some guidance about what types of expenses are specific expenses, it is not intended to be an exhaustive list and each expense must be considered in relation to the facts and circumstances in which it is incurred. For example, expenses related to income derived by an entity as a beneficiary of a trust through holding or acquiring a fixed entitlement to the income of a trust will always be specific expenses. This is because such expenses will always be related to a particular asset or assets as a fixed entitlement is itself a particular asset. No changes are made to how the existing provisions apply in circumstances where specific expenses are non-arm's length expenses beyond excluding large APRA regulated funds and exempt public sector superannuation funds.
[Schedule xx, item 3, paragraphs 295-550(5)(b) and (c) of the ITAA 1997]
- 1.33 Where a specific expense is incurred as a result of a scheme in which the parties are not dealing with each other at arm's length and the entity is a small complying superannuation entity, the amount of income that will become non-arm's length income is the same as the existing treatment prior to these amendments.
[Schedule xx, item 2, paragraphs 295-550(1)(b) and (c) of the ITAA 1997]
- 1.34 All of the ordinary or statutory income that results from the scheme will be non-arm's length income.
- 1.35 These amendments apply a different treatment to general expenses. General expenses will have a sufficient nexus to the entirety of the income of the fund, rather than a particular asset or assets of the fund. These will usually relate to the operation or obligations of the fund as a whole.
[Schedule xx, item 4, paragraph 295-550 (8)(b) of the ITAA 1997]
- 1.36 Currently, this can result in the entire income of the fund becoming non-arm's length income and being taxed at a higher rate, even when the expense that is incurred on a non-arm's length basis or not incurred at all can be relatively small.

General Expenses Treatment

1.37 Under these amendments, when the expense that is incurred on a non-arm's length basis is a general expense the income that is non-arm's length income as a result of the scheme will be limited by the 2 factor approach. This will be twice the amount of the difference between the actual amount of the expense incurred and the amount of the expense that might have been expected if the parties had been dealing at arm's length. Where no expense was incurred, the amount would be twice the amount that might have been expected if the expense had been at arm's length.

[Schedule xx, item 4, subsection 295-550(8) of the ITAA 1997]

1.38 Although not intended to be an exhaustive list, some of the items that would be expected to fall within the category of general expenses are:

- actuarial costs
- accountant fees
- fees to an auditor
- administrative costs in managing the fund
- trustee fees
- costs of complying with the regulatory obligations of the fund
- investment adviser fees, where those fees relate generally to the operation of the fund and not to a specific investment or a particular pool of investments

1.39 As the amount of any expense actually incurred has already been taken into account in the 2 factor approach, deductions will not apply to the non-arm's length income for general expenses. However, a new cap applies to limit the total non-arm's length component, which is the amount currently taxed at the highest marginal rate. The non-arm's length component will be capped at an amount equal to the entity's total taxable income for the year other than assessable contributions and excluding deductions against assessable contributions. This cap will apply where it results in a smaller amount than the combination of amounts calculated under the 2 factor approach for general expenses and the existing treatment for other amounts of non-arm's length income. If the cap calculation results in a negative number, the non-arm's length component will be zero.

[Schedule xx, item 4, subsection 295-545(2A) of the ITAA 1997]

1.40 In this way the maximum amount of non-arm's length component will not exceed taxable income for the year and will never include contributions even if there is no other income of the fund.

Example 1.1

AI is the sole trustee of their SMSF of which they are the sole member. AI is an accountant and provides general accounting services worth \$3,000 to their SMSF, which the SMSF acquires free of charge.

The acquisition of accounting services by the SMSF constitutes a scheme between AI and their SMSF in which the parties were not dealing with each other at arm's length, and no expense was incurred when the SMSF would have been expected to have incurred an expense in respect of its acquisition had the parties been at arm's length, so the non-arm's length expenditure provisions apply. The accounting services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(9).

The total income of the SMSF in 2023-24 is \$20,000 in rent from a rental property to which \$5,000 in eligible deductions for maintenance apply, resulting in a taxable income in 2023-24 of \$15,000. No assessable contributions were made in that income year.

As no expense was incurred towards the general accounting services, the amount of non-arm's length income under the 2 factor approach in (2A)(a)(ii) will be twice the amount that might have been expected to have been incurred, or twice the \$3,000 value of the services which is \$6,000.

Applying the cap on the total non-arm's length component, the cap amount is the total of income other than assessable contributions, minus deductions other than deductions against assessable contributions. In this case, the cap is the \$20,000 in rental income minus the \$5,000 in deductions against that rental income, giving \$15,000. As the cap on the total non-arm's length component is higher than the non-arm's length component arrived at above, the non-arm's length component remains at \$6,000 to be taxed at the highest marginal rate. This leaves a low-tax component of \$9,000. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Example 1.2

Min is the sole trustee of their SMSF. Min is a lawyer and provides general legal services worth \$10,000 to their SMSF which the SMSF acquires for \$5,000.

Min offers the same services she provides to SMSF to the general public and the market value of these services is readily apparent from the fee schedule available on Min's website.

The acquisition of legal services by the SMSF constitutes a scheme between Min and their SMSF in which the parties were not dealing with each other at arm's length, and the expense was incurred at a value less than what the SMSF would have been expected to have incur as an expense had the parties been dealing at arm's length, so the non-arm's length expenditure provisions apply. The legal services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(8).

The total income of the SMSF in 2023-24 is \$23,000 in rent from a rental property to which \$10,000 in eligible deductions for maintenance apply. No assessable contributions were made in that income year.

The taxable income is calculated as \$23,000 in rent income minus \$10,000 in deductions minus \$5,000 charged for legal services, equalling \$8,000.

As a general expense of \$5,000 was incurred, which would have been \$10,000 at arm's length, the amount of non-arm's length income under the 2 factor approach will be twice the amount of the difference between what was incurred and what would have been expected to have been incurred had the parties been dealing at arm's length, which is twice the difference between the 2 figures or \$10,000.

Applying the cap on the total non-arm's length component, the cap amount is the total of income other than assessable contributions, minus deductions other than deductions against assessable contributions. In this case, the cap is the \$23,000 in rental income minus the \$15,000 in deductions, giving \$8,000. This cap is lower than the non-arm's length component arrived at above, so the non-arm's length component becomes \$8,000 instead of the \$10,000 arrived at by applying the 2 factor approach.

This leaves a low-tax component of \$0. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Example 1.3

Andrew is the sole trustee of their SMSF and the only members of the fund are Andrew and Andrew's spouse Stephanie.

Andrew is a lawyer and provides general legal services to the SMSF worth \$2,000 which the SMSF acquires at no charge. The market rate for these services is \$2,000 which is readily apparent from the fee schedule available on Andrew's website.

The acquisition of legal services by the SMSF constitutes a scheme in which the SMSF and Andrew are not dealing with each other at arm's length, and the expense was incurred at a value less than what the SMSF might have been expected to have incurred at arm's length. The legal services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(9).

Stephanie is an investment advisor and provides advice on the investment strategy of the fund as a whole, not on any specific investment or pool of investments. The market value of these services is \$2,000 which the SMSF acquires at no charge.

The acquisition of investment advice for free constitutes a scheme in which the SMSF and Stephanie are not dealing with each other at arm's length, the advice is valuable and is provided at no cost and the facts establish that Stephanie can and does charge \$2,000 for the same service provided to unrelated parties. These services were general in nature, being advice acquired by the SMSF on its general investment strategies, and do not relate to any particular asset or assets of the fund. They are therefore a general non-arm's length expense captured under subsection 295-550(9).

The total income from the SMSF in 2023-24 is \$22,000, this is earned from a rental property. There are \$7,000 of deductions associated with this income resulting in taxable income for 2023-24 being \$15,000.

There were two general non-arm's length expenses for which a total of \$4,000 might have been expected to be incurred had the parties been dealing at arm's length, but no expense was incurred for either. The amount of non-arm's length income under the 2 factor approach would be \$8,000 representing twice the amount of the expenses that were not incurred but should have been.

Applying the cap on the total non-arm's length component under the 295-545(2A)(b), the non-arm's length component cap will be \$15,000. As the cap is higher than the amount calculated under the 2 factor approach, the non-arm's length component remains \$8,000.

This leaves a low-tax component of \$7,000. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Example 1.4

Jai is the sole trustee of their SMSF of which they are the sole member. Jai is an accountant and provides general accounting services to their SMSF worth \$3,000 which the SMSF acquires free of charge.

The acquisition of accounting services by the SMSF constitutes a scheme between Jai and their SMSF in which the parties were not dealing with each other at arm's length, and no expense was incurred when the SMSF would have been expected to have incurred an expense had the parties been dealing at arm's length. The accounting services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(9).

The total income of the SMSF in 2023-24 is \$20,000 in rent from a rental property to which \$5,000 in eligible deductions for interest apply. No assessable contributions were made in that income year.

Jai's spouse Sam is a licensed builder and blocks time out of their work calendar to conduct renovations on the rental property worth \$3,000 for which they charge nothing.

The renovations were an expense incurred in deriving income from a particular asset, the asset being the rental property. The renovations are a specific non-arm's length expense to which paragraph 295-550(1)(c) applies.

The taxable income of the fund in 2023-24 will be \$20,000 in rental income minus \$5,000 in deductions, which equals \$15,000.

When calculating the non-arm's length component, the fund must account for a non-arm's length specific expense related to the \$20,000 in rental income and a general non-arm's length expense related to the accounting services.

In relation to the specific expense, the amount under subparagraph 295-545(2A)(a)(i) is the non-arm's length income arising from the specific non-arm's length expense under subsection 295-550(1) minus attributable deductions, which is the \$20,000 in rental income minus the \$5,000 in rental attributable deductions resulting in \$15,000.

In relation to the general expense, the amount under subparagraph 295-545(2A)(a)(ii) is the non-arm's length income arising from the general non-arm's length expense under subsection 295-550(9), which sets out the 2 factor approach, which in this case is 2x \$3,000 which equals \$6,000.

The sum of the amounts under subparagraphs 295-545(2A)(a)(i) and (ii) is \$15,000 + \$6,000 which equals \$21,000.

The cap on the non-arm's length component under paragraph 295-545(2A)(b) is the entity's taxable income excluding assessable contributions and any deductions against assessable contributions. In this case, this is \$15,000 as there are no assessable contributions or deductions against them.

The amount of the non-arm's component is the lesser of the amount under paragraph 295-545(2A)(a) and the amount under paragraph 295-545(2A)(b). As \$15,000 is less than \$21,000, the total non-arm's length component is \$15,000.

This leaves a low-tax component of \$0. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Example 1.5

Malia is one of four members of a small superannuation fund. Malia is an accountant and provides general accounting services to the small superannuation fund worth \$10,000 which the small superannuation fund acquires for \$5,000.

The acquisition of accounting services by the fund constitutes a scheme between Malia and the small superannuation fund at arm's length, and no expense was incurred when the small superannuation fund would have been expected to have incurred an expense had the parties been dealing at arm's length, so the non-arm's length expenditure provisions apply. The accounting services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(8).

The total income of the small superannuation fund in 2023-24 is \$23,000 in rent from a rental property which is rented to Malia's accounting business. Had the property been rented at arm's length, it might have been expected to receive \$15,000 in rent based on known rents for comparable tenanted commercial properties.

The rental arrangement constitutes a scheme between Malia's accounting business and the small superannuation fund at arm's length, resulting in a higher rental income than the rental income that might have resulted had the property been rented at arm's length. The non-arm's length income provisions apply under paragraph 295-550(1)(a) to make the rental income non arm's length income.

Maintenance was carried out on the commercial property at arm's length constituting \$10,000 in eligible deductions. No assessable contributions were made in that income year.

The taxable income of the fund in 2023-24 will be \$23,000 rental income minus \$10,000 in deductions for property maintenance and minus \$5,000 incurred for accounting services, which equals \$8,000.

Under 295-550(1), the \$23,000 of property income of the fund is non-arm's length income. The non-arm's length component will be calculated by adding the non-arm's length rental income of \$23,000

minus the related deduction of \$10,000 plus the amount derived from 2 factor approach for the general expense of \$10,000, giving a total of \$23,000. However, the non-arm's length component cap in paragraph 295-545(2A)(b) equivalent to taxable income of \$8,000 will limit the non-arm's length component to \$8,000. This leaves a low-tax component of \$0. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Example 1.6

Tanya is the sole trustee of her SMSF. Tanya is a lawyer and provides general legal services to her SMSF worth \$17,000, which the SMSF acquires for \$12,000.

Tanya offers the same services she provides the SMSF to the general public and the market value of these services is readily apparent from the fee schedule available on Tanya's website.

The acquisition of legal services by the SMSF constitutes a scheme between Tanya and their SMSF in which the parties were not dealing with each other at arm's length, and the expense was incurred at a value less than what the SMSF would have been expected to have incurred as an expense had the parties been dealing at arm's length, so the non-arm's length expenditure provisions apply. The legal services were general in nature and did not relate to any particular asset or assets so are a general non-arm's length expense captured under subsection 295-550(8).

The taxable income of the SMSF in 2023-24 is \$34,000 in rent from a rental property, to which \$15,000 in eligible deductions for property maintenance apply, together with a \$12,000 deduction for the legal services, plus \$10,000 in assessable contributions to which a \$1,000 deduction applies. The taxable income of the fund will be \$16,000.

In relation to the general expense, the 2 factor approach under subsection 295-550(8) gives twice the difference between the \$12,000 that was incurred for legal services and the \$17,000 value of the expense had parties been dealing at arm's length, which gives \$10,000.

The cap on the non-arm's length component for the purposes of paragraph 295-545(2A)(b) is calculated as \$16,000 in taxable income minus less the \$10,000 in assessable contributions plus the \$1,000 deduction incurred in relation to the assessable contributions, equalling \$7,000. As this is lower than the \$10,000 calculated by applying the 2 factor approach, the cap applies to limit the non-arm's length component to \$7,000.

This leaves a low-tax component of \$9,000. The low tax component is any remaining taxable income after calculating the non-arm's length component.

The low tax component for this fund would be equal to the amount of assessable contributions excluded from the non-arm's length component minus deductions attributable to them. This ensures the assessable contributions are never taxed at the highest marginal rate.

Consequential amendments

- 1.41 Schedule [x] of this Bill makes consequential changes to the *Treasury Laws Amendment (2018 Superannuation Measures No.1) Act 2019* so that Act is taken to not apply and never to have applied to a loss, outgoing or expenditure that was, or might have been expected to be, incurred before the 2018-19 income year.
[Schedule xx, items 8 and 9, subitem 4 of Schedule 2 to the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019]
- 1.42 This ensures that Act will not make income non-arm's length income where it results from an expense incurred prior to the enactment of the measure. This will limit the application of the non-arm's length expenses rules to dealings which were entered into after the rules came into effect, from which point trustees could have reasonably taken steps to avoid incurring higher rates of tax under the rules.

Commencement, application, and transitional provisions

- 1.43 The amendments commence on the start of the first quarter after the day the Act receives Royal Assent.
[Schedule xx, item 7, Application provision]