

TAX TALKS

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133 | ITAA97 NANE

ITAA97 NANE is the new kid on the block. On the 1 July 2018 a new approach to the non-arm's length concept came to life. Non-arm's length expenses (NANE).

ITAA97 NANE

Non-arm's length expenses can be a time bomb. You might not think about it. And suddenly – when you sell – you get hit with non-arm's length income. It turns out that you had a non-arm's length expenses (NANE). And so now the entire capital gain plus any income the SMSF ever derived from that asset is non-arm's length income.

So we asked Peter Bobbin of Argyle Lawyers in Sydney for more details. Here is what we learned.

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ITAA97

The new NANE concept sits in s295-550 ITAA97, right next to its sister – non-arm's length income (NANI).

ATO Fixes Mistake

There is the view that NANE 'proves' the ATO overstepped its reach in PCG 2016/5. In this Practical Compliance Guideline it quoted itself as the authority for its conclusions. Otherwise NANE would not have been necessary.

This change to deal with a "technical deficiency" has far-reaching consequences. It means that any non-arm's length expenses (NANE) will now result in non-arm's length income. NANE includes scenarios where no expense was charged.

SMSF

NANE is particularly dangerous for SMSFs with respect to LRBA's. You might have an SMSF that acquired real property under a limited recourse borrowing arrangement. The rent derived under the scheme is at market rates but the interest paid on the loan is not (Explanatory Memorandum 1.20). As a result the expenses incurred in respect of that asset are not on arm's length terms and s295-550 comes to bite.

Revenue and Capital

The framework for the new non-arm's length income rules remains broadly the same. There must be a scheme. And the parties to the scheme must incur less (or nil) expenditure that would otherwise be expected if the parties were dealing with each other on arm's length basis in relation to the scheme.

Expenses may be of a revenue or capital nature, in the same way that non-arm's length income may be statutory or ordinary income (Explanatory Memorandum 1.23/4).

LRBAs

Non-arm's length interest on borrowings to acquire an asset will result in any eventual capital gain on disposal of the rental property being treated as non-arm's length income.

If the asset was acquired or maintained on some concessional basis, both the income and the future net capital gain will be treated as non arm's length income and taxable as such.

Arrangements that are purely internal are okay.

Free Services

An SMSF trustee may undertake bookkeeping activities for no charge. The trustee of an SMSF must not charge for the services or functions that it undertakes in its capacity as trustee by paragraph 17A(1)(f) of the SIS Act. Services of this kind do not involve a scheme between parties as they fundamentally relate to the trustee's obligations in respect of the fund.

Conclusion

In *Cam & Bear PTY Ltd v McGoldrick*, (NSW Court of Appeal) and *Aussiegolfa* the ruling stipulated to look for NALI inside the SMSF's investments.

The new NALE concept will now require to also look at the expenses and outgoings within the SMSF's investment. So NALE opens up a whole new world of audit-pain.

All this is just our brief take on the issue. Please listen to the episode above. Peter Bobbin explains all this in a much better way than we ever could.

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