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SMSF Expenses
Apportionment and Insurances

Are you claiming the right expenses?

In our previous article we discussed general requirements of SMSF expenses and deductibility. This article aims to look further afield at expenses for funds paying pensions.

Pensions and Expense Apportionment

Expenses are generally deductible when they are linked to gaining or producing assessable income. When a pension is commenced the underlying assets are treated as tax exempt, as is the related income. This is referred to as Exempt Current Pension Income (ECPI). Expenses are similarly treated as non-deductible, because there is no assessable income to be offset with deductible expenses.

In a SMSF where the fund is solely in accumulation (members are making contributions), the eligible expenses can be treated as tax deductions. Similarly, if the SMSF is completely supporting pension accounts then all expenses are treated as non-deductible. When a SMSF is receiving contributions and paying pensions in the same financial year not all expenses can be treated as deductible or non-deductible. If this has occurred, the expenses should be reviewed and classified as distinct and severable, or as indifferent expenses to determine their deductibility.

A distinct and severable expense can clearly be identified as relating to accumulation or pension accounts. For example, a pension administration fee is clearly related to the administration of the pension accounts. This expense will always be treated as non-deductible as it does not relate to gaining or producing assessable income. Distinct and severable expenses are often easier to identify when a fund is segregated. More on segregation later.

An indifferent expense is not clearly related to the accumulation or pension accounts and will be apportioned in the tax return between deductible and non-deductible. The expense is apportioned based on a fair and reasonable basis. The calculation(s) used to determine the split are in-depth calculations that use daily weighted average formulas and are explored briefly below.

The most common calculations are both income-based approaches which apportion investment expenses and general administrative expenses separately, noting that both will be applied to a daily weighted average calculation also.

The investment income approach uses the fund's assessable investment income as a percentage of total investment income to calculate the deductible portion of investment expenses and is expressed through the following formula.

$$\text{Investment Expense} \times (\text{Assessable investment income} \div \text{Total investment income})$$

For example

A fund has total income of $10,000.
$7,000 of this is assessable and was derived from investments.

The remaining $3,000 is not assessable, as determined by an actuarial certificate.

Investment management fees from a financial adviser are incurred for $2,000.

Ignoring daily weighted averages, the calculation to determine how much of the $2,000 can be claimed as a tax deduction is calculated as:

$$\$2{,}000 \times (\$7{,}000 \div \$10{,}000) = \$1{,}400$$

General administrative expenses can be apportioned by calculating the assessable income plus non-assessable contributions (which includes rollovers) as a percentage of total income, as seen below.

$$\text{General Administrative Expenses} \times \left[(\text{Assessable Income}) + (\text{Non-assessable Contributions}) \div \text{Total Income} \right]$$

For example

A fund has total income of $60,000.
$27,000 of this income is assessable.

The remaining $15,000 is from member non-concessional contributions.
Accounting fees of $2,400 are incurred.

Again, if we ignore daily weighted averages, the calculation for the deductible portion of this expense is seen below.

$$\$2,400 \times \left[(\$27,000 + \$15,000) \div \$60,000\right] = \$1,680$$

Depending on the fund, other approaches may be used that are fair and reasonable.

Fund Segregation and ECPI Apportionment

A segregated fund is, most commonly, when members have their own identifiable and separate assets and bank accounts. A fund may also be segregated in a manner that allows the identifiable separation of assets between the accumulation accounts and pension accounts of the fund or member. It should be noted that a fund solely in accumulation, or solely supporting pensions is treated as a segregated fund. That is because the assets are clearly identifiable as being linked to accumulation or pension accounts.

In contrast an unsegregated fund has all assets pooled together. These may commonly be referred to as pooled funds. When the assets are pooled it cannot be determined if they support the accumulation or pension accounts. When it comes to the completion of the tax return, the trustees will engage an actuary to calculate the ECPI. This calculation is summarised on an actuarial certificate and displays the ECPI as a percentage of total income. The simplest expense apportionment method is to use this ECPI percentage and apply it to the indifferent expenses.

For example, if an actuary has calculated that a fund's ECPI percentage is 75% (that is, 75% of total income relates to pension accounts, and is exempt from tax) then this can be applied to an expense totalling $1,000. In the tax return the expense will be split as $250 deductible and $750 as non-deductible.

In conclusion the claiming of a tax deduction should be considered carefully for each expense, and the nature should always be kept in mind. Keep your eye out for our next article on Insurance inside an SMSF.

Postal
GPO Box 1215
Adelaide SA 5001

Telephone
1300 787 576 (National)
08 8221 6540 (Adelaide)

Facsimile
08 8221 6552 (Adelaide)

Email
info@superguardian.com.au

Adelaide
65 Gilbert Street
Adelaide SA 5000

Melbourne
Level 4, 152 Elizabeth Street
Melbourne VIC 3000

Sydney
Level 13, 333 George Street
Sydney NSW 2000

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