NTAA ADVICE

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Significant penalties for super fund contraventions

The recent case of DFC (Superannuation) of T v Graham Family Superannuation Pty Ltd saw significant fines imposed upon the members of the fund.

The Federal Court endorsed pecuniary penalties and costs totalling $50,000 to be imposed on the members of an SMSF for contraventions of the Superannuation Industry (Supervision) Act 1993 ("SIS Act").

In this case, a husband and wife were the directors of the corporate trustee and members of the SMSF.

Between July 2008 and June 2012, the husband and wife used funds totalling $134,418 to make 80 loans to themselves. They subsequently spent this money on a caravan, stud cattle, two motor vehicles and other private purposes.

Further, a residential property held by the SMSF was leased fully furnished to a son of the husband and wife, without any rent ever being paid.

The court held that the 80 loans and the leasing of the residential property without collecting rent constituted various contraventions of the SIS Act by the trustee, including:

- failing to ensure that the SMSF was maintained solely for one or more of the purposes prescribed in S.62(1) (the "sole purpose" test);
- lending money using the assets of the SMSF to the members, in breach of S.65;
- having a loan from the SMSF, and also a lease of property from the SMSF to related parties, in breach of the in-house asset rules; and

- the trustee making investments in circumstances where it and the other parties to those transactions failed to deal with each other at arm's length, in breach of S.109 (the "arm's-length test").

The parties agreed before the Court to the basic facts, the nature and extent of the contraventions, the legal obligations, the declarations which should be made, the pecuniary penalties which should be imposed and the costs which should be assessed.

The Court decided that the statutory maximum penalty should not be imposed, as the husband and wife had shown remorse, made early admissions, and co-operated with the Commissioner, and they had also remedied their conduct.

Accordingly, the court endorsed the penalties and costs agreed to by the parties, i.e., that the husband and wife should pay penalties totalling $40,000, together with the agreed costs of $10,000.

Care should always be taken where personal use of SMSF assets or loans to a member are proposed.

Commutation of a transition to retirement income stream

Recently the ATO had cause to review a payment made as a result of a commutation of a transition to retirement income stream ("TRIS").

The result of this was Determination SMSFD 2014/1. It considered whether a payment made as a result of a commutation counts towards the minimum and maximum annual payment amounts, for such a pension.

A TRIS is a specific type of account based pension ("ABP"). However, unlike a standard ABP, a TRIS may be paid as soon as the relevant member attains their preservation age, even if they are still working.

Also unlike a standard ABP, the regulations provide for an annual **maximum** amount that may be paid under a TRIS, which is basically 10% of the pension account balance funding the TRIS.

By way of contrast, no maximum annual limit applies to a standard ABP. However, the same **minimum** annual payment amounts must be made as provided in the regulations to both a TRIS and a standard ABP.

In SMSFD 2014/1, it was held that a payment made as a result of a **partial** commutation of a TRIS only counts towards the **minimum** annual amount required to be paid under the regulations if the payment was rolled over within the superannuation system **before** 6 June 2009.

A payment made as a result of a **partial** commutation of a TRIS can only count towards the **maximum** annual amount allowed to be paid under the regulations if the payment was made **before** 16 February 2008.

The upshot of this determination is that a partial commutation of a TRIS will no longer be counted toward the annual income amount required to be paid by the TRIS.

This determination also held that a payment made as a result of a **full** commutation of a TRIS cannot count towards **either** the **minimum** annual amount or the **maximum** annual amount as that TRIS ceases before the payment is made.

The application of this determination is that a recipient of a TRIS who intends to commute the TRIS (either partially or fully), should ensure that the minimum annual amount is paid by the TRIS for that income year, before the TRIS is commuted. This way the TRIS will be seen to have met its payment obligations for the time before a full commutation takes place.

No "special circumstances" in relation to excess super contributions

The Administrative Appeals Tribunal (AAT) has recently affirmed the ATO's position that no special circumstances existed in relation to a taxpayer couple.

Because of this decision, the couple were liable for excess concessional contributions tax. (Refer *Hope and Commissioner of Taxation [2014] AATA 877*).

In this case, a company (of which the taxpayers were both directors and employees) made superannuation contributions on the taxpayers' behalf, in excess of the relevant concessional contribution caps of both the taxpayers.

One of the taxpayers (Mrs Hope) was responsible for making the company's employer superannuation contributions. The excess contributions were paid by the company and transmitted electronically through a MYOB Clearing House using M-Powered Superannuation ("MPS").

These payments were made by the company on 30 June 2008, but were only received by the superannuation funds in early July 2008 (i.e., in the next financial year).

The taxpayers submitted that there were special circumstances, and on this basis they sought the ATO's discretion to allocate the excess amount to another year or to disregard it. However, the ATO did not agree to this, and the taxpayers then went to the AAT for a review of the ATO's decision.

The taxpayers submitted to the AAT that:

(a) they were not aware that using MPS may result in delays in the receipt of their contributions by the superannuation funds (and they relied on their accountant to advise them about this);

(b) they expected a warning from the ATO if they were exceeding their contribution caps; and

(c) they normally only paid attention to the "bottom line" in relation to their respective superannuation fund balances.

However, the AAT affirmed the ATO's decision and held that there were no "special circumstances". More specifically, the AAT held that both taxpayers had some experience in relation to superannuation contributions, and they were the "controlling minds" of their employer.

Further, the delay between the payments and receipt of the contributions should have been brought to the taxpayers' attention by the Member Statements which they received from their superannuation funds.

The fact that the taxpayers were busy running their business did not take them outside the circumstances of the many other taxpayers in the community who were in the same position.

This provides a good example of how the stringent rules of administering an SMSF are regarded by the ATO and the AAT, and serves as a warning for all trustees.

Can an SMSF engage a member builder/tradie?

A question often raised in relation to running an SMSF is whether the fund can engage a member for the provision of building or trade services.

There are a number of criteria to satisfy, and issues to consider, before an SMSF may engage a related party (e.g., member) to provide building or other trade services to an SMSF (e.g., as part of a property development).

Broadly, a fund will fail to meet the basic conditions to be regarded as an SMSF if a trustee or director of a corporate trustee ('trustee/director') is remunerated from the fund, or from any person, for any duties or services performed by them in relation to the fund.

However, under S.17B of the Superannuation Industry (Supervision) Act 1993 ("SIS Act"), a trustee/director can be remunerated where the duties or services are performed other than in the person's capacity as trustee/director, and other specified criteria are satisfied.

It is important that the remuneration paid to the member reflects the market value of the services performed. If the remuneration paid does not reflect this market value (i.e., is more or less than the market value) then there may be adverse taxation and compliance issues. Accordingly, independent/benchmarking evidence should be obtained to prove that the amount paid is in line with market conditions.

Another issue of note in this area is that the ATO has advised (in TR 2010/1) that a fund's capital may be increased, and a contribution consequently made, when a person (such as a member or employer-sponsor) increases the value of an existing asset of the fund.

Further, under S.66 of the SIS Act, an SMSF trustee is prohibited from intentionally acquiring an asset from a related party of the fund, subject to certain exceptions. While the provision of services alone by a related party in respect of developing a property does not constitute the acquisition of an asset, acquisitions from a related party may occur, and potentially lead to a contravention of S.66, where the related party pays for the goods and materials used in the development.

However, the ATO takes the general view that an SMSF is only taken to acquire building materials from a related party where the materials are "not insignificant" in value and function. This is discussed in SMSFR 2010/1.

Detailed legal/superannuation advice should be sought whenever a trustee is considering the provision of building or other services for an SMSF.

Comparison of fund will be key

In making the move to provide advice under an Australian Financial Services Licence (AFSL), any recommendation must meet the requirements of "Clients' Best Interests" – S.961B of the Corporations Act.

This aspect of advice requires an adviser to ensure that the advice they are giving will see the client placed in a better position than they are currently.

While this might seem like common sense, the manner in which this is approached has several requirements.

With the requirement to provide such advice in writing in a Statement of Advice (SOA), there is also the requirement to show the client how they are better off. This involves not just telling them that they will be in a better position, but in certain circumstances actually demonstrating this.

Fund comparison

This is most important where the clients will be using the recommended SMSF in the place of another superannuation fund already in place.

In making such a recommendation, there should be a demonstration of the consideration of certain points:

- What are the administration costs of the SMSF compared to their existing fund?
- What are the other fees and charges, and what are other fees and charges within the SMSF?
- Are there any other benefits provided by the fund they have currently?

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This last point relates in particular to whether the current fund provides any insurance benefits for the clients. If the existing fund has insurance in place, rather than cancel this cover by rolling over the entire fund, it might be beneficial to keep it in place by leaving a small sum there to cover the premiums and maintain the insurance.

Whether an adviser is authorised to discuss insurances or not, the loss of such benefits must be pointed out to confirm that you are acting in the clients best interests.

Because of this, it may be tempting to consider retaining the old fund, under the belief that doing so will not require any comparison.

ASIC have provided guidelines on this situation in their Report 337 on advice to SMSFs. If you recommend using an SMSF, this is essentially a recommendation not to use their current fund. Ultimately this is giving advice about the other fund.

On this basis, the use of the SMSF does in some way replace the use of the current fund and therefore requires such a comparison.

Unfavourable terms

It may be that the costs involved with the running of the SMSF, though fully justified, are greater than what the member is subject to. This may be the case in particular where a member is in an industry fund or other low cost alternative.

While it may seem that a recommendation for an SMSF may not be viable, it is not only cost that is a consideration as to whether it will be in the clients' best interests.

ASIC have stated that the following points can also be viable reasons to act and meet the clients' best interest requirements:

- That the recommendation serves to inform and educate the client about their financial situation; and
- The recommendation will see the clients invested in line with their investor risk profile.

Further, if establishing an SMSF is more expensive than what they have now but shows to be of greater benefit in the future, the future potential should be demonstrated to show why the SMSF is the better option.

This might be the case where there is a purchase of business real property and, while on commercial terms, the clients are better off to benefit to have a reliable tenant (themselves) and enjoy the growth that property will give them over the long term.

While not a part of any requirement in the current way of providing advice under the accountants' exemption, making comparisons and informing the client of the overall picture should be something to consider introducing as part of your advice now, to get ready for the future.