



Taxpayer Alert

TA 2010/5

The use of an unrelated trust to circumvent superannuation lending restrictions



The ATO view regarding the giving of financial assistance to members or relatives of members of a self-managed superannuation fund is outlined in SMSFR 2008/1

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax and superannuation planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax and superannuation planning issues. Not all potential tax and superannuation planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert might obtain their own advice or contact the ATO to seek guidance in relation to the tax and superannuation regulatory issues covered in the Taxpayer Alert.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes an arrangement where a self-managed superannuation fund (SMSF) invests funds in an unrelated trust. The trust then on lends the funds to an SMSF member or a relative of the member.

This arrangement attempts to circumvent the prohibition on SMSF trustees lending money or providing financial assistance to a member or a relative of the member using the resources of the fund.

Context for the arrangement

Under the superannuation laws, trustees of SMSFs are prohibited from lending money or providing financial assistance to a member or a relative of the member using the resources of the fund. The provision of a loan or financial assistance through another entity may also contravene these laws. Contravention of this provision may result in the SMSF becoming a non-complying superannuation fund for tax purposes i.e. subject to 45% tax rate on the market value of assets at the start of the income year that the fund becomes non-complying less undeducted contributions.

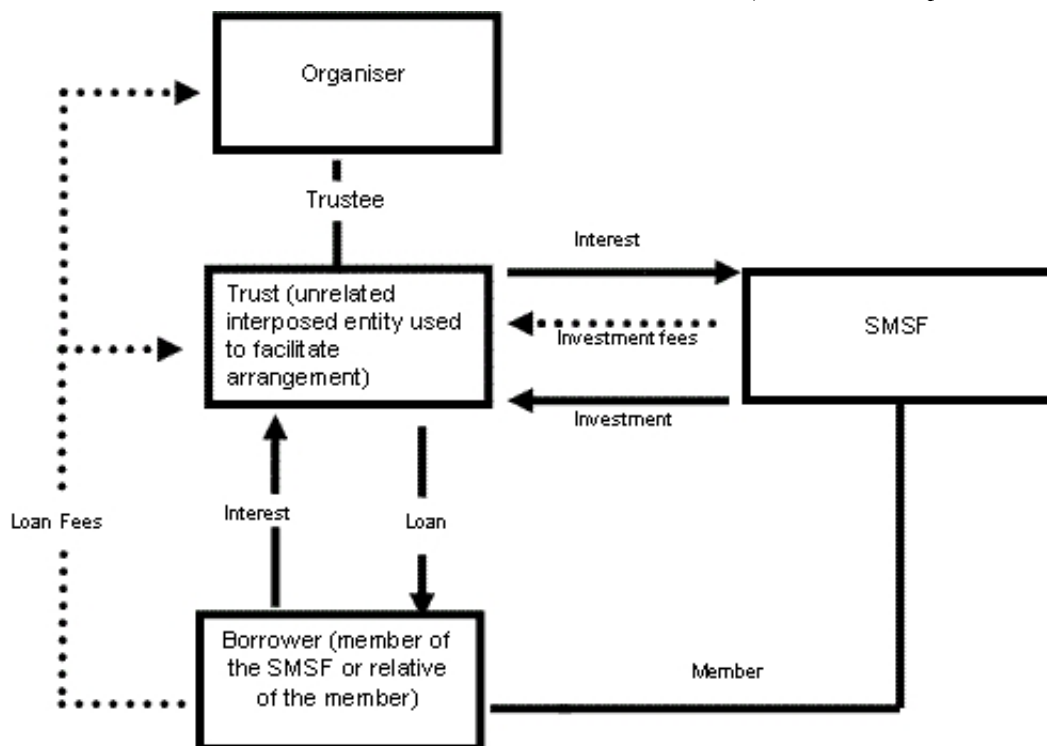
Description

This alert applies to arrangements with features that are substantially equivalent to the following:

1. An organiser sets up a trust ('the trust') which purports to offer fixed rate interest yielding investments to allegedly unrelated entities.
2. An SMSF invests in the trust.
3. The organiser (who may also be the trustee of the trust) or a licensee/franchisee of the organiser, sources borrowers ('the borrowers') to borrow funds from the trust.
4. The borrowers may include a member of the SMSF that invested in the trust or a relative of an SMSF member.
5. Each borrower enters into a loan agreement ('the loan') with the trust. The loan amount (or total loan amounts of all borrowers associated with the SMSF) may be comparable to the amount the SMSF invested in the trust.
6. Terms of the loan may include:
 - a. a range of available interest rates;
 - b. a range of interest payment terms, including flexibility in the repayment date (provided the funds are paid sometime in the future);
 - c. security over the loan in the form of a mortgage, personal guarantee or caveat; and/or
 - d. the use of borrowed funds for multiple purposes, including business, investment or personal use.
7. Each borrower makes interest only repayments on the loan to the trust for a substantial period of the loan.
8. The trustee of the trust pays the SMSF an interest yield on their purported investment.
9. Investment and loan fees payable under the arrangement may be considered excessive.

Diagram of arrangement

The basic structure of the arrangement can be summarised diagrammatically as follows:



Features which concern us

Superannuation regulatory issues

The ATO considers that arrangements of this type give rise to the following issues relevant to the application of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994*, being **whether** :

- a. the sole purpose test under section 62 of the SIS Act may have been breached e.g. where a purpose of the fund investment is to obtain a present day benefit for fund members or a related party, rather than for the purpose of providing retirement benefits for the members;
- b. the trustee of the SMSF may have breached section 65 of the SIS Act which prohibits a trustee or an investment manager of a regulated superannuation fund from lending money or giving any other financial assistance, using the resources of the fund, to a fund member or a relative of the member;
- c. members of the SMSF may have illegally accessed superannuation benefits if they do not repay the loan from the trust;
- d. the trustee of the SMSF may have contravened section 109 of the SIS Act which requires that SMSF investments are made and maintained on an arm's length basis;
- e. the SMSF's investment in the trust may be an in-house asset under section 71 of the SIS Act and therefore subject to the 5% limit; and
- f. section 85 of the SIS Act may apply to a person undertaking an arrangement where the arrangement artificially reduces the market value ratio of the SMSF's in-house assets to avoid application of the in-house asset restrictions.

Taxation issues

The ATO considers that arrangements of this type also give rise to the following issues relevant to taxation laws,

being **whether** :

- g.** income derived by the SMSF may be 'non-arm's length income' for the purposes of section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997) and therefore subject to a higher rate of tax;
- h.** payment of interest above the commercial rate by the SMSF member/a relative of the member to the trust, which is subsequently paid to the SMSF as an investment yield may in fact be superannuation contributions and therefore should be reported for excess contributions tax under Division 292 of the ITAA 1997;
- i.** any fee or commission received by the trust, licensee/franchisee and/or organiser of this arrangement may be assessable income for the relevant income year;
- j.** the borrowing expense incurred by the borrower (SMSF member or relative of a member) may be deductible under section 8-1 or section 25-25 of the ITAA 1997, and the extent to which it is deductible;
- k.** any investment fee purportedly incurred by the SMSF may be deductible under section 8-1 of the ITAA 1997 and the extent to which it may be so deductible;
- l.** the general anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply to all or part of the arrangement; and
- m.** any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953).

The ATO is currently examining these arrangements.

We have provided guidance to SMSF trustees on the issue of giving financial assistance using the resources of a self managed superannuation fund to a member or relative of a member in Self Managed Superannuation Funds Ruling SMSFR 2008/1.

- Note 1:** *An administrative penalty of 20 penalty units may apply to a trustee who makes a false or misleading statement to the Commissioner. If you have any information about the current arrangement, phone us on 13 10 20 . Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should also call us on 13 72 86 (and then key 3 and 4 for speed connection).*
- Note 2:** *Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where someone makes a false or misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 13 10 20. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should call us on 13 72 86 (and then key 3 and 4 for speed connection).*
- Note 3:** *Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the TAA 1953. At the time of this publication a penalty unit is \$110. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

Date of Issue: 21 October 2010

Date of Effect: 21 October 2010

Subject References:

Self-managed superannuation fund
Financial assistance
Sole purpose test
In-house asset
Non-arm's length income

Legislative References:

Superannuation Industry (Supervision) Act 1993
Section 62
Section 65
Section 71
Section 85
Section 109

Superannuation Industry (Supervision) Regulations 1994
Income Tax Assessment Act 1936
Part IVA
Income Tax Assessment Act 1997
8-1
25-25
Division 295
Taxation Administration Act 1953
Division 290 of Schedule 1

Related Practice Statements:

PS LA 2008/15

Related Rulings/Determinations:

SMSFR 2008/1

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Superannuation

SMSF Segment

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