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Ruling sends reminder to self-managed super funds

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A recent decision by the Administrative Appeals Tribunal has sent a harsh warning to people running their own self-managed super funds: get it right.

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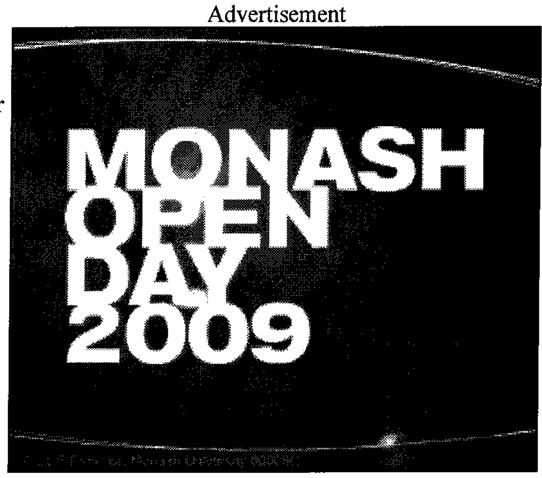

A couple have been penalised almost half the value of their fund's assets for breaching the in-house assets rule.
Most investors don't realise this, but you're not automatically entitled to tax breaks on your superannuation.

Those generous tax concessions are available only if your money is invested in a complying super fund.

Most funds manage to satisfy the regulators without too much angst. But if your fund is deemed non-complying, as occurred in this case, it can be like getting hit with a sledgehammer. Not only will your fund be taxed at the top marginal rate on its income, instead of the concessional tax rate of 15 per cent, but the assets within your fund will be taxed too effectively halving your retirement savings.

This stiff penalty comes about because if a complying fund becomes non-complying, its income for that year is deemed to include all its assets except for any undeducted contributions. So if you have a $1 million fund which is non-complying and contains no undeducted contributions, that 45 per cent top tax rate applies to the full $1 million. How's that for a fast way to blow your retirement lifestyle?

Understandably, the Tax Office has been loath to wield this stick for minor transgressions. If your fund does the wrong thing, the Tax Office can apply a range of penalties: from telling you to fix the problem, to administrative penalties, and disqualifying and/or prosecuting the fund's trustees.

In the case in question, it chose the higher penalty because of the severe nature of the breach and the time taken to rectify it after it was brought to the regulator's attention.

The case involved a couple of small-business people who also ran their own self-managed super fund. In 2004 their private company requested a loan from itsr super fund to help it through a difficult period, due in part to its normal banker refusing finance.

During this time, the trustee/company manager was suffering from chronic illness affecting his ability to run the business, the company's premises was damaged in a cyclone and there was a general downturn in trading in the region. Other parts of the family businesses were also experiencing financial problems.

A loan from the super fund was seen as a way of keeping the company out of administration.

But a loan like this falls under the definition of in-house assets in the superannuation rules. Specifically, in-house assets cannot comprise more than 5 per cent of the fund's assets. In this case, an agreement was made to lend the company up to $130,000 or almost all of the assets held by the fund.

A tribunal senior member, Margaret Carstairs, said the trustees admitted they were aware they were contravening the rules, but intended to repay the loan promptly.

As it turned out, that didn't happen.

In July 2007 the fund's auditor notified the Tax Office that the fund had breached the in-house assets rules and in July 2008 the fund was declared non-complying.

The couple had made two offers that year of enforceable undertakings to repay the loan, but both were knocked back by the Tax Office because the time frames were too far into the future.

The couple appealed the Tax Office's decision, but the tribunal found against them.

One of the arguments put forward by the couple was that, as a husband and wife team, all their business entities were effectively themselves. Carstairs said this showed "a less than full appreciation of their role as trustees of the fund, or of the sole purpose test set out in ... the act".

She said the seriousness of the contravention was also apparent in the fact that it had taken the couple more than four years to repay the loan after the initial breach of the act.

Even given their business activities, he said, they were able to pursue other investments and the undertakings they did offer came "much too late in the day".

The Tax Commissioner, Michael D'Ascenzo, said the decision was a reminder to trustees to act on any breaches. He stressed that the sole purpose of a self-managed super fund is to provide benefits for members in retirement and should not be used to invest in or help out related parties except for what is allowed within that 5 per cent in-house asset limit.

The decision comes as the Tax Office is stepping up its policing of self-managed funds, particularly in relation to in-house assets and related party transactions. These issues are still a major compliance focus for the regulator and among the most common breaches found in audits.

The regulator has recently issued rulings on in-house assets and related party transactions to help clarify the law and has warned trustees about arrangements being offered that try to circumvent the in-house assets rules to buy assets, particularly properties.

It said these arrangements typically used a paid third party to set up an agreement, sometimes referred to as "a joint venture agreement", between the fund and a related trust to purchase the asset. But the transaction is really an investment by the fund in the related trust.

The attitude that "it's all my money" is still common among self-managed fund investors. But this case is a tough lesson in just how dangerous that thinking can be.

This story was found at: ***http://www.theage.com.au/small-business/finance/ruling-sends-reminder-to-selfmanaged-super-funds-20090727-dy1v.html***