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Recent lessons in SMSFs and Notices of Compliance

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At the heart of the self-managed superannuation fund (SMSF) regime is whether the Commissioner will issue a Notice of Compliance.

In particular, pursuant to s 42A(5) of *Superannuation Industry (Supervision) Act 1993*, it must be the case that the Commissioner is satisfied that "no trustee of the entity contravened any of the regulatory provisions in relation to the entity during the year of income". This said, where there have been breaches, the Commissioner retains a wide discretion to take into account "all other relevant circumstances".

Before refusing to issue a Notice of Compliance however the Commissioner and must consider the tax consequences if the fund were to be treated as non-compliant and the seriousness of the contraventions. The tax consequences can be particularly punitive, namely the market value of the assets of the SMSF, less non-concessional contributions, are taxed at 45% in each year of contravention.

Coronica

The decision in *Coronica and FCT* [2021] AATA 745 (see 2021 WTB 14 [281]) is an example in this area, involving breaches such as:

- s 66(1): prohibition on a trustee intentionally acquiring an asset from a related party;
- s 83: restrictions on the acquisition of in-house assets if the ratio of in-house assets to total assets exceeds 5%;
- entering into transactions not at market value (as defined under s 10);
- contraventions of the accounting record keeping requirements, via the operation of a "suspense account" (s 35A and s 65, which prevent the provision of financial assistance), despite the trustee arguing the approach was supported by TD 2013/22, ATO ID 2012/16, APRA SMSF Regulator's Bulletin 2018/1 and ATOID 2015/21;
- contravention of the sole purpose test (s 62) and the covenants prescribed in s 52 to keep the money and other assets of the SMSF separate from "those (assets) that are held by the trustee personally";
- breach of regulations regarding contributions mandated by s 34.

The decision confirmed that in the circumstances it would be inconsistent with the objects of SIS to issue a Notice of Compliance. Thus the fund was held to be non-compliant and taxed at the penalty rate of 45%.

Some of the issues that supported this conclusion, in addition to those outlined above, were listed as follows, the seriousness of which were amplified by the trustee being an experienced accountant (of more than 50 years), registered tax practitioner and registered company auditor:

1. multiple contraventions over an extended period of time;
2. implementation by an experienced accountant, registered tax agent and registered company auditor, who ought to have known that the arrangements constituted contraventions of SIS;
3. breaches of the provisions of the trust deed;
4. lodgement of misleading documents with the ATO;
5. reliance on undocumented valuation of a private investment company that, while not wilful, was grossly negligent if not incompetent; and
6. the contravention in (5) was not corrected within amnesty periods made public by the Tax Office and instead only corrected well after an audit activities had concluded.

Driscoll

More recently, in *Driscoll and FCT* [2021] AATA 3892, a similar conclusion was reached.

In this case, a sole member SMSF:

- failed to lodge returns within the required time limits;
- invested a substantial percentage of the SMSF's assets in purchasing a "Signature Collection" of books which were described as a Limited Edition 18 volume set of "The Basics of Dianetics and Scientology" by L Ron Hubbard (for $11,000);
- otherwise treated the SMSF bank account as the personal account of the member, including to pay for the member to attend a "Havingness Rundown" course conducted by the Church of Scientology.

In deciding the Commissioner was correct to refuse to issue a Notice of Compliance, the following was confirmed.

- The centrepiece of the superannuation regime is the sole purpose test under s 62 of the SIS Act, namely that SMSFs must be maintained for one or more "core purposes" or "ancillary purposes".
- Despite the 18 volume book set being stored in the member's bedroom, and being unable to be sold (despite attempts to do so), the set was kept in its original packaging (and not ever used by the member). It was therefore determined that it was a permissible investment, although not "a particularly good" one.
- The failure of the SMSF to lodge the tax returns were clearly contraventions, however the consequences of the late lodgement were held to not have created any prejudice to anyone.
- The use of the SMSF for personal benefit was however considered a serious matter, and antithetical to the core objects of SIS; thus this conduct wholly justified the Commissioner's refusal to issue a Notice of Compliance.

This conclusion was reinforced by the fact that the withholding of a Notice of Compliance is a tool for the Commissioner in deterring, specifically and generally, people from using superannuation monies for personal purposes. The level of seriousness placed on the deterrence device is further highlighted by the fact that the SIS permits the Commissioner to impose maximum penalties (in addition to the 45% tax impost) of over $530,000 for those involved in contraventions.

Conclusion

The role of trusteeship of any entity is one the courts have regularly highlighted as one that requires conduct of the highest standards.

In relation to SMSFs, the expectations of trustees, based on recent decisions, are clearly heightened by the legislative obligations also imposed.

The new Subdiv 328-G rollovers (**the provisions**) commencing 1 July 2016 provide significant opportunities for Small Business Entities (**SBE**) to restructure into a more appropriate entity, assuming the "genuine restructure" provisions can be satisfied. While the restructure requirements have been reported previously (see 2016 WTB 7 [180]), this article considers a number of opportunities to restructure discretionary trusts. In particular:

- trust cloning with or without a Family Trust Election (**FTE**);
- trust splitting and effectively limiting the range of potential beneficiaries without causing a resettlement; and
- restructuring out of trusts with heritage issues.

The new rollovers were introduced via the *Tax Laws Amendment (Small Business Restructure Roll-Over) Bill 2016* (reported at 2016 WTB 5 [127]) which passed all stages without amendment and received Royal Assent on 8 March 2016.

Ultimate Economic Ownership (UEO) and cloning

Section 328-430(1)(c) requires the UEO of assets being transferred remain the same, or in the same proportion after the restructure. While this is relatively simple for companies or sole-traders, it presents difficulties for trusts, where beneficiaries do not have a direct and absolute interest in the assets of the trust (merely a right to due administration).

As previously discussed by John Middleton (see 2015 WTB 49 [1774]), trust cloning of discretionary trusts is again available following its abolition on 31 October 2008 through the provisions without causing any CGT consequences. Where a trust makes (or has previously made) an FTE pursuant to Sch 2F of the ITAA 1936, the provisions ensure (under s 328-440) access to the roll-over if the cloned trust has made the same FTE.

Historically, the Tax Office had set out its view of how to implement a valid trust clone for tax purposes in the (now withdrawn) Taxation Ruling TR 2006/4.

Although not free from controversy, the Tax Office was of the view that in order to implement a valid trust clone, it was necessary for the "beneficiaries and terms of both trusts (to be) the same".

In this context, the position of the Tax Office was that any FTE made by the original trust would need to be made by the cloned trust in order to gain access to the tax concession