

Beware of tax impost on income from a trust

by Keeli Cambourne, Deputy Editor, SMSF Adviser and Matthew Burgess, Director, View Legal

Any income derived by an SMSF as a beneficiary of a trust can be subject to penalty tax, warns a legal specialist.

Matthew Burgess, director of View Legal, said SMSF trustees should be mindful, in particular, that income earned other than through holding a fixed entitlement, is non-arm's length income and will be taxed according to the NALI provisions of the Income Tax Assessment Act at a flat rate of 47 per cent.

"Income derived by a superannuation fund as a beneficiary of a fixed trust will also be non-arm's length income if the fund acquired the entitlement under a scheme, or the income was derived under a scheme, the parties to which were not dealing with each other at arm's length," Burgess said.

"Additionally, it will also be classified as NALI if the amount of the income is more than the amount that the fund might have been expected to derive if those parties had been dealing at arm's length."

Burgess said for an SMSF to avoid the impact of the NALI rules it is vital to ensure that first, no distributions are made to an SMSF from a discretionary trust, and second, where an SMSF owns units in a unit trust, the unit trust is a fixed trust for tax purposes.

"From a planning perspective, given the Medicare levy and other surcharges, there may be a saving on overall tax payable by triggering the non-arm's length income rules by, for example, distributing from a family trust to an SMSF and capping the tax rate at 47 per cent," Burgess said.

"It is also relevant to note that the non-arm's length income rules may apply where an SMSF allows its fixed entitlement to remain as an unpaid present entitlement, as this generally does not reflect an arm's length arrangement."

He said when allowing unpaid present trust entitlements in favour of an SMSF, it is necessary to ensure that interest on those unpaid distributions is paid by the trust at market rates as would be the case if the SMSF and trust were dealing with each other at arm's length.