

Pre-1999 super transitional provisions - ATO alert

By Dhiwakaran Sathananthan, Lawyer & Luis Batalha, Director

27 April 2009

In the recently released *Taxpayer Alert TA 2009/8*, the ATO issued a warning that certain arrangements involving the transfer of benefits associated with the pre-1999 transitional provisions regarding SMSFs with pre-existing interests in related unit trusts may cause the fund to be non-complying.

Background

The in-house assets of an SMSF are limited to less than 5% of the total market value of the fund's assets (sections 71 and 83 of the *Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act)*). In 1999, the law was amended to include investments in related trusts as in-house.

However, transitional provisions were also included in the new provisions to ensure that prior investments held in trusts were not immediately affected. These transitional provisions applied to SMSFs registered before 11 August 1999 (**pre-1999 SMSFs**). The transitional period, however, ends soon on 30 June 2009 (section 71A of the SIS Act).

Scheme

The ATO is concerned with recent arrangements being promoted involving the sale of inactive pre-1999 SMSFs that hold an interest in a related trust. Basically, a fee is paid to an organiser to gain control or membership in an inactive pre-1999 SMSF. The

organiser then changes the composition of the fund to give control to the fee payer by changing the member, trustee and/or the director of the fund. The investment strategy of the fund may also be updated to attempt to comply with other superannuation laws.

In order to exploit the benefits of pre-1999 SMSFs, the new member(s) make contributions and/or rollover existing benefits held in a complying fund(s) into the pre-1999 SMSF. Later, the funds are invested in the related unit trust which may include paying up partly paid up units or applying the funds to existing units to facilitate the purchase of real property.

These pre-1999 SMSFs which are registered with a nominal contribution may be inactive due to any of the following reasons:

- no active members
- not received any subsequent contributions
- not made any investments, or
- been continuously maintained for providing superannuation benefits to members on retirement.

Under the scheme, the seller typically advertises that the arrangement is compliant with the pre-1999 transitional provisions, alleging tax and superannuation benefits such as the following:

- allowing ownership of a residential property through the pre-1999 SMSF and gearing through a related trust. The property can subsequently be leased to a related party
- deducting interest expenses which may not be deductible to other parties such as private or domestic expenses of a member of the SMSF, or expenses incurred in producing exempt income of the SMSF, and
- reducing or avoiding CGT on property held through the related unit trust due to lower taxes payable by the SMSF.

Basically, the scheme purports to circumvent the regulatory restrictions such as the in-

house asset rule which would normally result in the SMSF's income or capital gains being subject to higher rates of tax. The organisers of such schemes claim substantial fees for the alleged future commercial benefits.

ATO concerns

The following are the ATO's concerns regarding the scheme:

- whether the inactive pre-1999 SMSFs meet the definition of a 'superannuation fund' before and/or after implementation of the arrangement
- if the transitional provisions apply after the exit of the original members
- whether there is a breach of the anti-avoidance provisions in section 85 of the SIS Act
- if the interest expense incurred by the related unit trust is deductible under section 8-1 of the ITAA 1997
- whether any CGT concessions apply to complying superannuation funds
- any fee or commission paid is deductible to the Australian taxpayer for the relevant income year
- if the anti-avoidance provisions in Part IVA of the ITAA 1936 applies
- if any fee or commission received by the organiser(s) of this arrangement constitutes assessable income for the relevant income year, and
- if any entity involved in such an arrangement may be considered to be a promoter of a tax exploitation scheme within Division 290 of Schedule 1 to the TAA 1953.

Conclusion

The ATO's alert warns Australian taxpayers to the dangers of investing in potentially non-complying SMSFs. The pre-1999 transitional provisions were only intended to apply to the initial members in such pre-1999 SMSFs. Accordingly, it is advisable to avoid such arrangements and their promoters. Whilst the Alert does not represent the ATO's final determination on the issues, it does represent its considered view. Thus, those who are engaged in such a scheme or one that is similar may be liable to penalties for breach super law, avoiding tax and/or promoting tax avoidance schemes.