

Aggressive tax planning – what attracts the ATO's attention?

Another concern for breaches of the Sole Purpose Test is where the ATO believes individuals are deliberately using 'aggressive tax planning' in order to obtain present-day benefits or to gain inappropriate access to tax concessions.

SMSF trustees should be aware that the ATO is exchanging information with other federal and state government agencies to determine what they regard as 'aggressive tax planning', and they will act against people and organisations promoting unacceptable arrangements and schemes.

Further, it should be noted that SMSFs are one of the ATO's main targets for this type of activity.

What is 'aggressive tax planning'?

The ATO regards this as a situation that entails artificial and contrived arrangements that are designed to avoid tax or deliver a tax benefit.

Trustees and advisers utilising SMSFs to inappropriately access tax concessions, or to deliver present-day benefits should be on notice that the ATO will deal with such arrangements using the full force of the law.

Moreover, the income tax and regulatory issues associated with these arrangements will not be treated in isolation. Trustees engaging in tax-minimisation schemes also face the strong likelihood of being disqualified from being an SMSF trustee.

Dividend stripping arrangements

Dividend stripping arrangements are an example of what the ATO regards as an aggressive tax planning arrangement. These quite often involve SMSFs, and as a result see a high level of ATO scrutiny when identified.

These arrangements are generally put into place where a private company has significant previously taxed profits which could be paid to shareholders as franked dividends (these would ordinarily be subject to 'top-up' tax at the individual shareholder's marginal rate).

A shareholder in the company transfers their shares in the company to an SMSF of which the shareholder or their associate is a member. The trustee of the SMSF treats the shares as supporting the payment of pensions to the member(s) of the SMSF. With the income of an SMSF in pension phase being untaxed, all or part of the income from the shares is then exempt from paying tax in the SMSF.

After the SMSF has satisfied the "45-day holding period rule", the company distributes its accumulated profits to the SMSF as fully or partially franked dividends. The SMSF trustee treats the franked dividends and the attached franking credits as exempt income, entitling the SMSF to a refund of the unused franking credit tax offsets. The company is placed into liquidation and/or deregistered after the value of the shares is reduced to nil by the payment of the franked dividends.

The ATO's view of the dividend stripping arrangements they have detected and identified so far is that none are effective at law. Such an arrangement would also be called into question from the aspect of being a related party transaction, and whether or not the action taken was, in fact, a breach.

Because of this, use of such an arrangement would be viewed as a breach that could have severe impact on your retirement savings.

As with any strategy to do with your SMSF, please be sure to seek professional advice before taking any action.

Breach of 'Sole Purpose Test' still a major concern

According to the ATO, SMSFs not meeting the 'Sole Purpose Test' accounts for approximately 8% of the contravention reports received.

The 'Sole Purpose Test' provides that a regulated superannuation fund must be maintained for the purposes of providing retirement benefits to members, or for earlier payments due to the death or disability of the member.

A breach of the 'Sole Purpose Test' essentially happens if a member of a fund receives a benefit from their superannuation prior to being eligible. It should be noted though that a benefit does not necessarily mean taking money from the fund before retirement.

An example of receiving a 'benefit' from an SMSF would be buying a holiday house, and then the member using that property for a vacation for a few months each year, but does not pay rent to the SMSF for its use.

Another common example of a breach of the sole purpose is where an SMSF owns a business real property, and this property is leased to the member's business for an amount of rent that is below what would be available in the market.

An important aspect of the test is that the key is intention rather than outcome. Effectively, this relates to the initial decision as to why a particular asset will be included in the SMSF.

As however it is difficult to prove intention, in determining whether an asset meets the sole purpose test, the outcome often provides the only visible evidence of what the intention might have been.

For this reason, where an investment is to be included in an SMSF that would not be considered 'mainstream' (shares, bank deposits, etc.) it is important to document the rationale for inclusion of a particular investment.

This would be best placed in the fund investment strategy, the document that outlines how an SMSF will invest. While this would normally cover investment 'asset classes', treatment of specific investments can also be included, and is viewed by some as being 'best practice' where the inclusion of any investment that might be viewed as possibly contravening the 'Sole Purpose Test'.

If you have concerns about whether any of your fund assets might be in breach of the 'Sole Purpose Test' please contact our office to make an appointment to discuss your situation.

New standards for artwork and collectibles in full force from 1 July 2016

To ensure compliance with the 'Sole Purpose Test', the government introduced stricter guidelines relating to artwork and other collectibles held in an SMSF.

On 1 July 2011, a new set of guidelines was given to direct how artwork and collectibles purchased by an SMSF were to be treated. This included measures such as:

- Where artwork and collectibles were to be displayed and/or stored;
- That they were to be insured; and
- They must be independently valued.

For collectibles held before 1 July 2011, a five year period was provided to fall in line with these guidelines.

This transition period finishes on 30 June 2016 – in three months' time.

The main reason for the introduction of these measures has been to prevent SMSF trustees receiving a personal benefit from the SMSF investment.

If your SMSF includes any of the following types of assets, you will need to review your arrangements for display, insurance and valuation:

- jewellery;
- antiques;
- artefacts;
- coins, medallions or bank notes;
- postage stamps or first day covers;
- rare folios, manuscripts or books;
- memorabilia;
- wine or spirits;
- motor vehicles;
- recreational boats; or
- memberships of sporting or social clubs.

If you believe you have any of these type of assets as part of your SMSF, please make contact to review your arrangements to ensure compliance by 30 June, 2016.

