NTAA

ADVICE

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'Loans' involving illegal access to super held to be shams

The Full Federal Court has recently confirmed that loan transactions entered into by husband and wife taxpayers (involving moneys being withdrawn from their superannuation fund) were shams.

The dispute in question centred on where the balance of the money for the purchase of an apartment by husband and wife taxpayers came from. The taxpayers argued that they received a $600,000 loan from a bank, and that it was a condition of the loan that the taxpayers would 'deposit' an equivalent $600,000 with this bank. On the advice of their accountant, they transferred $600,000 from their superannuation fund to the bank and the bank transferred the funds to a solicitor's trust account.

The Commissioner held that the arrangement between the taxpayers and the bank was a sham, and that the loan documents disguised the fact that the taxpayers had accessed their superannuation moneys without permission in order to purchase the apartment.

In dismissing the taxpayers' appeal, the majority of the Full Federal Court found that the taxpayers had failed to discharge their responsibility of proving that the loans were not a sham. Further, that the existence of a sham could not be rebutted by evidence of the subjective intentions of the parties alone in the circumstances.

The issue of whether the taxpayers had met their burden of proof that the transactions were not shams also depended upon establishing that they had actually entered into loan agreements. It was necessary for the taxpayers to at least establish that they had entered into a legally effective loan (in order to rebut the sham intention), and not merely that they believed their accountant had done so by way of accepting the arrangement he had put in place for them.

There were serious discrepancies between what was said in the loan documents and what actually happened, and therefore the taxpayers could not rely on the transaction documents alone to prove that they did not have a 'shamming intention'.

Any SMSF members considering making use of such a scheme would benefit from a warning of the ramifications of such actions.

Refer *Millar v FCT* [2016] FCAFC 94.

ATO warning regarding SMSFs and buy-sell agreements

The ATO has recently updated a previously published case study to clarify its view about buy-sell agreements ('BSAs'). This update is set out below.

John and his wife Robin are the only members of an SMSF. John and his sister Kate own and run a separate company. John and Kate enter into a BSA where the SMSF buys a life insurance policy covering John's life with the insured amount based on an agreed market value of his interest in the company. The company makes contributions that are allocated to his member account. Under the terms of the BSA, these amounts are used to pay the premiums on the policy.

If John dies, the terms of the insurance policy stipulate:

- the proceeds are paid to the SMSF and added to his benefits;
- all of his benefits are paid to Robin; and
- his shareholding in the company is transferred to Kate and Robin relinquishes all claims on his shareholding in the company.

The fund has been utilised by an external agreement which effectively relieves Kate from providing money to pay premiums and, in the event of John's death, from having to fund the purchase of his share of the company.

Significantly, the policy can only be purchased in accordance with the terms of the BSA.

The ATO says that under this type of arrangement, the fund would breach the sole purpose test (refer S.62 of the Superannuation Industry (Supervision) Act 1993 (SIS Act)).

The terms of the BSA also allow Kate to obtain total ownership and control of the company upon John's death, without the need to pay any consideration either in the way of insurance premiums or as a direct sum to Robin for her expected inherited share of the company.

Also, because some of the benefits of the arrangement flow to Kate, financial assistance has been provided to a relative of a member of the SMSF (in breach of S.65 of the SIS Act).

While the ATO says a BSA on its own generally will not result in a breach of the sole purpose test, it nevertheless recommends that anyone that has entered into an agreement of this type seek independent professional advice.

For those clients with large amounts of life insurance in their SMSF who also own and operate a small to medium business enterprise, whether or not the insurance is funding a BSA should be a point of discussion with them at their regular review, and alerting them to this situation.

SMSF trustee incurs penalties for serious contraventions

In a recent decision, the Federal Court has imposed penalties for serious contraventions by a trustee of an SMSF, mainly in relation to making unauthorised withdrawals.

By way of background, the SMSF in question was established in February 2005, with the initial trustees being the respondent and his wife.

During the relevant period (from shortly after the fund was established until January 2012), the respondent made unauthorised withdrawals from the SMSF on many occasions, totalling over $200,000, although some repayments were also made to the SMSF. The withdrawals were generally made for the respondent's personal use and benefit.

The SMSF's auditor issued a qualified audit report in September 2012 for the 2010/2011-income year, and also lodged an Audit Contravention Report. In February 2013, the respondent was notified by the ATO that the fund had been selected for audit for the period 1 July 2005 to 30 June 2011.

The Court held that the following contraventions of the Superannuation Industry (Supervision) Act (SIS Act) had occurred:

- in making the loans and giving financial assistance, the respondent failed to ensure that the fund:
  - (a) was maintained solely for one or more of the purposes prescribed in S.62(1); and
  - (b) did not lend money or give any other financial assistance using the resources of the fund to a member in contravention of S.65(1); and
- the respondent, as trustee, failed to prepare a written plan specifying: the amount by which the in-house assets of the fund exceeded the market value ratio of 5% at the end of each income year; and the steps by which the trustee proposed to dispose of the in-house assets equal to or greater than the excess amount in contravention of S.82.

The Court took into account the respondent's cooperativeness with the ATO and others, and accepted that the respondent was contrite and apologetic, and was a person of good character. The Court also noted that it appeared from a psychological report that the respondent was a troubled person at the time of the contraventions.

In the circumstances, the Court imposed a monetary penalty of $40,000, and the respondent was barred from acting as a trustee.

Refer *DC of T v Rodriguez* [2016] FCA 860.

SCT decision regarding death benefit upheld

A decision made by the Superannuation Complaints Tribunal (SCT), to set aside a trustee's determination to pay a death benefit to the deceased's legal personal representative, has been upheld by the Federal Court.

The SCT's original ruling, to instead pay that benefit to the deceased member's de facto spouse was held by the Court to be correct.

By way of background, the applicant was the legal personal representative of her deceased daughter ('the deceased'), who died on 22 April 2011. The deceased was a member of a non-self managed superannuation fund.

The respondent contended that the time leading up to her death he had been living with the deceased in a relationship. However, the fund's trustee did not accept this, and determined to pay all of the deceased's death benefit to the applicant.

On application by the respondent, the SCT focussed on whether the deceased and the respondent had terminated their relationship before the deceased's death. The SCT subsequently set aside the trustee's decision and determined that all of the death benefit should be paid to the respondent.

On appeal by the applicant, the Court found that the SCT had recognised that it must determine whether the trustee's decision to pay all of the deceased's superannuation benefits to the applicant was fair and reasonable in relation to the respondent in the circumstances.

The Court noted that the SCT took into account that prior to the deceased's death, the deceased had lived with the respondent for at least three years on a genuine domestic basis as a couple. Accordingly, the respondent had been the deceased's spouse and, therefore, her sole dependant.

The SCT had concluded it was more likely than not that the trustee would have elected to pay all of the deceased's superannuation benefit to the respondent.

In upholding the SCT's decision, the Court said that the SCT had the power to determine that the respondent was the de facto of the deceased, and there was sufficient evidence to support this. The SCT could then determine that the trustee should distribute all of the deceased's superannuation benefit to the respondent.

While we note that this decision is relevant for all superannuation funds, it should also be noted that SMSFs do not have access to the SCT.

It is for this reason that it is important for those in an SMSF to ensure that they have clear direction for the payment of death benefits.

Refer *Ievers v Superannuation Complaints Tribunal* [2016] FCA 936.