1. ACQUISITION & DISPOSAL OF CERTAIN ASSETS BETWEEN RELATED PARTIES

(Referred to as “Off-market Transfers” Rules)

Background

The Government released an Exposure Draft for public comment in January 2013 for new legislation concerning the acquisition and disposal of certain assets between a SMSF and related parties.

The Bill to include these measures was incorporated in Tax & Superannuation Laws Amendment (2013 Measures No 1) Bill 2013 which was introduced into the House of Representatives in February 2013, but the Bill in its final format did not gain royal assent until 28th June 2013.

However, the final Act when finally passed did not include Schedule 4 of the Bill, which detailed the proposed amendments concerning the changes to Section 66 of SIS Act.

New Rules proposed

Schedule 4 of the original Bill was to

- amend the existing prohibition of funds acquiring assets from related parties so that it applies to all regulated superannuation funds other than SMSF’s
- introduce a specific prohibition against trustees of SMSF acquiring assets from related parties, subject to certain exceptions
- introduce new rules for SMSF when disposing of assets to related parties
- introduce a new prohibition on schemes which would avoid the operation of these new rules regulating SMSF related party transactions, and
- introduce administrative and civil penalties for breaching the new rules

New concepts included:

- Use of underlying market if one available, i.e. no off market transfers if a market exists
- If no underlying market available, market value determined by appropriately qualified independent valuer
- Rules that applied to acquisitions, similarly were to apply to disposals of assets to related parties

So what are we left with?

With the proposed changes being omitted from the Act, then by default the old provisions will simply continue to apply:

As you will be aware the old provisions simply provide

Section 66 SIS Act

(1) Prohibition – a trustee of a regulated superannuation fund must not intentionally acquire an asset from a related party.

(2) Exceptions re acquisitions: prohibition not apply if:

a. Asset is a listed security acquired at market value, or
If SMSF or Small APRA fund, the asset is Business Real Property acquired at market value, or

Asset is acquired under a merger between regulated superannuation funds, or

Asset is of a kind that the regulator has determined that maybe acquired, or

Asset is an in-house asset that is acquired at market value and the acquisition would not result in a breach of the level of in-house assets.

**Intentionally Acquire an Asset**

In order to provide clarity around the phrases what is “intentionally” acquired and to “acquire an asset” the ATO released SMSFR 2010/1.

The ruling provides that to contravene the Act, must ‘acquire an asset’.

- Asset is defined in Section 10(1) of SIS, and means ‘any form of property’, but money is specifically excluded in Section 66(5).
- Property is not defined in SIS, and therefore takes on its ordinary meaning to include all forms of property, including rights, interest or thing of value that is capable of legal ownership and encompasses real or personal property.
- ‘Acquire’ not only encompasses purchase but also the concept of acquisition for no consideration through in-specie contributions, or for consideration less than market value, etc.

**S 66(2) (a) - Acquiring Listed Securities**

*Listed security* is defined in Section 66(5) and means a security listed for quotation in the official list of any of the following:

- A licensed market within the meaning of Section 761A of the Corporations Act 2001, or
- An approved stock exchange within the meaning of ITAA 1997, or
- A market exempted under Section 791C of Corporations Act 2001

**Acquiring Business Real Property**

A SMSF or small APRA fund can acquire business real property from a related party at market value without breach of in-house levels.

Section 66(5) defines Business real property:

- Any freehold or leasehold interest of the entity in real property, or
- Any interest of the entity in Crown Land, other than a leasehold interest, being an interest that is capable of assignment or transfer, or
- If another class of interest in relation to real property, as prescribed by the regulations that is held by the entity

Where the real property is used wholly and exclusively in one or more businesses, but not necessarily by that entity, but does not include any interest held in the capacity of beneficiary of a trust estate.
Again in order to provide some clarity, the ATO issued SMSFR 2009/1 to detail what is meant by Business Real Property for the purposes of SIS.

Principally, it provides for 2 basic conditions:

- The entity must hold an eligible interest in real property, as identified in the definition, and
- The underlying land must satisfy the business use test definition, i.e. to be used wholly and exclusively in one or more businesses carried on by an entity.

Mergers & Special determinations

A further exception includes acquiring an asset from a related party where

- The asset is acquired for the benefit of a particular member of the acquiring fund by way of a transfer or roll-over from another regulated superannuation fund, and
- The asset represents the whole or part of either:
  - The member’s own interest in the transferor fund, or
  - The member’s entitlement as determined under Pt VIIIIB of the Family Law Act 1975 in relation to the interests of the member’s spouse or former spouse in the transferor fund, and
- The transfer or roll-over as a result of that member’s marriage breakdown

Purchase of “In-house” Assets

Section 66(2A) provides an exception which simply provides the link between the prohibition on acquiring assets from related parties and the in-house asset provisions which allow a percentage of fund assets to be invested in, lent or leased to related parties.

- The acquisition of the asset constitutes an investment that:
  - Is an in-house asset of the fund within the meaning of Section 71(1) or
  - Would be an in-house asset of the fund within the meaning of Section 71(1) apart from the operation of Subdivisions of Part 8, or
  - Is a life insurance policy issued by life insurance company other than a policy acquired from a member or relative of member of the fund
- Is acquired at market value, and
- The acquisition of the asset would not result in the level of in-house assets of the superannuation fund exceeding the level permitted by Part 8, i.e. 5%.

Collectables

Whilst addressing transfer of assets between related parties, probably appropriate to raise a reminder on collectables. Whilst the provisions governing collectables was quarantined from the proposed off-market provisions, it is a timely reminder that some funds will need to remove certain assets by 30 June 2016.

Applicable assets that require attention are Collectables and certain personal use assets.

Section 62A specifies the assets that are taken to be collectables and personal use assets, and include:
(a) artwork (within the meaning of the *Income Tax Assessment Act 1997*); or

(b) jewellery; or

(c) antiques; or

(d) artefacts; or

(e) coins or medallions; or

(f) postage stamps or first day covers; or

(g) rare folios, manuscripts or books; or

(h) memorabilia; or

(i) wine; or

(j) cars; or

(k) recreational boats; or

(l) memberships of sporting or social clubs; or

(m) assets of a particular kind, if assets of that kind are ordinarily used or kept mainly for personal use or enjoyment (not including land).

**Transitional Arrangements**

If a fund owned a collectable or personal use asset prior to 1 July 2011, they have until 1 July 2016 to dispose of that asset.

It is possible to sell the applicable asset to a related party, provided

- the sale is at market value, and
- is determined by a qualified independent valuer

If sell pre 1 July asset 2011, but sells after 1 July 2016, new rules apply

If sell pre 1 July 2011 asset prior to 1 July 2016, the transaction does not need to be supported by a valuation from an independent valuer, but must still have taken place on an “arm’s length” basis.
2. NEW SMSF PENALTY REGIME

An outcome of the Super System Review was that whilst the majority of SMSF Trustees seek to manage their funds correctly, with the vast size of the industry, there will be a proportion that disregards the rules.

As the ATO is responsible for regulation of SMSF’s, the SIS Act provides little alternatives to apply effective, flexible, and proportionate measures against non-compliance.

Currently, the ATO’s tools are limited to:

- making an SMSF non-complying for tax purposes
- applying to a court for civil penalties to be imposed, or sometimes criminal penalties for serious breaches
- accepting an enforceable undertaking in relation to a contravention, and
- disqualifying a trustee of an SMSF

Proposed New Laws

In response to the Super System Review, the Government introduced a Bill, *Superannuation Legislation Amendment (Reducing Illegal Early Release and Other Measures) Bill 2012*, which incorporated administrative consequences for contraventions relating to SMSF’s including:

- The power to give rectification directions and education directions, and
- Impose administrative penalties for certain contraventions

Key Points

- The Bill defines:
  - What is a Rectification Directive
  - What is an Educational Directive
- The new regime affects both current SMSF’s, plus those that ceased to be SMSF’s for the purposes of the SIS Act
- Impose administrative penalties, for certain prescribed contraventions
- Ensures that the costs incurred from either the directives or the penalties are borne by the Trustee, not the fund

(a) Directions

The Bill provides that the Regulator can impose Directions to a person who has contravened a provision of the Act, other than those in Part 3B, i.e. the superannuation and data payment regulations and standards.

(i) Rectification Directives

Currently, rectifying contraventions occur through the enforceable undertaking process under Section 262A SIS Act. The issue though with them is that they rely on the offender initiating the application, and the regulator either accepting or declining it.

If not adhered to, then the regulator must apply to the Courts to have the undertaking enforced.
The Bill provides that a *Rectification Directive* may be given to a trustee or director of an SMSF who has contravened either the SIS Act or SIS Regulations.

A *Rectification Directive* can be given to the following who have contravened the SIS Act or SIS Regulations:

- An individual trustee
- A body corporate that is a trustee of an SMSF, and/or
- A director of a body corporate trustee of an SMSF.

A rectification directive is

- A written direction issued by the regulator requiring the person to
- take a specified action to rectify the contravention, and
- provide the regulator with evidence of compliance with the direction
- will specify the period within which person must comply by

In deciding whether to give a rectification directive, the regulator must give regard to:

- Any financial detriment that might be expected to be suffered by the fund as a result of complying with the directions, and
- The nature and seriousness of the contravention, and
- Any other relevant circumstances

Issues the regulator may consider could include:

- If financial impact to members, would some other pecuniary compliance mechanisms be more appropriate
- The provision contravened, and the nature of the contravention,
- The behaviour and circumstances of the person, including history of compliance
- Value of assets involved
- Whether a rectification direction is appropriate versus issuing non-compliance notice under Section 40 SIS Act

The regulator cannot give a rectification directive in relation to a contravention if:

- The regulator has already accepted an enforceable undertaking per Section 262A from that person, and
- The contravention is covered by that undertaking, and
- The undertaking is still current in respect to that contravention

A person, who fails to comply with a rectification direction, commits an offence of “strict liability” equivalent to 10 penalty points. “Strict Liability” is defined in the Criminal Code Act 1995, and relates to a lack of action.
(ii) **Education Directives**

Similarly to rectification directives, education directives can be issued to a person who is a Trustee or Director of a body corporate that is Trustee of an SMSF.

An education directive is:

- A written direction to undertake a specified approved course of education
- Provide the regulator with evidence of completion of course
- Will specify the period within which the person must comply

Similarly to above, a person who fails to comply with an education direction commits an offence of “strict liability” equivalent to 10 penalty points. “Strict Liability” is defined in the Criminal Code Act 1995, and relates to a lack of action.

**Approved Education Courses**

The Bill includes a process for approving education courses for the education directives.

- Courses can be provided by the regulator or others, and
- Must be a course for which no fees are charged for persons undertaking the course as a result of an education directive.

An approved course is designed to improve the knowledge of persons for compliance, not to impose further monetary penalties. It is considered that other sanctions such as the administrative penalties are sufficient monetary penalties.

The Bill also states that any costs associated with the course, such as travel, etc, cannot be borne by the fund.

**Review Rights**

The Bill also provides for certain rights to vary or revoke either a rectification or educational directive.

Variations or revocations can be

- Regulator initiated, or
- On written request from a person, before the end of the period specified in the direction. Request must set out reasons for the request.

If the Regulator does not decide within 28 days of receipt of request, then it is deemed that the regulator has refused the request.

If the regulator decides before 28 days, then must

- Notify person of decision, and
- If to vary, give person copy of varied direction, and
- If refuse request, give the person written reasons for the decision
**Taxation Objection**

A person, who is dissatisfied with a decision of the regulator under the review process as set out above, may object to the decision in the manner set out in Part IVC of the Taxation Administration Act 1953.

**(b) Administrative Penalties**

The Bill also introduces the option for the regulator to impose a series of administrative penalties on a person who has a contravened a specified provision of the SIS Act or SIS Regulation.

A person on whom an administrative penalty maybe imposed on is:

- A trustee of an SMSF (either individual or body corporate), or
- A director of a body corporate that is a trustee of an SMSF

If a person contravenes a provision specified in the table, the penalty is the amount specified in the table.

The value of the penalty units, is specified in Section 4AA of the Crimes Act 1914, which is currently $170 per unit

<table>
<thead>
<tr>
<th>Item</th>
<th>Provision of this Act</th>
<th>Administrative penalty</th>
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<tbody>
<tr>
<td>1</td>
<td>Subsection 34(1)</td>
<td>20 penalty units</td>
</tr>
<tr>
<td>2</td>
<td>Section 35B</td>
<td>10 penalty units</td>
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<tr>
<td>3</td>
<td>Subsection 65(1)</td>
<td>60 penalty units</td>
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<tr>
<td>4</td>
<td>Subsection 67(1)</td>
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<td>5</td>
<td>Subsection 84(1)</td>
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<td>16</td>
<td>Subsection 254(1)</td>
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<tr>
<td>17</td>
<td>Subsection 347A(5)</td>
<td>5 penalty units</td>
</tr>
</tbody>
</table>

Collection and recovery of administrative penalties imposed by the Bill is dealt with in Part 4-15 of Schedule 1 to Taxation Administration Act 1953.
Imposition of an administrative or civil penalty does not restrict the regulator from continuing with proceedings, but if he does, then the administrative penalty must be remitted.

Administrative penalties are a personal liability of the person, and cannot be claimed back against the fund.

If an administrative penalty has been imposed on a trustee of a body corporate, the liability is joint and several against the directors.

The Explanatory Memorandum for the Bill also includes the following examples as to the affect of some of the various administrative penalties, and how they interact depending on whether there is an individual or body corporate trustee.

**Example 1 - Corporate trustee that contravenes a provision**

Stuart and Alison are members and the directors of a body corporate that is the trustee of Green SMSF. Stuart and Alison fail to ensure that accounts and statements for Green SMSF are prepared for the 2013-14 year of income. As a result, the corporate trustee has contravened section 35B.

An administrative penalty of 10 penalty units is imposed on the body corporate that is the trustee of the Green SMSF. Stuart and Alison as directors of the body corporate become jointly and severally liable to an administrative penalty of 10 penalty units imposed on the body corporate.

**Example 2 - Individual trustees that contravene a provision**

Jill and Merryn are members and individual trustees of Yellow SMSF. Jill and Merryn fail to ensure that accounts and statements for Yellow SMSF are prepared for the 2013-13 year of income. As a result, each individual trustee has contravened section 35B.

An administrative penalty of 10 penalty units is imposed on each individual trustee of Yellow SMSF in their personal capacity. Jill and Merryn are each liable to an administrative penalty of 10 penalty units.

**Example 3 - Director of corporate trustee that contravenes a provision**

Marita and Peter become directors of a body corporate that is trustee of Blue SMSF. Peter fails to sign a trustee declaration and contravenes subsection 104A(2).

An administrative penalty of 10 penalty units is imposed on Peter. Peter is liable to an administrative penalty of 10 penalty units.

**Example 4 - Individual trustees that contravene a provision**

Cameron and Rohan are individual trustees of Red SMSF. Cameron fails to sign a trustee declaration and contravenes subsection 104A(2).

An administrative penalty of 10 penalty units is imposed on Cameron in his personal capacity. Cameron is liable to an administrative penalty of 10 penalty units.