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Early engagement and voluntary disclosure

Case studies to help trustees decide if they are eligible to use the early engagement and voluntary disclosure service.

9 August 2019

The following examples explain the benefits of the Early engagement and voluntary disclosure service and are provided to assist self-managed super fund (SMSF) trustees in deciding whether they are eligible to use this service.

Example 1: Stephens superannuation fund

The Stephens Superannuation Fund bank account was overdrawn twice during the 2014–15 financial year. After rectifying the breach the trustee engaged an SMSF auditor and disclosed the breaches to ATO via the SMSF early engagement and voluntary disclosure process.

We advised the trustees that given the contraventions were rectified, there was no need for them to use the service and by raising the breaches with their approved auditor they had discharged their reporting obligations. The trustees also put controls in place to prevent the fund bank account being overdrawn in the future.

Given it was a reportable contravention the SMSF auditor lodged an auditor/actuary contravention report (ACR). As a result of the ACR, we sent an education letter to the fund in relation to the breach.

Example 2: Klein superannuation fund

The approved auditor for trustees Emma and Jonas Klein identified a Limited recourse borrowing arrangement (LRBA) breach in relation to the Klein Superannuation Fund for the 2014–15 financial year.

The breach arose because the Klein Superannuation Fund entered into an LRBA that had not been structured correctly. A holding trust did not hold the property on trust for the fund trustees and the LRBA was with a non-related party. The trustees made a voluntary disclosure of the breach and provided all relevant facts and supporting documentation. They also provided a proposed undertaking to rectify the contravention within six months.

The trustees actively engaged with us throughout the resolution process and lodged the outstanding returns. We accepted their undertaking to rectify the contravention. The terms of the enforceable undertaking were that the property was to be transferred into the holding trust within six months.

Example 3: Okafor superannuation fund

The trustees made an SMSF voluntary disclosure that the Okafor Superannuation Fund had not lodged annual returns for four years because all its money was lost in an investment scam. The trustees made their disclosure prior to the notification of an ATO SMSF review or audit and provided all relevant facts and supporting documentation including bank statements. The trustees provided an undertaking to wind up the fund and not to act as trustees of another SMSF in the future.

The trustees actively engaged with us throughout the process and we verified the investment scam claims. We accepted the undertaking and the SMSF was wound up.

49176

Retirement – Establishing whether gainful employment has ceased

Case study explaining if gainful employment has ceased.

6 April 2016

Case study scenario

Charlie is 57 years old and a beneficiary of the Crackle discretionary trust (Crackle). Crackle carries on a smash repairs business. Charlie has been an employee of Crackle for nearly 20 years. For the 2016 income year, Charlie ceases his employment with Crackle. He is paid out any accumulated leave entitlements owed to him.

Charlie no longer has an employment contract with either Crackle or any other entity (related party or arm's length). The directors of the corporate trustee of the SMSF of which Charlie is a member, are satisfied he never intends to be gainfully employed on either a full-time or a part-time basis. Charlie's SMSF commences to pay Charlie an account-based pension.

However, after Charlie's employment has ceased, Charlie continues to perform substantive duties for Crackle (much the same as when he was an employee). Charlie receives distributions of trust income from Crackle.

Analysis

- The superannuation definition of 'retirement' for a person under the age of 60 is determined by establishing whether they have ceased to (and never intend to again) be gainfully employed.
- Passive investment income (such as the receipt of rent, trust distributions or dividends) would not normally affect the retirement definition, as the income received is not a direct result of actions or exertion by the member in a particular task.
- However, where a business is operated through a family trust or private company, like in Charlie's example, we may need to have a closer look at the arrangement before we can determine that Charlie has satisfied the retirement condition of release. This is because any evidence that he was still performing substantive duties for Crackle could indicate there is an on-going relationship between the two.

It's unusual for a business like Crackle to allow someone who is not employed or contracted to assist in running the business, without an agreement or understanding in place. If Charlie's work leads to increased turnover for the business, resulting in larger trust distributions or a disproportionate increase in dividends, the Commissioner could take a view that the arrangement under which Charlie was 'gainfully employed' has not 'come to an end' as he is still receiving 'gain or reward' from distributions from the Crackle Discretionary Trust.

As each business and arrangement is different, it would always have to be decided on a case-by-case basis what 'substantive duties' would entail. However, the following factors may be taken into consideration:

- the time spent by Charlie assisting the business – the trustee must be satisfied Charlie does not intend to work more than 10 hours a week in the future
- the expectation/understanding/agreement that Charlie will receive "reward" for his efforts, even if it not in the traditional form of salary and wages

- whether the amount received is linked to Charlie's direct or indirect performance
- whether the payments received are referred to in Crackle's trust deed
- whether the business would be able to operate (or earn as much income) if Charlie was not performing these duties

Result

Although Charlie's employment contract was terminated and he has been paid his leave entitlements, the fact he continues to assist Crackle, performing essentially the same duties he did as an employee, warrants further consideration. Based on the facts available, the Commissioner cannot be certain Charlie has satisfied the retirement condition of release.

How this may affect you

If you are under the age of 60 and thinking of starting a super pension, extra care should be taken to ensure you have satisfied your trustee (and if required, the ATO) that you have ceased to be gainfully employed and do not intend to be gainfully employed in the future.

48668

Paying a lump sum benefit

This case study deals with the calculation of the components of a lump sum benefit.

5 February 2018

Scenario

Rose is 59 and has retired. She wants to withdraw $400,000 from her SMSF as a lump sum benefit. Rose's total super interest in the fund is $500,000 made up of:

- $40,000 personal contributions for which she did not claim a tax deduction

- $300,000 employer contributions (that were taxed in the fund)
- $160,000 crystallised segment (all super fund trustees had to calculate the crystallised amount by 30 June 2008 as it applied to super held at 30 June 2007).

Work it out

Before the payment can be made, the tax-free and taxable components need to be worked out. In this case the components are:

- $200,000 tax-free ($160,000 crystallised segment plus $40,000 personal contributions)
- $300,000 taxable ($500,000 total super interest minus $200,000 tax-free component).

The benefit is paid from the tax-free and taxable components in the same proportions as they are represented in the total super interest. The tax-free and taxable proportions are:

- 40% tax-free ($200,000 tax-free component / $500,000 total super interest)
- 60% taxable (100% - 40%).

Result

Rose can be paid a $400,000 lump sum benefit that will consist of:

- $160,000 tax-free component (40% of $400,000)
- $240,000 taxable component (60% of $400,000).

Although Rose has met a condition of release, if she takes a lump sum before she is 60, she may have to pay some tax on the taxable component. Because her employer contributions were taxed in the fund there will be no tax payable on the lump sum if she receives it after she turns 60. Rose decides to wait until then.

See also:

- Calculating components of a super benefit
- Conditions of release
- Super lump sum tax table

- Super income stream tax tables
- Preservation age

47412

Starting an income stream at 60

This case study describes the conditions you need to meet to start an income stream at 60.

6 July 2018

Circumstances

Chris, Rob and Jan are all 60 years old and want to start receiving an income stream from their SMSF.

1. Rob has two jobs and will be leaving one job shortly but intends to keep working in the other job for many years.
2. Jan has one job and intends to keep working until she is 65.

Results

Individual super fund members can receive an income stream when they meet a condition of release.

1. Chris retired from his job on 1/7/2017 and never intends to work again. Chris has met a condition of release because he is over 60 and has retired from permanent employment. He can start an account-based income stream and his fund must make the minimum annual payments required by law which are based on his age. There is no maximum payment amount. The fund must lodge a Transfer balance account report (TBAR) to report the starting value of the income stream.
2. Rob has two jobs. He retires from his first job on 30 September 2017 and has met a condition of release because he has reached preservation age (60) and is retired. Rob can start an income stream and his fund must make the minimum annual payments required by

law. There is no maximum payment amount. Rob's fund must lodge a Transfer balance account report (TBAR) to report the starting value of the income stream.

As Rob is still employed and his employer is paying super guarantee payments to his Super fund, the contributions must go into his accumulation account. When Rob retires from his second job then he can start a new retirement phase account-based income stream. Rob's fund must then lodge a Transfer balance account report (TBAR) to report the starting value of the second income stream.

Alternatively, Rob can commute his existing retirement phase account-based income stream back to accumulation phase and start a new account-based income stream with the combined value upon retiring from his second job.

Rob's fund would be required to report the commutation event of the existing account-based income stream and the starting of the new account-based income stream on the Transfer balance account report.

2. Jan is still working but she has reached her preservation age. This means she can apply for a transition to retirement income stream (TRIS). Her annual income stream payments must be within the minimum and maximum amounts required under the TRIS rules. Jan's TRIS is not in the retirement phase at this point and her fund will not be required to lodge a Transfer balance account report.

   If Jan continues her TRIS into retirement and she notifies her fund when she retires, the SMSF will be required to lodge a Transfer balance account report at that time. A TBAR would also need to be lodged if Jan turns 65 before retiring.

See also:

- Minimum annual payments for super income streams
- Maximum annual pension payment limit from a TRIS
- Conditions of release
- Transfer Balance Cap
- TBC reporting requirements for SMSF's

46666

Case study scenario

Case study of death benefit lump sum payments.

14 October 2016

Paul and Marie are married and are the trustees and members of their self-managed super fund. Marie had been ill for some time and passed away.

Paul is the beneficiary of Marie's super benefit and because he was Marie's husband, he was also the dependant at the time of her death.

Paul manages a personal investment portfolio and requested that Marie's death benefit lump sum be paid out in three instalments to suit his financial commitments.

Result

Under subparagraph 6.21(2)(a)(ii) of the Superannuation Industry (Supervision) Regulations 1994 (SISR), death benefits may be cashed in the form of an interim lump sum and a final lump sum.

Paul cannot request the payment in more than two instalments. To meet the SISR death benefit payment rules, Paul had to tailor his financial commitments around two payments.

How this may affect you

You need to be aware of the SISR rules for paying death benefit lump sums.

Payments must be made in accordance with the rules to ensure the payment arrangement does not breach super law.

If you realise that your SMSF has breached the death benefit payment rules or any other super laws, you should speak to your auditor. Some matters are most appropriately dealt with by the auditor when they do their annual audit. If this is not the case, you should contact us to discuss your options.

See also:

- How to make a voluntary disclosure

44719

Case study scenario

A case study covering the impacts on an SMSF if a trustee is disqualified.

14 October 2016

Sally is a member and a trustee of the ABC SMSF with two others who are trustees and members. Sally has recently been involved in illegal activities and convicted of an offence involving dishonesty. Not being aware of her obligations as a trustee, she continues her trusteeship with the SMSF.

What happens now?

Sally's conviction means that she is a disqualified person and she must cease being or acting as a trustee **immediately**.

The remaining trustees must **notify us in the approved form** of the change in trustees within 28 days.

When Sally resigns her trusteeship, she remains a member of ABC until the remaining trustees cease her membership.

Generally, to be an SMSF, all members of the funds must be trustees and all trustees must be members. However even after Sally resigns, ABC will continue to meet the definition of an SMSF for up to six months. This time allows the remaining trustees to take the necessary action to meet their obligations to comply with the law. They have the following options.

- Roll-over or transfer Sally's superannuation interest into another complying fund, or if she meets a condition of release pay it to her as a benefit and cease her membership of the fund. After she ceases being a member, ABC will have only two members who are

also the only two trustees and will continue to meet the definition of an SMSF.

- Appoint a registrable superannuation entity (RSE) licensee as trustee, that is, become a small APRA fund (the fund will be eligible for the investment and other concessions available to funds with fewer than five members and Sally can remain a member).
- Wind-up the SMSF.

Because Sally was disqualified for being convicted of dishonest conduct, she may be able to apply to us for a waiver if she wants to continue acting as a trustee. She doesn't have to resign until we make our decision (and then only if we don't give a waiver) if she applies within 14 days of her conviction. If we receive the request more than 14 days after the conviction, Sally must resign immediately.

Result

Sally will commit an offence if she continues to be or act as a trustee when she knows she is disqualified. Penalties including fines and imprisonment can apply.

If the remaining trustees don't take any action after Sally resigns ABC will become an RSE. Trustees of an RSE commit an offence if they don't have an RSE license.

See also:

- Disqualified persons
- Notify us if there is a change

44470

Improvements to LRBA assets

Conditions to determine whether improvements to a fund's asset constitute a fundamental change to that asset.

19 August 2015

Case study scenario 1

Anita and Nathan purchased an existing commercial property currently being used as a florist under a limited recourse borrowing arrangement (LRBA). They intend to extensively refurbish the property so they can operate an optometrist business. The costs associated with the refurbishment will be met from accumulated funds held inside the SMSF and not from borrowings.

The refurbishment will not fundamentally change the commercial use of the property and the proprietary rights of the trustees will not change. The asset is still a commercial property providing income to the fund.

Result

Under subparagraph 67A(1)(a)(i) of the *Superannuation Industry (Supervision) Act 1993* (SISA), borrowings under an LRBA cannot be used to fund improvements. Money from other sources can be used to improve (or repair or maintain) a single acquirable asset. However, any improvements must not result in the acquirable asset becoming a different asset.

On the basis that there are no significant changes to the nature of the property i.e. it is still used as a commercial property, the improvements will not cause the commercial property to become a different asset.

How this may affect you

There are several conditions trustees must comply with that determine whether improvements to a fund's asset constitute a fundamental change to that asset.

Where the fundamental nature of the property has changed by the addition to, or fit-out of, the property, it is important to establish if the change has resulted in a different asset.

In this case, the property would remain as a commercial property with the fit out being the essential difference. As there were no significant changes to the commercial nature of the property, updating the premises from a florist to an optometrist would not cause the commercial property to become a different asset.

Case study scenario 2

Fiona and Walter have purchased a residential property under a limited recourse borrowing arrangement (LRBA). They intend to extensively refurbish the property into a clothing shop. The costs associated with the refurbishment will be met from accumulated funds held inside the SMSF and not from borrowings.

The refurbishment will fundamentally change the residential use of the property. The proprietary rights of the trustees will also be affected as the asset is a non-commercial property that is expected to generate an income to the fund.

Result

Under subparagraph 67A(1)(a)(i) of the *Superannuation Industry (Supervision) Act 1993* (SISA), borrowings under an LRBA cannot be used to fund improvements. Money from other sources can be used to improve (or repair or maintain) a single acquirable asset. However, any improvements must not result in the acquirable asset becoming a different asset.

There are significant changes to the nature and use of the property, and fundamentally, the property has become a different asset.

How this may affect you

There are several conditions trustees must comply with that determine whether improvements to a fund's asset constitute a fundamental change to that asset.

Where the fundamental nature of the property has changed either from residential to commercial or by the addition to, or fit-out of, the property, it is important to establish if the change has resulted in a different asset.

In this case, the asset is being changed from a residential property to a commercial property. As there are significant changes to the fundamental nature and use of the property, updating the premises in this case would clearly cause the property to become a different asset.

Life insurance and buy-sell agreements

Case study on whether a SMSF contravenes super laws by purchasing a life insurance policy covering the life of a member.

6 April 2016

The **Self-managed super fund: Life insurance - Buy-sell agreement - financial assistance - sole purpose (ATO ID 2015/10)** interpretative decision clarifies our view of whether a SMSF contravenes super laws by purchasing a life insurance policy covering the life of a member, where the purchase is dependent on a buy-sell agreement.

The following case study is based on a similar agreement to the one described in ATO ID 2015/10.

Case study

John is a member of a SMSF. The only other member of the SMSF is his wife, Robin. John and his sister Kate own and run a separate company. John and Kate enter into a buy-sell agreement 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 buy-sell agreement, 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
- his shareholding in the company is transferred to Kate and Robin relinquishes all claims on his shareholding in the company.

Result

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

Significantly, the policy would not be purchased at all if it cannot be purchased in accordance with the terms of the agreement.

By purchasing and holding a life insurance policy under this type of arrangement, the fund is not being maintained in accordance with the requirements of section 62 of the *Superannuation Industry (Supervision) Act 1993* (SISA) and would breach the sole purpose test.

The terms of the agreement 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.

It is our view that 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 and a contravention of section 65 of the SISA has occurred.

What you should do

If you have entered into an agreement of this type you should seek independent professional advice. All insurance held by an SMSF trustee should be consistent with the purposes of super, and therefore correspond with one of the requirements of the core or ancillary purposes set out in the sole purpose test in s62 of SISA.

Deciding if the trustee has complied with the sole purpose test requires an examination of all the facts and circumstances associated with the maintenance of the SMSF. Generally, the presence of a buy-sell agreement on its own will not result in a breach of the sole purpose test.

If you realise your SMSF has breached the sole purpose test, or provision of financial assistance or any other super laws, you should speak to your auditor. Some matters are most appropriately dealt with by auditors when doing their annual audit. If this is not the case, you should contact us to discuss your options.

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Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.

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