PS LA 2006/19 - Self-managed superannuation funds - issuing a notice of non-compliance

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PS LA 2006/19
Self-managed superannuation funds – issuing a notice of non-compliance

This Practice Statement outlines what factors we take into account in deciding whether to issue a self-managed superannuation fund with a notice of non-compliance.

This Practice Statement is an internal ATO document and an instruction to ATO staff.

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1. What this Practice Statement is about

As the regulator of self-managed superannuation funds (SMSF), the ATO is responsible for determining whether or not an SMSF is a complying superannuation fund.

This Practice Statement sets out the factors you should consider when deciding whether to issue a notice of non-compliance to an SMSF.

2. Compliance requirements for SMSFs

For an SMSF to qualify for concessional income tax treatment, it must first be a complying superannuation fund.[1] A complying superannuation fund is one that satisfies the conditions set out in section 42A of the SISA. All further legislative references in this Practice Statement are to the SISA, unless otherwise indicated.

An SMSF is a complying superannuation fund for a year of income if:

- the fund was a 'resident regulated superannuation fund' at all times during the year of income when it was in existence, and
- the trustees of the fund have not contravened any regulatory provisions[2] during that year of income.

If the fund satisfies these conditions, we may give the trustee a notice of compliance in relation to a year of income.[3]

Where the trustee has contravened a regulatory provision, we may consider that a notice of compliance should nevertheless be given after considering[4]:

- the taxation consequences of treating the entity as non-complying
- the seriousness of the contravention
- all other relevant circumstances.

For income tax purposes, an SMSF will be a complying superannuation fund if:

- we have issued a notice of compliance in the current or previous years of income
- the fund has not subsequently been issued with a notice of non-compliance.

3. Issuing a notice of non-compliance – general considerations

Issuing a notice of non-compliance is one option available when a fund trustee contravenes any regulatory provisions[5] for a year of income.

Whether it is appropriate to issue a notice of non-compliance will depend on the individual circumstances of the case. When making the decision you should look to achieve a fair and reasonable outcome, and take into account the principles of:

- Our Charter
- the Compliance model
- the ATO technical decision making model – overview (link available internally only).

[1] See sections 42A and 45 of the *Superannuation Industry (Supervision) Act 1993* (SISA). The entity must also meet the definition of a regulated superannuation fund in sections 10 and 19 of the SISA.
[2] The term 'regulatory provision' is defined in section 38A and includes any provision of the SISA or the *Superannuation Industry (Supervision) Regulations 1994* (SISR 1994).
[3] Section 40.
[4] Subsection 42A(5). See also *Triway Superannuation Fund and Commissioner of Taxation* [2011] AATA 302.
[5] See section 39 for contraventions that may cause a fund to be issued with a notice of non-compliance.

However, you should also carefully consider whether issuing a notice of non-compliance is the most appropriate outcome, given there are other compliance options available.[6]

4. When it is appropriate to issue a notice of non-compliance

The factors to consider when deciding if it is appropriate to issue a notice of non-compliance are:

- taxation consequences of non-compliance
- seriousness of the behaviour or contravention
- other relevant circumstances.[7]

Note: All factors are equally relevant and are to be considered on a case-by-case basis, with no one factor being determinative.

Taxation consequences of non-compliance

If an SMSF is made non-complying, its taxable income is taxed at the top marginal tax rate rather than the concessional tax rate of 15% in each year it is non-complying.[8] An additional amount will also be included in the assessable income of the fund in the year it is made non-complying. This amount will be the market value of the fund's assets just before the start of the income year it is made non-complying, less any contributions not previously included in the fund's assessable income.[9] As such, the decision to make a fund non-complying will have a serious financial impact on the fund and is not a decision that should be taken lightly.

We will consider whether it would be reasonable for the SMSF to be treated as a complying fund and still receive concessional tax treatment. This will depend on the particular circumstances of the case, the seriousness of the contravention and the trustee's attitude to complying with the regulatory provisions.

Seriousness of the behaviour or contravention

Any one of the following circumstances may prove decisive individually, but they must be considered collectively when determining the seriousness of a contravention:

- Was the trustee reckless?
- Did they intentionally disregard the relevant legislation?
- Was an honest mistake involved?
- To what extent were the fund's assets affected?
- How many contraventions were there?
- Over what period of time did these contraventions occur?
- The seriousness of any specific contravention.

Other relevant circumstances

Other relevant circumstances may include, but are not limited to:

- the trustee's willingness to comply with the law, to rectify the contravention and take action to prevent it happening again
- the trustee's skill and knowledge in managing the affairs of their fund
- the fund's compliance history before and after the contravention – a fund with an acceptable history may be treated more favourably than a fund with a poor history
- the events that led to the trustee's contravention – for example, serious illness, the death of a close relative (or a trustee), natural disasters
- any decisions made by us that may have contributed to the trustee's action, for example, if the trustee relied on a ruling that was subsequently withdrawn or changed[10]
- whether alternative sanctions (see section 6 of this Practice Statement) may be more appropriate in the particular circumstances
- other legal consequences of the contravention, for example, an assessment of a member under Division 304 of the ITAA 1997 for early access to benefits.[11]

[6] See section 6 of this Practice Statement.
[7] Refer to paragraph 42A(5)(b).
[8] Refer to section 26 of the *Income Tax Rates Act 1986*.
[9] Refer to section 295-325 of the *Income Tax Assessment Act 1997* (ITAA 1997).
[10] Reference should be made to Law Administration Practice Statement PS LA 2011/27 *Determining whether the ATO's views of the law should be applied prospectively only.*
[11] You should consider whether an assessment under Division 304 of the ITAA 1997 would lead to a heavy tax burden. For example, where a non-complying SMSF is taxed at 45% for early release of benefits, the inclusion of those benefits in a member's assessable income under Division 304 at a 45% marginal rate could impose a heavy tax burden on the member. The member (who is also a trustee) is effectively taxed at 90% for the same amount.

5. When it is not appropriate to issue a notice of non-compliance

Generally, you should not issue a notice of non-compliance where other compliance options may be more appropriate, such as when:

- we have accepted an enforceable undertaking (formal or informal) by the trustee to rectify a contravention or wind-up the fund, and the trustee is genuinely attempting to satisfy the terms of that undertaking
- there are no longer any remaining assets in the fund or where assets have been removed from the fund in breach of the payment standards and the trustee or individual is unable to restore the fund to its full and proper asset level within a reasonable period
- the trustee is genuinely making an effort to meet a direction to rectify a contravention pursuant to section 159
- the trustee has wound-up the fund prior to any ATO compliance action[12] and all money in the fund has been rolled over to a fund regulated by the Australian Prudential Regulatory Authority (APRA) and is being (and will continue to be) independently managed. However, where our subsequent compliance action indicates serious contraventions by the trustee preceding the wind-up, we reserve the right to make the fund non-complying and amend the necessary returns.

6. Alternate compliance options

Depending on the circumstances of the case, one or a combination of other sanctions may be determined as more appropriate, including:

- issuing a direction to undertake education if the contravention occurred after 1 July 2014[13]
- issuing a direction to rectify a contravention that occurred after 1 July 2014[14]
- accepting an undertaking from the trustee to rectify the contravention[15]
- preventing the fund from appearing in Super Fund Lookup if the relevant fund or the individual trustee poses a continuing risk to compliance
- imposing tax penalties, such as failure to lodge penalties
- disqualifying the trustee[16]
- suspending or removing the trustee[17]
- seeking wind-up of the fund and rollover of its assets into an APRA-regulated fund through an oral or written request by the trustee or individual
- freezing the assets of the fund if there is a risk of the members' benefits being eroded[18]
- seeking a court order[19] or seeking civil or criminal penalties through the courts.[20]

7. How long a notice of non-compliance will be in effect

A notice of non-compliance will be effective from the start of the year of income for which it is issued and all following years of income, until such time as the fund is issued a notice of compliance.

8. Examples

The following are examples to illustrate the application of the principles in this Practice Statement.

Example 1 – SMSF breaches in-house asset rules and fails to comply with an enforceable undertaking

A husband and wife were the trustees of their own SMSF. The husband was also the sole director and general manager of a related company. The fund made several loans to the husband's related company. The reason for the loans was to assist the company through a difficult financial period.

The fund, during the period in question, had lent more than 40% of its assets to the husband's company. This resulted in the fund breaching the 5% in-house asset limit on loans to related parties. The company made one initial repayment; however, no further repayments were made over the next 2 and a half years.

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[12] Unless it was decided that the actions of the trustee preceding the wind-up warranted that action.
[13] Section 160.
[14] Section 159.
[15] Section 262A. See also Law Administration Practice Statement PS LA 2006/18 *Self-managed superannuation funds – enforceable undertakings*.
[16] Section 126A. See also Law Administration Practice Statement PS LA 2006/17 *Self-managed superannuation funds – disqualification of individuals to prohibit them from acting as a trustee of a self-managed superannuation fund*.
[17] Subsection 133(1). This would only occur in exceptional circumstances.
[18] Section 264. This would only occur in exceptional circumstances.
[19] Subsection 262A(4).
[20] Part 21.

During this period of non-repayment, the husband suffered from a chronic illness which affected his ability to manage the company's operations. The company's premises also sustained significant flood damage in 2 consecutive years and these floods were followed by a general downturn in trading in their region.

The loan was outstanding for over 2 and a half years and the trustees made no attempt to rectify the situation.

We determined that the loan arrangement was a serious contravention because not only had the fund breached the in-house asset rules, the trustees had also failed to take appropriate steps to ensure that the loan was repaid.

Given the circumstances, it was decided to impose administrative penalties on the trustees and allow an enforceable undertaking where the trustees committed to ensuring that the loan was repaid.

After the initial repayment, the trustees ceased to genuinely engage with us and failed to comply with the terms and conditions of the enforceable undertaking.

Given the seriousness of the contravention and the trustees failure to rectify it, we decided it was reasonable to issue the fund with a notice of non-compliance. We considered these factors outweighed the taxation consequences of making the fund non-complying.

Example 2 – SMSF fails to lodge annual returns

An SMSF was established on 1 July 2012. The trustee lodged self-managed superannuation fund annual returns for the 2012–13 and 2013–14 years of income but has not lodged returns for the 2014–15, 2015–16 and 2016–17 years of income. We requested the lodgment of the outstanding returns on several occasions. The trustee disregarded every request, without offering any reasons.

Failure by the trustee of a fund to lodge a return for a year of income constitutes an offence. Each of the contraventions is serious because lodging returns is a fundamental requirement of the regulatory regime and the trustee is expected to know this requirement. The number of contraventions involved and the trustee's disregard of our requests add to the seriousness of the contraventions.

We decided it would be reasonable to give the fund a notice of non-compliance, which we issued on 1 July 2018 effective from the start of the 2015–16 income year and for all following income years. This is because of the seriousness of the contraventions, the trustee's attitude to compliance as indicated by the trustee's disregard of our requests and the fact that there are no relevant circumstances to mitigate the trustee's failure to lodge the outstanding returns.

Example 3 – SMSF enters into a dividend stripping arrangement and breaches a range of regulatory provisions

An SMSF acquires shares from its members, at less than market value, in a related private company with significant previously taxed accumulated profits. The acquired shares represent 30% of the fund's total assets.

The private company distributes these accumulated profits to the fund as franked dividends. Being in pension phase, the fund treats the franked dividends and franking credits as exempt current pension income and receives a large refund of franking credits while avoiding the 'top up' income tax that members would pay if they received the dividends.

A number of serious contraventions of the regulatory provisions have occurred:

- *The fund has contravened the prohibition on acquiring private company shares from its members.*[21]
- *The share acquisition represents more than 5% of the fund's total assets and is therefore in breach of the in-house asset rules.*
- *The fund has contravened the requirements for maintaining accounts and statements by failing to value its assets at market value.*[22]
- *The fund has not been maintained solely for the purposes permitted by the sole purpose test.*[23]

We decided it would be reasonable to give the fund a notice of non-compliance because of the seriousness of the contraventions and because the contraventions arose out of a deliberate attempt to avoid tax.

9. Relevant cases

Refer to the following Administrative Appeals Tribunal decisions for further guidance:

- *Montgomery Wools Pty Ltd as trustee for Montgomery Wools Pty Ltd Super Fund and Commissioner of Taxation* [2012] AATA 61
- *Shail Superannuation Fund and Commissioner of Taxation* [2011] AATA 940
- *Triway Superannuation Fund and Commissioner of Taxation* [2011] AATA 302

[21] Section 66.
[22] Section 35B; regulation 8.02B of the SISR 1994.
[23] Section 62.

- *The Trustee for the R Ali Superannuation Fund and Commissioner of Taxation* [2012] AATA 44
- *ZDDD and Commissioner of Taxation* [2011] AATA 3.

10. Review rights

The decision to issue a notice of non-compliance under subsection 40(1) is a reviewable decision.[24] A request to reconsider must be made within 21 days and clearly state, in writing, the reasons for the request.[25] If dissatisfied with the outcome, the person may then apply to the Administrative Review Tribunal for a further review.

11. More information

For more information, see:

- PS LA 2006/17
- PS LA 2006/18
- How we deal with non-compliance
- Check your fund is an Australian super fund.

Date issued: 30 November 2006

Date of effect: 30 November 2006

[24] Section 10.

[25] Section 344.

Amendment history

28 November 2024

Part	Comment
Section 10	The Administrative Review Tribunal replaced the Administrative Appeals Tribunal on 14 October 2024. Updated reference to Administrative Appeals Tribunal to Administrative Review Tribunal accordingly.

11 July 2024

Part	Comment
Throughout	Updated in line with current ATO style and accessibility requirements.
Section 5	Updated to correct an erroneous legislative reference and a minor typographical error

6 January 2020

Part	Comment
Section 4 – Other relevant circumstances	Minor update to correct an error.

17 October 2019

Part	Comment
All	Updated to include a further reference to the taxation consequences of a fund being made non-compliant and to clarify the effective date of a notice of non-compliance. Examples 1 and 2 have also been updated.

6 December 2018

Part	Comment
All	Updated to new LAPS format and style. Contact details updated.

15 November 2012

Part	Comment
Footnote 17	Updated to reference PS LA 2012/5 as PS LA 2006/2 has been withdrawn.

6 September 2011

Part	Comment
Paragraphs 13, 14, 17, 26, 34 and 35	Paragraph number references updated after former paragraph 9 was deleted.

28 July 2011

Part	Comment
Paragraph 9	Deleted for currency purposes.
Paragraph 36	Updated to include reference to matters articulated in PS LA 2011/27.
Examples	Updated to reflect the Commissioner has considered the taxation consequences of the SMSF being treated as a non-complying superannuation fund.

13 May 2010

Part	Comment
Various	Minor revisions to update 'Tax Office' to 'ATO' and improve the technical currency of the document.

3 July 2009

Part	Comment
Paragraphs 17 and 18 and Example 3	Updated to reflect that the Commissioner may give a fund a notice of non-compliance even though the fund has been wound-up.
Various	Minor updates to improve the technical currency of the document.

References

Legislative references	
	SISA 1993 10 SISA 1993 19 SISA 1993 35B SISA 1993 38A SISA 1993 39 SISA 1993 40 SISA 1993 40(1) SISA 1993 42A SISA 1993 42A(5) SISA 1993 42A(5)(b) SISA 1993 45 SISA 1993 62 SISA 1993 66 SISA 1993 126A SISA 1993 133(1) SISA 1993 159 SISA 1993 160 SISA 1993 Pt 21 SISA 1993 262A SISA 1993 262A(4) SISA 1993 264 SISA 1993 344 SISR 1994 8.02B ITAA 1997 295-325 ITAA 1997 Div 304 ITRA 1986 26

Case references	Montgomery Wools Pty Ltd as trustee for Montgomery Wools Pty Ltd Super Fund and Commissioner of Taxation [2012] AATA 61; 2012 ATC 10-233; 87 ATR 282 Shail Superannuation Fund and Commissioner of Taxation [2011] AATA 940; 2011 ATC 10-228; 86 ATR 339 Triway Superannuation Fund and Commissioner of Taxation [2011] AATA 302; 83 ATR 766 Trustee for the R Ali Superannuation Fund and Commissioner of Taxation [2012] AATA 44; 2012 ATC 10-231; 86 ATR 826 ZDDD and Commissioner of Taxation [2011] AATA 3; 81 ATR 872
Other references	ATO technical decision-making model – overview (link available internally only) Check your fund is an Australian super fund Compliance model How we deal with non-compliance Our Charter Super Fund Lookup
Related practice statements	PS LA 2006/18 PS LA 2006/17 PS LA 2011/27

ATO references

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