


# ***PS LA 2023/1 - Self-managed superannuation funds - rectification directions for contraventions of the Superannuation Industry (Supervision) Act 1993***

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# Self-managed superannuation funds – rectification directions for contraventions of the *Superannuation Industry (Supervision) Act 1993*

This Law Administration Practice Statement provides guidance to staff about whether to give a trustee, or a director of a body corporate that is a trustee, of a self-managed superannuation fund, a rectification direction under section 159 of the *Superannuation Industry (Supervision) Act 1993*.

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

## 1. What this Practice Statement is about

This Practice Statement sets out what you need to consider when deciding whether to give a trustee, or a director of a corporate trustee, of a self-managed superannuation fund (SMSF) a rectification direction under section 159 of the *Superannuation Industry (Supervision) Act 1993* (SISA).

All legislative references in this Practice Statement are to the SISA, unless otherwise indicated.

## 2. Compliance treatments – general principles

The Commissioner is responsible for ensuring SMSF trustees comply with relevant tax and super laws as well as dealing effectively with those who fail to do so.

This role is fundamental in safeguarding the integrity of the superannuation system and the preservation of members' benefits. Our role also ensures tax concessions available within superannuation are appropriately targeted towards those who choose to operate within the regulatory framework.

In carrying out this role, the SISA provides a range of compliance options to deal with conduct which has resulted in a contravention of the SISA or *Superannuation Industry (Supervision) Regulations 1994* (SISR).

One such option is to give a rectification direction.

You can use other compliance options alongside a rectification direction. The appropriateness of any additional compliance option you choose will depend on the circumstances of each case.

The compliance options you might commonly use in combination with a rectification direction include:

- giving an education direction<sup>1</sup>
- charging administrative penalties.<sup>2</sup>

<sup>1</sup> See section 160.

<sup>2</sup> See subsection 166(1).

<sup>3</sup> See section 126A.

<sup>4</sup> See subsection 40(1).

However, you would not give a rectification direction where you will be:

- disqualifying an individual and prohibiting them from acting as a trustee of an SMSF or as a responsible officer of a body corporate that is trustee of an SMSF<sup>3</sup>
- issuing a notice of non-compliance to the fund<sup>4</sup>
- taking action to wind-up the fund.

In addition, you must not give a rectification direction where:

- we have accepted an enforceable undertaking which covers the contravention, and
- the undertaking has not been withdrawn or varied in a way that means the contravention is no longer covered by it.<sup>5</sup>

## 3. What is a rectification direction?

A rectification direction is a written notice the Commissioner gives to a person and within a stated period requires them to:

- take specified action to rectify the contravention such as repay a loan or borrowing, dispose of an asset or lodge a return, and
- provide us evidence showing they have complied with the direction.<sup>6</sup>

The term 'rectify' includes putting in place managerial or administrative arrangements that could reasonably be expected to ensure there will be no further contraventions of a similar kind.<sup>7</sup> Therefore, a rectification direction may also require establishing preventative measures and controls so that a contravention is not repeated. It may also require corrective action.

<sup>5</sup> See subsection 159(5). For enforceable undertakings, see section 262A. Breach of an enforceable undertaking on its own does not mean the contravention is no longer covered.

<sup>6</sup> See subsections 159(2) and (4).

<sup>7</sup> See definition of 'rectify' under subsection 10(1).

#### 4. What are the circumstances in which a rectification direction can be given?

You may give a rectification direction where you reasonably believe a person has, on or after 1 July 2014, contravened a provision of the SISA (other than Part 3B) or the SISR.

You can only give a rectification direction to a person who is:

- an individual trustee of an SMSF, or
- a director of a body corporate that is trustee of an SMSF.<sup>8</sup>

You may reasonably believe a person has contravened the SISA or SISR if someone closely connected to the fund (such as a trustee or approved auditor) has reported a contravention to us. However, a mere suspicion that a contravention has occurred is not sufficient. In such cases, you would need to gather more information before you can conclude a contravention has occurred.

#### 5. What should you consider when deciding whether to give a rectification direction?

When deciding whether to give a rectification direction, you should consider the general principles and case-specific factors which include all of the following:

- any financial detriment that might reasonably be expected to be suffered by the fund as a result of the person complying with the direction
- the nature and seriousness of the person's contravention
- any other relevant circumstance.<sup>9</sup>

You need to consider each factor. The weight you give to a particular factor will vary depending on the circumstances of the case.

##### *General principles*

You should complete your decision by considering the following general principles in the:

- Taxpayers' Charter – which requires that taxpayers be treated fairly and reasonably
- ATO Compliance model – which helps in choosing the most appropriate compliance response, depending on the person's behaviour and circumstances
- Good decision-making model – which requires that the decision be legal, ethical, equitable,

overt, sensible, timely and consistent with the principles of natural justice.

##### *Case-specific factors*

###### *Financial detriment*

A fund will often experience some level of financial detriment as a result of complying with a rectification direction. This is because potential exposure to financial costs or losses is a natural consequence of unwinding a commercial arrangement.

When weighing up any expected financial detriment, you should focus on:

- the significance and degree of that detriment
- the proportion of the fund's assets involved in the contravention
- reasonable estimates or opinions the fund may have provided about the expected financial costs or losses in complying with a direction.

Some types of financial detriment would not usually bear much weight on your decision. For example, this could include situations where the fund would be required to:

- dispose of an asset and would incur typical transaction costs for disposal or experience adverse market fluctuations
- rectify a prohibited borrowing and would incur costs in clearing the loan early or restructuring the arrangement.

###### *Nature and seriousness of the contravention*

You should evaluate the nature and seriousness of the contravention based on the established facts. The following points expand on this factor.

###### *The type and nature of contravention*

A rectification direction may be considered appropriate for certain types of contraventions. However, a rectification direction may become less appropriate depending on the inherent nature or severity of the contravention.

In addition, certain contraventions cannot be rectified and, therefore, you could not issue a rectification direction. For example, where a fund has paid super benefits to a member without meeting a condition of release, it is not possible to rectify this because any returned amounts are considered new contributions, rather than repayments.

<sup>8</sup> See subsection 159(1).

<sup>9</sup> See subsection 159(3). You are not limited to considering these factors only.

### *The person's behaviour, circumstances and compliance history*

A rectification direction will generally be appropriate where the person's behaviour and circumstances which gave rise to the contravention involved mistakes due to insufficient trustee knowledge or failing to take sufficient care in their duties. However, it may become less appropriate as the person's behaviour and circumstances approaches or involves recklessness, or intentional disregard of trustee obligations.<sup>10</sup>

As all trustees and directors of corporate trustees are responsible for ensuring the provisions of the SISA and SISR are complied with, a person may still 'contravene' one of the provisions even if they:

- do not take an active role in managing the fund
- were not directly involved in the conduct that gave rise to the contravention.

However, the person's level of involvement in the contravention will still be a relevant factor when deciding whether it is appropriate to give a direction.

When considering compliance history, it may be appropriate to take other compliance action, such as issuing a notice of non-compliance, if there have been a number of contraventions over an extended period of time.

A rectification direction may be appropriate for a fund with a good compliance history and no prior contraventions. If a fund has a poor compliance history, this will likely increase the seriousness of the latest contravention. A fund may demonstrate poor compliance history by repeating a past contravention or later contravening other provisions.

### *Value of assets involved in the contravention*

A contravention is likely to be more serious as the value and proportion of the fund's assets involved in the contravention increases.<sup>11</sup> Further, a contravention may be serious if it results in a significant proportion of the fund's assets being put at risk, even if no loss eventuated.<sup>12</sup> While a rectification direction may be less appropriate where the contravention involves multiple assets which combined represent a substantial proportion of the fund's assets, it does not prevent such a direction from being issued in this instance.

<sup>10</sup> Law Administration Practice Statement PS LA 2012/5 *Administration of penalties for making false or misleading statements that result in shortfall amounts* and Miscellaneous Taxation Ruling MT 2008/1 *Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard* discuss the concepts of 'recklessness' and 'intentional disregard'.

### *The number of contraventions during the income year*

For an income year, a single contravention on its own may not be serious, but a number of contraventions taken together may be serious. While a rectification direction may become less appropriate as the number and range of contraventions increases, it does not preclude such a direction from being issued.

### *Other relevant circumstances*

If you identify other circumstances which are relevant to your decision, those circumstances should also be taken into account.

This gives you the flexibility to work out the best course of action for a broad range of situations.

### *Person takes proactive steps to rectify*

A person may have taken steps to rectify a contravention before we started to investigate, or as part of a voluntary disclosure to us. While these types of actions are constructive, they should not prevent you giving a rectification direction.

If you identify a person has already taken timely steps to rectify a minor contravention, a rectification direction may not be required.

### *Capability of trustees to carry out required actions*

The actions required to rectify a contravention will often involve several steps, some of which may be complex. You should be satisfied the person given the direction is capable of carrying out those actions or steps. If the person is unlikely to have the means or the willingness to do so, a rectification direction will not be appropriate.

If a contravention is relatively straightforward to rectify, it may still be appropriate to give a direction despite that person not wanting to engage with us. This ensures a person who should be able to carry out the required steps is directed to do so under a formal written direction.

### *Previously given an education direction*

A person who has been given an education direction<sup>13</sup> for a previous matter, may be given a rectification direction if they subsequently contravene a regulatory

<sup>11</sup> See *Re Insurance and Superannuation Commissioner* [1994] AATA 248.

<sup>12</sup> See "QX971" and *Australian Prudential Regulation Authority* [1999] AATA 6.

<sup>13</sup> See section 160.

provision. However, it may be more appropriate to take firmer compliance action if there has been no change in the trustee's non-compliant behaviour.

### *ATO compliance action*

A person is more likely to be given a rectification direction if an ATO review or audit confirms the trustee has not rectified (or attempted to rectify) a reported contravention.

## **6. How much time should you give to comply with a rectification direction?**

The period of time you give to comply with a rectification direction must be reasonable in the circumstances.<sup>14</sup>

In deciding on a reasonable period of time, you should have regard to factors including but not limited to:

- the circumstances, abilities and constraints of the person to whom you will be giving the direction
- the likely period required to carry out the type of actions specified in the direction and, if there are a number of steps involved, whether those steps need to occur in sequence
- whether the person given the direction will be relying on the availability and expertise of professional advisors.

Generally, a period of up to 6 months will be sufficient to rectify most contraventions, with up to 12 months in extreme cases.

If you give a direction and later determine the period given was not reasonable, you can vary the direction – see section 7 of this Practice Statement.

## **7. Can you vary or revoke a rectification direction after it has been given?**

A rectification direction may be varied upon request or on your own initiative; however, it can only be revoked on your own initiative.

The principles discussed in section 5 of this Practice Statement should be relied upon for all such decisions.

## **Variation requests**

You can vary a rectification direction where the person given the direction:

- makes a written request before the timeframe allowed for complying with the direction has expired, and
- sets out the reasons for the request.<sup>15</sup>

A valid request to vary a direction will extend the time the person has to comply with it from the day the request was made until you notify the trustee of your decision.<sup>16</sup> If you do not make a decision on the request within 28 days after the request was made, the request is taken to have been refused and you should send written notification of the deemed decision to the trustee.<sup>17</sup>

If you decide to vary the direction in any way, you must notify the person and give them a copy of the varied direction. Additionally, if you decide to refuse the request, or vary it in a way otherwise than requested, you must give the person written reasons for the decision.<sup>18</sup>

### *On your own initiative*

You are able to revoke or vary a rectification direction on your own initiative. You do so by giving the relevant person a written notice either revoking or varying the terms of the rectification direction.<sup>19</sup>

Although you can revoke or vary a rectification direction at any time, it would generally not be appropriate to do so merely where the person given the direction failed to comply with it.

## **8. Does an administrative penalty apply where a person fails to comply with a rectification direction?**

An administrative penalty is not imposed for failing to comply with a rectification direction. However, you can explore other compliance options, including firmer action.

However, if the person fails to comply with a rectification direction by the specified period of time, the person commits an offence of strict liability which carries a maximum of 10 penalty units.<sup>20</sup>

<sup>14</sup> See subsection 159(4).

<sup>15</sup> See subsections 164(1) to (3).

<sup>16</sup> See subsection 164(7).

<sup>17</sup> See subsection 164(5).

<sup>18</sup> See subsection 164(6).

<sup>19</sup> See section 163.

<sup>20</sup> See subsection 159(7).

## 9. Can a person object to the decision to give a rectification direction or to not vary a direction?

A person may object to a decision in the manner set out in Part IVC of the *Taxation Administration Act 1953* if they are dissatisfied with our decision to:

- give a rectification direction
- refuse to vary the direction (including a deemed refusal)
- vary the direction but not in accordance with the request.<sup>21</sup>

## 10. More information

For more information, see:

- [PS LA 2020/3](#) *Self-managed superannuation funds – administrative penalties imposed under subsection 166(1) of the Superannuation Industry (Supervision) Act 1993*
- [PS LA 2012/5](#) *Administration of penalties for making false or misleading statements that result in shortfall amounts*

- [PS LA 2008/3](#) *Provision of advice and guidance by the ATO*
- [PS LA 2006/19](#) *Self-managed superannuation funds – notice of non-compliance*
- [PS LA 2006/18](#) *Self-managed superannuation funds – enforceable undertakings*
- [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*
- [MT 2008/1](#) *Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard*

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<sup>21</sup> See section 165.

## ATTACHMENT – EXAMPLES

### Example 1 – rectification direction not given – enforceable undertaking a more suitable option

An SMSF has been operating for 8 years. The trustees of the SMSF contravened the SISA after loaning money to a related company which exceeded the 5% limit on in-house assets. The contravention is considered serious.

The ATO started a review of the SMSF and the case officer asked the trustees whether the contravention had been rectified. The trustees provided a written plan to divest the in-house asset and advised they have not carried out the plan within the designated timeframe. After considering their options, the trustees presented a written undertaking to divest the in-house asset as set out in the plan and proposed a revised period of a further 3 months to do so.

In considering whether to issue a rectification direction, the case officer determines:

- the fund is unlikely to experience financial detriment by recalling the loan early, and little weight should be placed on any financial detriment to the related company in refinancing to a suitable lender
- while the contravention is serious, the value of the assets put at unauthorised risk due to the prohibited lending is not extreme, and the fund has a good compliance history
- the trustees are capable and committed to carrying out the written plan, and both the proposed undertaking and the revised period specified are reasonable.

#### Outcome

After considering general principles and case-specific factors, the case officer considers a rectification direction would be a suitable option. However, the case officer instead accepts the undertaking by following the principles in Law Administration Practice Statement PS LA 2006/18 *Self-managed superannuation funds - enforceable undertakings*. This is because the enforceable undertaking would achieve the same desired outcome as a rectification direction.

However, if the revised period in the proposed undertaking had been too great, the case officer would not have accepted it. Instead, the case officer would have given a rectification direction to each of the individual trustees granting a shorter rectification period.

### Example 2 – rectification direction given – disposal of a non-liquid asset

An SMSF has been operating for 3 years. The approved auditor reported the corporate trustee of the SMSF borrowed money from a fund member to finance the fund's residential property purchase. The property was held directly by the fund and was not structured as a limited recourse borrowing arrangement. The contravention is considered serious.

The ATO started an audit of the SMSF. The case officer asked about the circumstances of the contravention. The director of the corporate trustee explained the fund borrowed money from a member because the fund's assets could not cover the minimum deposit required by the bank. Further, the director did not get adequate advice about correctly setting up the arrangement. Nevertheless, the director does not want to sell under the weak market conditions for vendors as well as incur further legal and agent's fees. The director also acknowledged the property would sell within weeks if it was put on the market, but the fund would make a loss on the sale.

In considering whether to issue a rectification direction, the case officer determines:

- the fund will likely experience some financial detriment to unwind the arrangement, although weak market conditions in itself is not sufficient to preclude giving a direction and transaction costs are to be expected
- the contravention is serious and involves a significant portion of the fund's assets, although the errors made by the director of the corporate trustee can be attributed to inexperience, insufficient knowledge and carelessness
- the fund does not have the ability to repay the borrowing from other means
- the unrectified contravention was confirmed during an ATO audit and the director is competent and capable of selling the asset, even in the current market conditions.

#### Outcome

The case officer gives the director of the corporate trustee a rectification direction requiring the fund to dispose of the property within 3 months. The decision is also consistent with the ATO's general decision-making principles.

The case officer also considers giving an education direction and determines the level of any remission on the administrative penalty imposed.

### **Example 3 – rectification direction not given – notice of non-compliance issued**

An SMSF has been operating for 3 years. The fund failed to lodge annual returns for each of those years despite requests from the ATO. When the annual returns are received, the approved auditor reports a number of contraventions that had taken place over each of those years.

The ATO commences an audit and the facts and evidence show that besides the non-lodgment of annual returns by the due date the trustees also:

- had not formulated an investment strategy
- failed to keep accounting records to explain the transactions and financial position of the fund, and
- loaned a substantial amount of money to one of the members of the fund.

Due to the nature and seriousness of the contraventions, and the amount of fund assets that were put at risk and the trustees disregard to requests to lodge the annual returns, the case officer, having regard to the relevant Practice Statements, considers that it is more appropriate to issue a notice of non-compliance in this case.

## References

<b>Legislative references</b>	SISA 1993 Pt 3B SISA 1993 10(1) SISA 1993 40(1) SISA 1993 126A SISA 1993 159(1) SISA 1993 159(2) SISA 1993 159(3) SISA 1993 159(4) SISA 1993 159(5) SISA 1993 159(7) SISA 1993 160 SISA 1993 163 SISA 1993 164(1) SISA 1993 164(2) SISA 1993 164(3) SISA 1993 164(5) SISA 1993 164(6) SISA 1993 164(7) SISA 1993 165 SISA 1993 166(1) SISA 1993 262A SISR 1994 TAA 1953 Part IVC
<b>Case references</b>	Re Insurance and Superannuation Commissioner [1994] AATA 248; 94 ATC 417; 29 ATR 1086 “QX971” and Australian Prudential Regulation Authority [1999] AATA 6
<b>File references</b>	1-HRR4W9J
<b>Related practice statements</b>	PS LA 2020/3 PS LA 2012/5 PS LA 2006/17 PS LA 2006/18 PS LA 2006/19 MT 2008/1

## ATO references

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