


# ***TA 2023/2 - Diverting profits of a property development project to a self-managed superannuation fund, through use of a special purpose vehicle, involving non-arm's length arrangements***

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## Taxpayer Alert

# Diverting profits of a property development project to a self-managed superannuation fund, through use of a special purpose vehicle, involving non-arm's length arrangements

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### **!** About Taxpayer Alerts

Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more information about Alerts. See [Alerts](#) issued to date.

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### **Overview**

- We are currently reviewing arrangements under which:
  - one or more self-managed super funds (SMSFs) have, or acquire, direct or indirect ownership of a special purpose vehicle (SPV) that undertakes a property development project, and
  - because of the non-arm's length arrangements between the SPV and other entities, the SPV derives a profit that ultimately benefits the SMSFs which is more than what it would have been if all the parties had dealt with each other at arm's length.
- The non-arm's length arrangements have the effect of shifting what would otherwise be the profits of the related entities (taxed at the corporate rate, for example) to

the SMSFs, being concessional tax entities. If the SPV is a company, the SMSFs may also receive tax offset refunds in relation to the dividends received.<sup>1</sup>

3. The Commissioner will consider whether the dividends and other income received by the SMSFs are non-arm's length income (NALI) as defined in section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997), and the application of the regulatory requirements in the *Superannuation Industry (Supervision) Act 1993* (SISA) and other relevant law in respect of these arrangements.

4. If you are a trustee of, or an adviser to, an SMSF that is looking to participate in a property development, refer to the SMSF Regulator's Bulletin *Self-managed superannuation funds and property development* on how SMSF trustees can ensure they meet their income tax and regulatory obligations when participating in property development activities.

### Description

5. These arrangements typically display some or all of the following features:
- The controlling minds of one or more property development groups carry out a particular project by establishing an SPV for this purpose.
  - The controlling minds are members of their respective SMSFs.
  - Interests in the SPV can be directly or indirectly owned by the SMSFs and the SMSFs' interests can be acquired for either an arm's length or non-arm's length<sup>2</sup> price.
  - The SPV contracts with related entities, often within the controlling minds' property development groups (related entities), to carry out some or all of the property development project work. The price charged by the related entities is less than what would be expected in an arm's length arrangement and, as a result, the related entities derive a lower (or nil) profit than if they had dealt at arm's length.
  - The related entities or SPV, or both, may also enter into loans to facilitate the property development project. The terms of the loans are not consistent with those that would be expected in an arm's length dealing (for example, the interest rate may be lower). In some instances, the loan terms may appear at arm's length but those terms are not followed or fully enforced.
  - The SPV earns profits in respect of the property development project that are higher than what would have been expected if the SPV, SMSFs or the related entities had dealt with each other at arm's length. The SMSFs ultimately derive dividends or distributions in respect of the SPV's profits and they may also receive tax offset refunds in relation to any dividends received.

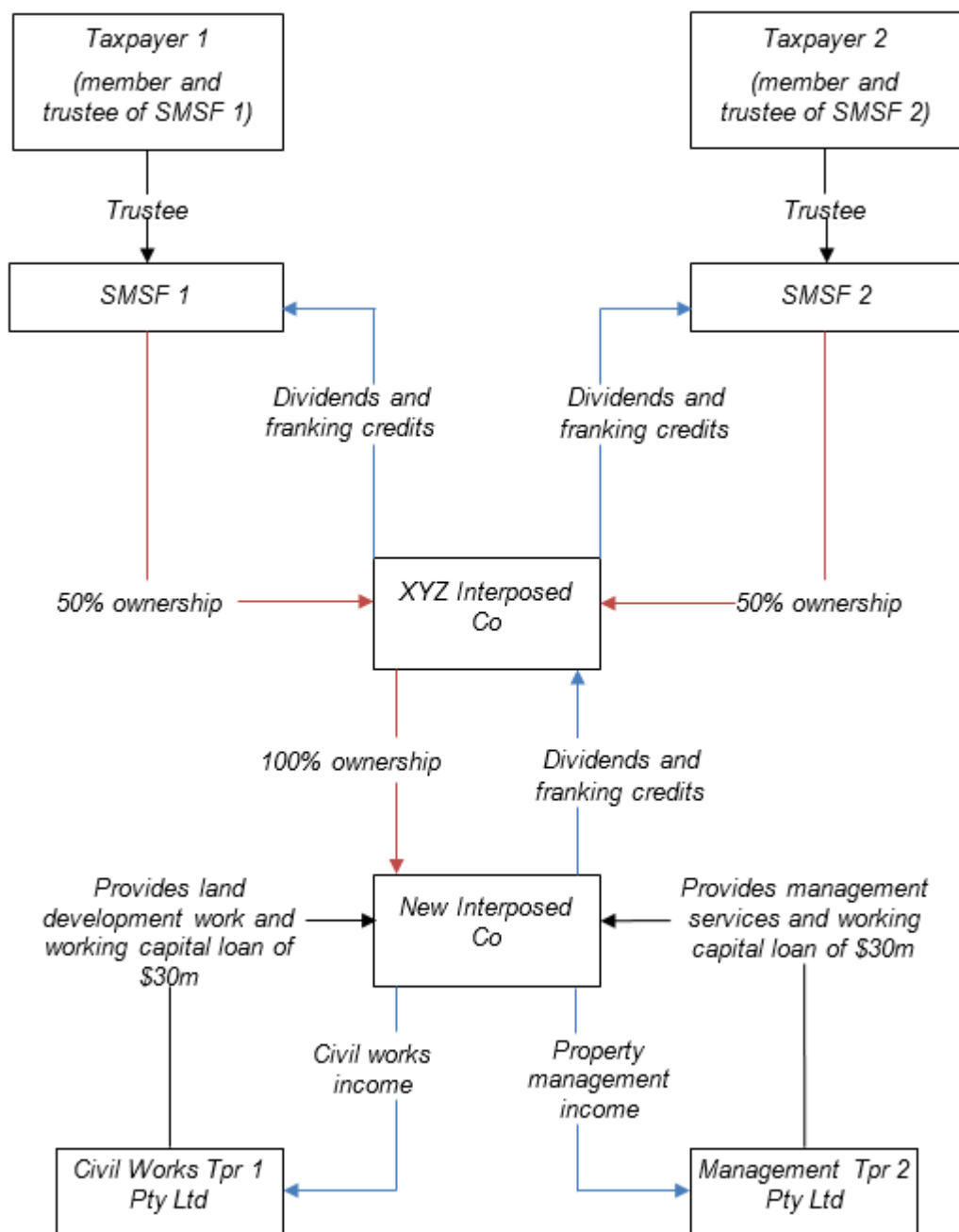
<sup>1</sup> Under the refundable tax offset rules in Division 67 of the *Income Tax Assessment Act 1997* and the common rules for tax offsets in Division 63 of that Act.

<sup>2</sup> Where a non-arm's length price is paid by the SMSF to acquire the direct interest in the SPV (or other entity) such that the price is less than the arm's length price (including nil), then paragraphs 295-550(1)(b) or (c) of the ITAA 1997 can apply to make all income, including any capital gain in respect of that interest, NALI. Further, depending on the arrangement, paragraph 295-550(1)(a), and subsections 295-550(2), (4) and (5) may also be applicable.

**Example**

**Example: Non-arm's length income arrangement involving the diversion of profits of a property development project to 2 self-managed superannuation funds**

**Diagram: Group structure including ownership of entities, and flow of income**



6. Taxpayer 1, an individual, is a member and trustee of SMSF 1 and also a shareholder, director and controlling mind of Civil Works Tpr 1 Pty Ltd which is engaged in property construction.

7. *Taxpayer 2, an individual, is a member and trustee of SMSF 2 and a shareholder, director and controlling mind of Management Tpr 2 Pty Ltd which is engaged in the management of construction projects and providing finance.*
8. *A third-party land owner is seeking to engage a property developer to construct buildings on its land, for which the property developer will be paid a fixed portion of the sale proceeds of each developed property.*
9. *Taxpayer 1 and Taxpayer 2 agree to form new entities to undertake the property development project. Under the agreement:*
- *XYZ Interposed Co is created and owned 50% each by SMSF 1 and SMSF 2.*
  - *New Interposed Co, a special purpose vehicle, is created and owned 100% by XYZ Interposed Co.*
  - *New Interposed Co contracts with the third-party land owner to undertake the property development.*
  - *New Interposed Co subcontracts all property development functions to Civil Works Tpr 1 Pty Ltd and property development project management functions to Management Tpr 2 Pty Ltd.*
  - *Management Tpr 2 Pty Ltd and Civil Works Tpr 1 Pty Ltd each provide a working capital loan of \$30 million to New Interposed Co.*
10. *Ordinary shares are issued by XYZ Interposed Co to SMSF 1 and SMSF 2 for an arm's length price.*
11. *Ordinary shares in New Interposed Co are issued to XYZ Interposed Co, for a non-arm's length nominal price.*
12. *New Interposed Co sub-contracts the property construction function to, and obtains a loan of \$30 million from, Civil Works Tpr 1 Pty Ltd. Under the property construction function, Civil Works Tpr 1 Pty Ltd charges non-arm's length fixed fees that are below the fees that it would charge third parties for the same services. The loan by Civil Works Tpr 1 Pty Ltd to New Interposed Co is on non-arm's length terms, including no interest and no set repayments of principal and interest.*
13. *New Interposed Co sub-contracts the property development project management function to, and obtains a loan of \$30 million from, Management Tpr 2 Pty Ltd. Under the management contract, Management Tpr 2 Pty Ltd charges fixed fees which are at arm's length and consistent with fees it charges to third parties for the same services. The loan by Management Tpr 2 Pty Ltd to New Interposed Co is on non-arm's length terms, including no interest and no set repayments of principal and interest.*
14. *New Interposed Co receives its fixed portion of the proceeds from the sale of the developed properties over the duration of the property development project. New Interposed Co pays franked dividends sourced from the proceeds of these sales to XYZ Interposed Co. In turn, XYZ Interposed Co pays franked dividends to SMSF 1 and SMSF 2.*
15. *As a consequence of the arrangement, New Interposed Co earns profits in respect of the property development project that are more than what would have been expected if the New Interposed Co, the SMSFs or the other entities had dealt with each other at arm's length.*
16. *As a result of the scheme, some or all of the profits of New Interposed Co. are diverted to SMSF 1 and SMSF 2 through the payment of dividends from XYZ Interposed Co. The dividends received from XYZ Interposed Co are assessed at a 15% rate of tax or are exempt from tax if the shares in XYZ Interposed Co are supporting the payment of*

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*pensions to members of SMSF 1 or SMSF 2. SMSF 1 or SMSF 2 may also receive a refund of any excess franking credits associated with the dividends.*<sup>3</sup>

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### **What are our concerns?**

17. We are concerned that some of the arrangements lack commerciality and result in diverting profits attributable to a property development project (that would otherwise be taxed at the corporate, or other applicable, rate) to an SMSF being a concessionally taxed entity. Depending on the facts, our concern also extends to any capital gain derived from the subsequent disposal of the SPV or other entity in which the SMSF has an indirect or direct interest.

18. A view has been expressed that as long as the SMSF is not directly involved in any non-arm's length dealing, the NALI provisions cannot apply. These views are not correct and have been addressed judicially.<sup>4</sup> Non-arm's length dealings by any party in respect of any step in relation to the scheme, can give rise to NALI as defined in section 295-550 of the ITAA 1997.

19. In respect of the arrangement covered in this Alert, we are concerned that:

- an examination is not being made in respect of each step in the scheme to ensure that they are all at arm's length. For example, while the SMSFs' acquisition of ordinary shares in XYZ Interposed Co are for an arm's length price, the fact that XYZ Interposed Co's acquisition of New Interposed Co shares was at a non-arm's length nominal price is one factor that may give rise to the application of the NALI provisions
- shares in entities in which the SMSFs have a direct and indirect interest in (XYZ Interposed Co and New Interposed Co in the Example in this Alert) may not be purchased by the relevant entity at an arm's length price<sup>5</sup> and this may give rise to NALI consequences. For example, as XYZ Interposed Co's interest in New Interposed Co was acquired at less than the arm's length market value, any dividends paid to the SMSFs that are sourced from a capital gain in respect of XYZ Interposed Co's disposal of New Interposed Co may be NALI
- an entity (New Interposed Co in the Example in this Alert) enters into an arrangement to sub-contract (Civil Works Tpr 1 Pty Ltd) the property construction function on non-arm's length terms to maximise the profits from the property development project, that ultimately benefits the SMSFs
- an entity (New Interposed Co in the Example in this Alert) borrows monies (from Civil Works Tpr 1 Pty Ltd and Management Tpr 2 Pty Ltd in the Example) on non-arm's length terms – including charging no interest, to

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<sup>3</sup> Under subsection 207-20(2) of the ITAA 1997, an SMSF will be entitled to a (refundable) tax offset on receipt of a franked distribution equal to the amount of the franking credit on the distribution. If the tax offset exceeds their basic income tax liability, the SMSF may be entitled to a refund of the excess (see table item 40 of subsection 63-10(1) of the ITAA 1997 and Division 67 of the ITAA 1997).

<sup>4</sup> See the Full Federal Court decision of Keane CJ, Greenwood and Middleton JJ in *Allen (Trustee), in the matter of Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation* [2011] FCAFC 118.

<sup>5</sup> See the High Court decision of *Commissioner of Succession Duties (SA) v Executor Trustee and Agency Company of South Australia Limited* [1947] HCA 10; (1947) 74 CLR 358 at 362 and the decision of BJ McCabe (Deputy President) and Hespe (Senior Member) in *GYBW and Commissioner of Taxation* [2019] AATA 4262.

maximise its profits from the property development project, that ultimately benefits the SMSFs

- the SMSFs may be maintained for a purpose outside those permitted by the sole purpose test under section 62 of the SISA<sup>6</sup>
- the SMSFs may not continue to meet the relevant operating standards under the SISA, including record-keeping requirements, ensuring assets are appropriately valued and recorded at market value<sup>7</sup>
- the SMSFs may have breached other SISA requirements, such as the in-house asset<sup>8</sup> and borrowing provisions<sup>9</sup>
- other risks may arise, as mentioned in SMSFRB 2020/1.

20. From our review of these arrangements, we consider that the following consequences may arise:

- Dividends and franking credits received by the SMSFs (such as those from XYZ Interposed Co in the Example in this Alert) – that arise as a result of their direct or indirect interest in the SPV that undertakes the property development project (New Interposed Co in the Example) – are NALI, as defined in section 295-550 of the ITAA 1997, and taxed at the top marginal rate.<sup>10</sup>
- Depending on the facts, capital gains, or income that flows to the SMSFs from those capital gains, that arise in respect of the disposal of entities in the scheme may have NALI consequences under section 295-550 of the ITAA 1997.
- The Commissioner may make a determination under Part IVA of the *Income Tax Assessment Act 1936* in relation to the imputation benefit or tax benefit arising under the arrangement.
- The Commissioner may, under section 126A of the SISA, disqualify a person from acting as a trustee or director of a corporate trustee of the SMSFs.
- The Commissioner may issue a notice of non-compliance under subsection 40(1) of the SISA to the SMSFs.

### What are we doing?

21. We are currently reviewing these arrangements and are engaging with taxpayers who have entered into, or are considering entering into, these and similar arrangements.

22. Taxpayers and advisers who enter into these types of arrangements will be subject to increased scrutiny.

<sup>6</sup> Self Managed Superannuation Funds Ruling SMSFR 2008/2 *Self Managed Superannuation Funds: the application of the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993 to the provision of benefits other than retirement, employment termination or death benefits.*

<sup>7</sup> Subsection 35B(2) of the SISA and Regulation 8.02B of the *Superannuation Industry (Supervision) Regulations 1994.*

<sup>8</sup> Under section 84 of the SISA; see also the anti-avoidance rules in section 85 of the SISA.

<sup>9</sup> Footnote 33 in SMSFR 2008/2.

<sup>10</sup> *Income Tax Rates Act 1986.*

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**What should you do?**

23. If you have entered, or are contemplating entering, into an arrangement of this type, we encourage you to:

- phone or email us using the contact details provided at the end of this Alert
- ask us for our view through a [private ruling](#)
- seek independent professional advice
- make a [voluntary disclosure](#) to reduce penalties that may apply.

24. Arrangements entered into by an SMSF, or other entity in which the SMSF has a direct or indirect interest, should be subject to strong governance, care and diligence.

25. Penalties may apply to participants in, and promoters of, this type of arrangement. This includes serious penalties for promoters under Division 290 of Schedule 1 to the *Taxation Administration Act 1953*. Registered tax agents involved in the promotion of this type of arrangement may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*.

**Do you have information?**

26. To provide information about this type of arrangement, or a promoter of this or another arrangement:

- phone us on 1800 060 062
- complete the [ATO Tip-Off Form](#)
- contact the officer named in this Taxpayer Alert.

**Contact officer:** Mia Dang  
**Email:** [mia.dang@ato.gov.au](mailto:mia.dang@ato.gov.au)  
**Phone:** 02 6216 2112

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**Commissioner of Taxation**  
15 June 2023

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**Amendment history**

Date	Comment
19 January 2024	Updated ATO tip-off hotline number

**References***Legislative references:*

- ITAA 1936 Pt IVA
- ITAA 1997 Div 63
- ITAA 1997 63-10(1)
- ITAA 1997 Div 67
- ITAA 1997 207-20(2)
- ITAA 1997 295-550
- ITAA 1997 295-550
- ITAA 1997 295-550(1)(a)
- ITAA 1997 295-550(1)(b)
- ITAA 1997 295-550(1)(c)
- ITAA 1997 295-550(2)
- ITAA 1997 295-550(4)
- ITAA 1997 295-550(5)
- SISA 1993 35B(2)
- SISA 1993 40(1)
- SISA 1993 62
- SISA 1993 84
- SISA 1993 85
- SISA 1993 126A
- SISR 1994 8.02B
- TAA 1953 Sch 1 Div 290

- Tax Agent Services Act 2009

*Related rulings:*

- SMSFR 2008/2

*Case references:*

- Allen (Trustee), in the matter of Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation [2011] FCAFC 118; 195 FCR 416; 2011 ATC 20-277; 84 ATR 853
- Commissioner of Succession Duties (SA) v Executor Trustee and Agency Company of South Australia Limited [1947] HCA 10; 74 CLR 358; [1947] ALR 240; 21 ALJR 210
- GYBW and Commissioner of Taxation [2019] AATA 4262; 2019 ATC 10-510; 111 ATR 107

*Other references:*

- [SMSFRB 2020/1](#)

## ATO references

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 Superannuation ~~ Self-managed super funds ~~ Restrictions ~~ Related parties

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