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NEW ATO SMSF PENALTIES

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With the new penalties for self-managed super funds (SMSFs) commencing from 1 July, 2014, trustees and advisers need to ask themselves: “should I be afraid, very afraid,” to quote Geena Davis from the movie *The Fly*, or should they just be mildly concerned. The answer is that it all depends on what they think the superannuation fund is to be used for. For those who think it’s just a piggy bank to be drawn upon at will, then the Geena Davis quote is spot on. However, for the vast majority of trustees, understanding the new penalties is something they need to get under their belt and to ensure they steer clear of.

There has been a lot of noise about the new penalties from both the Australian Taxation Office (ATO) as regulator of SMSFs and other commentators. But we need to remember they come on top of a penalty system most of which has been in existence since the Superannuation Industry (Supervision) Act and Regulations came into being in the 1990s. Those penalties consist of court imposed civil and criminal penalties as well as the ability of the ATO to obtain enforceable undertakings from trustees, disqualify a trustee and treat the fund as non-complying. The ATO has disqualified a number of trustees since taking over the supervision of SMSFs in 1999 as well as making funds non-complying. The attempts by the ATO to have court imposed penalties were proven to be successful in a number of cases stemming from about 2007 with a peak in 2010 and 2011.

Civil penalties

The civil penalty provisions of the SIS Act cover some breaches of the operating standards but not all of them. Civil penalties of up to 2000 penalty points (\$340,000) can be imposed by the court on SMSF trustees for breaches of the sole purpose test, lending and

borrowing by the fund, in-house assets and failure of the trustees to report significant events. Other penalties for breaches of the operating standards are included in the particular provision. For example, if the fund acquires an asset from a related party in breach of section 66 the penalty can be the joy of up to one year in prison. To my knowledge no one has gone down at Her Majesty’s pleasure for such a breach, however, the threat is still there. In these cases it would be reasonable to expect that the ATO may disqualify the trustees or make the fund non-complying to sort the issue out.

Civil penalties

- Cover most breaches of the operating standards of the SIS Act and Regulations
- Can result in financial penalties of up to \$340,000

Case study – Mr MacLeod

Mr MacLeod rolled over a superannuation benefit of \$40,032 in August, 2005. He then withdrew \$20,028 from the fund so he could settle some legal proceedings for a former client. Then in 2006 and 2007 further amounts were withdrawn from the fund to meet other financial needs in relation to school fees and due to a relationship breakdown. The auditor for the fund reported the contraventions in an Audit Contravention Report to Mr MacLeod and the ATO in 2007. Despite this, Mr MacLeod continued on his merry way and withdrew further amounts from the fund. In January 2010 the fund was closed and anything that was left in the fund was transferred to a retail superannuation fund.

The ATO disqualified Mr MacLeod from being a trustee for the repeated breaches. This meant that he could not act as a trustee of any superannuation fund. The breaches were considered to be so significant that they sought penalties to be imposed by the Federal

Court. In its decision the Court held that Mr McLeod had contravened the sole purpose test by making a significant number of withdrawals over the years. This included that financial assistance was provided to him under section 67 of the SIS Act by using the resources of the fund.

The Court imposed the civil penalty of \$12,500 due to the seriousness and deliberate nature of the breach over a number of years. The penalty was imposed for the illegal release of benefits from the fund in breach of the sole purpose test. [*Olesen v MacLeod* [2011] FCA 229]

Criminal penalties

The imposition of criminal penalties has been few and far between with none impacting on SMSFs under the SIS legislation. However, there are some cases where weekend detention has been imposed for severe non-lodgement of fund returns – imagine sitting next to a hardened criminal explaining what you have done and the look of horror on his or her face. One of the reasons for not imposing criminal sanctions on trustees could be that if the same matter is being considered under the civil penalty provisions then it is precluded from later criminal proceedings. Another may be that the onus of proof is less as the imposition of a criminal penalty relates to the fact that the matter must be proven ‘beyond reasonable doubt’. These matters would involve dishonesty, deceit and reckless behaviour of the trustee. Civil penalties are determined on the ‘balance of probabilities’ which is a lesser standard of proof.

Criminal penalties

- The onus of proof must be ‘beyond reasonable doubt’
- Usually involves dishonesty, deceit and reckless behaviour of the trustee
- If the trustee is found guilty the penalty is a custodial sentence

What happens from 1 July 2014

The administrative directions and penalties for breaches for SMSFs which apply from 1 July 2014 became law principally because of the complexity involved in seeking court imposed penalties for what were probably seen as relatively minor breaches in the overall workings of the justice system. In addition, in most cases there was a prolonged delay in getting matters to court and at a considerable cost to the parties. Also, the potential penalty of up to 2000 penalty points could have resulted in an outcome where a sledge hammer was being used to crack a nut – effective yet devastating. These reasons may have been the reluctance of the ATO proceeding with only but the most serious offences where significant and repeated breaches of the superannuation standards occurred.

The new legislation helps in adding to the arsenal of penalties and actions available to the ATO which now includes:

- Rectification directions,
- Education directions, and
- Administrative penalties.

A rectification direction can be imposed by the ATO if the trustee, individual or corporate, has breached the SIS Act or Regulations.

Education directions

An education direction may be given by the ATO in situations where the trustee has been identified with a first time contravention of the operating standards. It could also be imposed where the trustee has displayed a lack of knowledge of the rules. However, a trustee who has committed contraventions in previous years or has been advised of the rules or has previously received a direction would not usually be a candidate for an education direction.

Once the course has been undertaken within the required time the ATO must be provided with evidence the course that has been approved by the ATO has been completed. If the course has not been undertaken as required an administrative penalty of five penalty units (\$850) is imposed. This is a strict liability offence which relates to the lack of action by a person to whom the direction has been given and who is liable for the offence. The aim is to discourage careless non-compliance and it will be interesting to see whether the threat of an \$850 fine will achieve that outcome.

Education directions

- ATO can require the trustee to undergo an ATO approved course
- Failure to undergo the course can result in a penalty of \$850

Rectification directions

To some extent rectification directions have similar features to enforceable undertakings which can be obtained in terms of s262A of the SIS Act. However, in the case of the rectification direction it is the ATO who provides the direction to the trustee. With an enforceable undertaking it is provided by the trustee as part of the negotiation to correct the breach. Where the trustee of the fund already has made an enforceable undertaking it is not possible for the ATO to make a rectification direction in relation to the same matter. Failure to meet the terms of a rectification direction is a strict liability offence.

Rectification directions

- Requires failure to correct the breach or ensure the breach does not reoccur
- Failure to correct breach or meet requirements of the direction can result in penalties depend on the repetition and seriousness of the breach

Administrative penalties

Administrative penalties are financial penalties which range from \$850 to \$10,800 and are imposed for some breaches of the SIS legislation. At the lower end of the scale penalties apply for not providing the ATO with information or meeting the requirements of an education direction. The penalty in those cases is \$850. Where books and records or accounts and other documents have not been prepared or retained for the fund a penalty of \$1,700 applies. Failure to notify the Commissioner of a change in the status of the SMSF results in a



The quote

There are a number of breaches for which the trustee could also be penalised as an administrative penalty under the new rules.

Table 1:

Administrative penalties for SMSFs from July 1 2014

124 (1)	Failure to record the appointment of an investment manager in writing.	5 penalty units (\$850)
160 (4)	Failure to undertake a trustee course as directed by the regulator by the time required.	5 penalty units (\$850)
254 (1)	Failure to provide the Commissioner with information in the approved form.	5 penalty units (\$850)
347A (5)	Failure to provide statistical information to the Commissioner with information in the approved form.	5 penalty units (\$850)
35B	Failure to prepare accounts for the fund for a financial year.	10 penalty units (\$1,700)
103 (1)	Failure to keep a particular books and records of the fund for at least 10 years.	10 penalty units (\$1,700)
103 (2)	Failure to keep copies of minutes and records of decisions of the fund for at least 10 years.	10 penalty units (\$1,700)
103 (2A)	Failure to keep a particular election for in-house asset purposes for at least 10 years.	10 penalty units (\$1,700)
104 (1)	Failure to keep records relating to the change of trustees.	10 penalty units (\$1,700)
104A (2)	Failure to complete and retain for 10 years the declaration of responsibilities as a trustee of an SMSF.	10 penalty units (\$1,700)
105 (1)	Failure to retain member or beneficiary report for the fund.	10 penalty units (\$1,700)
34(1)	Failure to meet the standards in subsection 31(1) at all times	20 penalty units (\$3,400)
106A (1)	Failure to notify the Commissioner in the change of status of the entity.	20 penalty units (\$3,400)
65 (1)	Lending money or providing financial assistance to a member or relative.	60 penalty units (\$10,200)
67 (1)	Breaches of the rules that limit the fund borrowing.	60 penalty units (\$10,200)
84 (1)	Failure to comply with the in-house asset rules for related party investments.	60 penalty units (\$10,200)
106 (1)	Failure to notify the regulator of significant events about the SMSF.	60 penalty units (\$10,200)

penalty of \$3,400. At the top end of the scale a penalty of \$10,400 applies to lending and borrowing, in-house asset breaches as well as failing to notify the Commissioner of a significant event relating to the fund.

Case study – Ms Ward

Ms Ward is not an organised person by any stretch of the imagination. She keeps all of the information about her tax and superannuation affairs in a box. At the end of the financial year she prepares accounts based on what's available and hands them over to her brother who audits the books and signs off on them.

As part of an ATO audit of the fund it is discovered that the accounts have been prepared on a cost basis and after 3 years they are put in the recycling bin and never seen again.

For purposes of s35B of the SIS Act the accounts and records of a fund must be retained for at least 5 years and must be valued on a market value basis as provided in SIS Reg 8.02B. In addition, Ms Ward's brother is a qualified accountant but not registered as an SMSF auditor with ASIC nor would he satisfy the independence requirements.

In Ms Ward's case the trustee is being exposed to the probability there is a breach of the rules for preparing accounts and statements in s35B of the SIS Act which brings with it a penalty of up to 100 penalty units (\$17,000). In addition, there are a number of breaches for which the trustee could also be penalised as an administrative penalty under the new rules. These would include:

Table 2: Proportion in the number and dollar value of total contraventions reported in ACRs per contravention category, for ACRs to 30 June 2013.

Contravention Category	% Number	% \$ value
Loans	21.3%	14.8%
In-house assets	18.7%	28.3%
Administrative	11.3%	1.8%
Separation of assets	12.8%	26.0%
Operating standards	8.1%	6.2%
Borrowings	7.9%	6.9%
Sole purpose	7.9%	5.4%
Investments at arm's length	7.6%	7.5%
Other	2.9%	1.0%
Acquisitions of assets from related parties	1.4%	2.2%
Total	100.0%	100.0%

- Failure to provide the Commissioner with information in the approved form – 5 penalty units (\$850)
- Failure to prepare accounts for a financial year – 10 penalty units (\$1,700)
- Failure to keep particular books and records for at least 10 years - 10 penalty units (\$1,700)

As the fund has been audited by Ms Ward's brother who is not a registered SMSF auditor it means that the fund has not been audited by an approved auditor. In addition, the independence requirements have not been met.

Whether the ATO would attempt to press the point with all of these offences and impose the penalties depends on a range of factors such as the repetition of the offence. They do have the power to remit penalties that are automatically imposed. However, don't count your chickens on that one as the trustee may end up copping the lot. One thing's for sure, it doesn't look rosy for Ms Ward's SMSF or her brother.

Where to from here

The lesson with the new penalty system that is to what was in place prior to 1 July this year is to make sure those niggling compliance issues which may have been overlooked in the past are seriously addressed. The new penalties include strict liability penalties which mean if the breach occurred then it is an offence which doesn't take taking into account the intention or knowledge of the trustee at the time the breach took place.

It seems that making sure the trustees seek advice from a professional before getting into a mess is all the more important as well as an education campaign to make sure those trustees are well aware of their responsibilities in running an SMSF properly. 'Be afraid, be very afraid' or maybe not, can only be answered by you or your client when the tax man comes knocking with his box of directions and penalties. **FS**



The quote

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