

TA 2008/4 - Self-managed superannuation funds deriving income from certain uncommercial trusts



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The Taxation Office view on the major issue in this arrangement is set out in Taxation Ruling TR 2006/7



Taxpayer Alert

TA 2008/4

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FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. (It should be noted that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Self-managed superannuation funds deriving income from certain uncommercial trusts

This Taxpayer Alert describes a non-arm's length arrangement under which a self-managed superannuation fund (SMSF) derives income through a direct or indirect interest in a closely-held trust. The arrangement may be of the type of trust described in Taxpayer Alert TA 2008/3, where an individual or another entity borrows funds to invest in a trust and seeks a tax deduction for its interest costs. This Alert should be read in conjunction with Taxpayer Alert TA 2008/3.

DESCRIPTION

The alert applies to arrangements which have some or all of the following features.

1. A trust is established which is controlled by an individual or a family group.
2. An SMSF is or becomes a beneficiary of the trust. Alternatively, the SMSF holds or obtains an indirect interest in the trust, through one or more interposed entities. The trust may also have other beneficiaries, who are associated with or related to the individual or family group.

3. The income derived directly or indirectly by the SMSF from the trust is disproportionate to its investment in the trust. As such, the SMSF derives more income from the trust than it might be expected to derive from an ordinary commercial arrangement. The SMSF may consider that the trust income is subject to the same concessional rate of tax as the SMSF's other income. This is not necessarily correct. The arrangement may be achieved in a number of ways.
4. The trust deed may provide for:
 - (a) entitlements to income which appear to be fixed, but which can be defeated by the trustee exercising a discretion to distribute income and/or capital gains to the SMSF (whether directly or indirectly). For that reason, the trust may be described as a 'hybrid trust' or 'hybrid discretionary trust'
 - (b) the issue of units or other interests to the SMSF (or to another entity in which the SMSF holds an interest) for no consideration, or for consideration which falls short of the market value of such interests at the time of issue
 - (c) the redemption of trust interests held by the individual or other entities for below market value or at face value. As such, the SMSF may effectively obtain a disproportionate share of the trust's income which is not commensurate with its investment.
5. The trust deed may also purport to deny the individual or other family members any interest in capital gains of the trust. Alternatively, the capital gain to which the SMSF is entitled may be disproportionately large, in comparison to the amount of trust capital which the SMSF has funded. The deed may achieve this by preventing or restricting the distribution of capital gains to the individual or other family member, or by enabling the individual or family member's interest in the trust to be redeemed at face value, or face value, adjusted for inflation.
6. As beneficiaries of the SMSF, the individual or family members may ultimately benefit from the income and capital gains distributed to the SMSF.

FEATURES WHICH CONCERN US

The Tax Office considers that the arrangement outlined above may give rise to taxation issues that include whether:

1. income derived by the SMSF from the trust is 'non-arm's length income' for the purposes of section 295-550 of the ITAA 1997, which is taxed at a higher rate than other income of the SMSF;
2. other taxation consequences arise for the individual or other family members as discussed in Taxpayer Alert TA 2008/3.

Entities considering entering into the arrangement outlined above should also consider the requirements of the *Superannuation Industry (Supervision) Act 1993*.

The Australian Taxation Office is examining these arrangements.

Subject References:

hybrid trust
self-managed superannuation fund
unit trust
trust distributions
capital gains
non-arm's length income

Legislative References:

Income Tax Assessment Act 1997
Section 295-550
Part 3-1

Related Taxpayer Alerts:

TA 2008/3

Date issued:

Authorised by:

Deputy Commissioner

Stephanie Martin

Contact Officer:

Stuart Forsyth

Business Line:

Superannuation

Section:

Phone:

(07) 3149 5504
