Super Concepts

Case Study Answers

SMSF Audit Report: Common Part A & B Qualifications

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CASE STUDY A

Rose SMSF lends $10,000 to the family company (a related party), which represents less than 5% of all fund assets. The SMSF loan is supported by a written loan agreement, at a commercial rate of interest, with the capital to be repaid in three years.

Shortly after that, the company provides financial assistance to members of the fund by lending them $10,000 at a commercial rate of interest. The fund members use the $10,000 to cover personal credit card debt.

Question 1: Is this a breach?

a) Yes
b) No
c) Not sure

Question 2: Is it reportable?

a) Yes
b) No
c) Not sure

Question 3: Could it have been avoided?

a) Yes
b) No
c) Not sure

Question 4: Would it have been different if the money was used in acquiring equipment or machinery?

a) Yes
b) No
c) Not sure

ANSWER

At face value, the loan would be in accordance with the in-house asset rules. In this case, there is however a clear breach as the company uses the money of the fund to facilitate loans from the company to fund members. In other words, financial assistance using SMSF resources has been indirectly provided to members. The investment is not allowed, and thus the loan must be repaid in full to the fund.

On the other hand, the family company had used the $10,000 to acquire machinery or equipment for the business (instead of using the money to satisfy a personal debt of fund members), there would have been a completely different result. In these circumstances, the loan to the company would not cause a contravention and would therefore be allowed.

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CASE STUDY B

During August 2021, it came to light that Andrew had a serious gambling addiction and lost hundreds of thousands of dollars of his own money.

Andrew withdrew $50,000 in cash from his SMSF in the second half of 2020 to help pay for his gambling debts. Andrew confided this in Johan on 10 July 2021 but only confessed to the auditor last week.

Question 1: Is this a breach?

a) Yes
b) No
c) Not sure

Question 2: Is it reportable?

a) Yes
b) No
c) Not sure

Question 3: Could it have been avoided?

a) Yes
b) No
c) Not sure

ANSWER

This is an example of early release - would have to report as it fails on sole purpose test and the threshold test of $30k. However, it is important that trustees/accountants advise the auditor earlier, to ensure that work could be done to rectify the situation before the ACR lodged. Should ensure a plan in as to how it would be rectified and ensure met. This is always considered more favourably by the ATO.

CASE STUDY C

Mr and Mrs Peach have established an SMSF in which they are the members and trustees. The fund has $70,000 in cash, with which they as trustees would like to purchase a one third interest in a residential property in Byron Bay used for holiday letting.

Mr and Mrs Peach as individuals will own the other two third interest. They will borrow money to fund their purchase but their private residence will be used as security.

Mr and Mrs Peach intend to use the holiday property when it is not being rented. It will however be available to rent for the whole year.

Question 1: Is this a breach?

a) Yes
b) No
c) Not sure

Question 2: Is it reportable?

a) Yes
b) No
c) Not sure

Question 3: Could it have been avoided?

a) Yes
b) No
c) Not sure

ANSWER

The SMSF and Mr and Mrs Peach as trustees of the SMSF can invest as tenants in common in a residential property, as it falls within one of the exceptions of an 'in-house asset'. The property would need to be bought from an unrelated party.

A member or any related party would not be permitted to rent or reside in the property otherwise it would constitute an 'in-house asset'. The 'in-house asset' rule is a day by day test and any stay by Mr and Mrs Peach or a related party would require the trustee to include the full market value of the property as an 'in-house asset' of the fund. If the market value exceeds the 5% rule, then the trustee is in breach of the 'in-house asset' rules.

Not a situation any SMSF wants to find themselves in so be careful and if uncertain, seek advice.

CASE STUDY D

John and Jane Orange are the trustees and members of the Orange Super Fund. They are also the directors and shareholders of Orange Furniture Pty Ltd, a newly incorporated company through which they intend to run a furniture manufacturing business.

John and Jane (as trustees of the Orange Super Fund) lend $500,000 to Orange Furniture Pty Ltd at a commercial rate of interest with the capital to be repaid to the Orange Super Fund in 5 years. Orange Furniture Pty Ltd uses this money to buy its business premises and equipment.

Question 1: Is this a breach?

a) Yes
b) No
c) Not sure

ANSWER

Does the above contravene s 65 of the SISA?

On the facts, not only is financial assistance being provided to Orange Furniture Pty Ltd but also a loan. However, this does not necessarily give rise to a contravention of s 65 of the SISA. Section 65 of the SISA expressly prohibits loans and financial assistance being provided to *members of the fund and/or their relatives*. It does not go so far as to prohibit loans and financial assistance being provided to all related parties.

Therefore, the above facts do not give rise to a contravention of s 65 of the SISA.

However, this loan would be considered an in-house asset and would be required to meet the 5% rule.

CASE STUDY E

As at year end Apple SMSF had an in-house asset, a loan to an associate entity of over $200,000, which represented more than 50% of fund assets, of which all but $15,000 had been repaid by the time the audit was to commence.

Question 1: Is this a breach?

a) Yes
b) No
c) Not sure

ANSWER

This fund was selected for a high-risk audit by the ATO, which identified that the fund was established for a family, who used their SMSF to help prop up their business. Over a three -year period, the trustees withdrew amounts from the fund, and would repay these to the SMSF at the end of each year to keep amounts below the 5% in house assets threshold.

The trustees repeatedly and intentionally played on the edge of IHA thresholds, until such time as they experienced financial difficulty and were unable to reduce the amount below the required thresholds. An administrative penalty of $10,200 was imposed upon the corporate trustee with the directors jointly and severally responsible for the payment of the administrative penalty. The fund trustees entered into an enforceable undertaking to return the fund assets upon sale of one of their properties and to wind up the fund.