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SMSF NEWSLETTER

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SPECIAL POINTS OF INTEREST:

- **Issues to consider regarding bankruptcy and superannuation**
- **The ATO is concerned about SMSFs breaching the rules**

INSIDE THIS ISSUE:

PROTECTING YOUR SUPERANNUATION

For many Australians, superannuation savings are their second largest asset after the family home.

With such a large proportion of assets at risk, it is important to consider whether your superannuation savings are protected in the event of bankruptcy.

What happens if you go bankrupt?

At the end of 2013, the Australian Bureau of Statistics reported that total household debt stood at $1.84 trillion, or $79,000 for every Australian.

With debt such a large part of our lives, we run the risk of being unable to pay these debts as and when they fall due. If your debt levels become unmanageable, you may voluntarily go bankrupt or a creditor may take legal action and force you into bankruptcy.

In a nutshell, the process of bankruptcy involves you giving up your assets and control of your finances, in exchange for gaining protection from legal action by creditors (definition from the Federal Court of Australia).

Therefore, going bankrupt allows you to clear your debts and make a fresh start. However, the downside is that you basically hand control of your finances across to a trustee for the duration of your bankruptcy (generally for a period of three years).

WARNING–The consequences of bankruptcy are serious, and include:

- financial restrictions being placed on you for a period of three years;
- a permanent record being made of your bankruptcy; and
- the bankruptcy will be recorded on your credit reports for up to five years.

Is your superannuation protected in bankruptcy?

If you go into bankruptcy, the trustee can sell your assets and distribute the proceeds amongst your creditors. However, not all of your assets are available to be sold to pay back your creditors. Accordingly, you will usually retain these 'protected' assets when your bankruptcy period is over.

One of these 'protected' assets is your superannuation savings (note, exceptions apply). Therefore, the trustee in bankruptcy generally cannot 'claw back' your superannuation to pay out your creditors.

However, the bankruptcy laws do allow superannuation contributions to be recovered and paid to your creditors if the contributions were made to avoid creditors getting hold of the money.

Hence, if you are in financial trouble and try and hide money in your superannuation fund, laws may allow the contributions to be recovered and paid to creditors.

EXAMPLE–Prior to going into business for himself, Sam (aged 45) built his superannuation balance to $500,000 as an employee. He went into business three years ago, and ended up in financial difficulty, and then bankruptcy. Provided he has not made contributions to hide his money from creditors, his superannuation balance is likely to be protected from creditors.

WARNING–The bankruptcy rules are complex and strict requirements must be followed to ensure that your superannuation is protected from creditors. For example, creditors can potentially claw back both superannuation contributions and benefits withdrawn from your SMSF.

Therefore, it is best to seek advice before running into financial difficulties to ensure you don't inadvertently trip up.

THE LATEST ATO ALERTS FOR SMSFS

In a recent speech, the ATO has warned SMSFs about two schemes that it has come across recently.

Overseas seminars

The ATO has alerted SMSF trustees about promoters who advertise overseas SMSF conferences.

According to the ATO, the promoters claim that the travel costs (including flights and accommodation) are fully tax deductible to the fund.

However, conference expenses paid for by an SMSF for its trustees to attend a conference may not be fully tax deductible for one or more of the following reasons:

- **content –** there is very little content that relates to SMSFs;
- **personal expenses** – if some or all of the expenditure is for holidaying, rather than conference attendance; and/or
- **pension phase** – if the fund is paying a pension for at least one member, the expenses will not be fully tax deductible. This is because the expenses are related to income that is not assessable to the fund.

NOTE–If your SMSF is paying a pension, income derived by the fund on assets supporting the pension is exempt from tax. However, this also means that expenses incurred by the fund in earning exempt pension income are generally not tax deductible.

EXAMPLE–Glen is trustee of his SMSF, and is aged 41. He arranges for his SMSF to pay for travel expenses to attend an SMSF conference in Hawaii. The costs cover airfares, accommodation, conference expenses and sightseeing.

The trip is six days long, with the first three days of the conference covering administration of an SMSF and advanced retirement strategies. The remaining three days are for sightseeing around Hawaii.

Are the conferences expenses fully tax deductible to the fund?

No, the expenses are not fully tax deductible to the fund. This is because half of the conference expenses are actually private holiday expenses, rather than conference costs.

WARNING–The ATO also stated that the 'sole purpose test' may be contravened by SMSFs who seek to pay for conference expenses from their fund. This is because the fund is paying for benefits outside of those permitted under the superannuation rules.

Home loan unit trusts

The ATO has also cautioned SMSF trustees that some SMSFs are breaching the superannuation rules by investing in what it refers to as 'home loan unit trust arrangements'.

More specifically, the ATO is concerned about an arrangement where the SMSF and other related parties invest in a unit trust structure. The unit trust then uses the money obtained from the SMSF and the related party to purchase a residential rental property.

The ATO states that the next stage of the arrangement involves the unit trust renting the property it owns across to a member of the fund, who lives in the property. In effect, the SMSF is financing accommodation for the member through the unit trust. The ATO stated that this arrangement is likely to result in the SMSF breaching the following superannuation rules:

- **financial assistance** – the SMSF's retirement savings are being used to provide a house for the member to live in; and
- **sole purpose test** – using superannuation savings to provide accommodation to the member (or a relative for that matter) goes against the legal requirement for the SMSF's assets to be used for providing retirement savings to the member.

The arrangement can also create additional compliance headaches if the unit trust uses borrowings to help finance the purchase of the property. If you have been involved with either of these arrangements, make sure you seek advice from us as soon as possible.

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