

The ATO is looking for personal services income diverted to SMSFs



The ATO has announced that it is reviewing arrangements where members of an SMSF (typically at, or approaching, retirement age) purport to divert income earned from their personal services to their fund, which results in minimising or even avoiding tax altogether on that income.

The ATO says these arrangements typically display all or most of the following features:

- An individual performs services for a client or other “acquirer” of the personal services for which the individual does not directly receive any (or adequate) consideration for the services provided.

- The client does not pay or remit funds to the individual directly; rather the client remits the consideration for the services provided to a company, trust or other non-individual entity (which may be an unrelated third party).
- The entity then distributes the income to an SMSF, of which the individual is a member, purportedly as a return on an “investment” of the SMSF in the entity.
- The trustee of the SMSF treats the income received as subject to a concessional rate of tax, or as exempt current pension income of the SMSF.

The ATO also points out that such arrangements may also include one or more of the following characteristics or variations:

- The income may be remitted by the entity to the SMSF via a written or oral agreement between them, instead of as a return on an investment in the entity.
- The SMSF may receive the income from more than one entity or through a chain of entities. Alternatively, the entity may distribute the income to more than one SMSF of which the individual and/or associates are members.

What are the ATO’s concerns?

The worry for the ATO is that in order to avoid paying tax at applicable personal marginal rates, individuals are entering into these arrangements in an attempt to divert “personal services income” (PSI) to an SMSF, where the income is concessionally taxed or treated as exempt current pension income.

The ATO says that it considers that:

- The arrangement may be ineffective at alienating income such that it remains the assessable income of the individual.
- The income may be included in the individual's assessable income as personal services income.
- The amounts received by the SMSF may constitute non-arm's length income of the SMSF, such that the income is not eligible to be concessional tax and is not exempt current pension income.

Of course, the ATO considers that the general anti-avoidance rules may apply to cancel tax benefits obtained by the individual.

It says other compliance issues for arrangements of this type may include:

- the amounts received by the SMSF under the arrangement could instead be deemed to be a contribution to the fund, and subject to the contributions caps
- superannuation regulatory issues, in particular the SMSF is maintained for purposes other than those set out in the sole purpose test, leading to the SMSF being made non-complying or the disqualification of an individual as a trustee.

What the ATO is doing about it

The ATO says it will be undertaking reviews of a number of cases involving arrangements of this type, and will be engaging with taxpayers whose affairs concern it in this regard where it becomes aware of this occurring.

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