TRUSTEE USED MONEY AS BUSINESS LIFE RAFT

The Australian Financial Review

Published: 22 August 2011

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The case of a self-managed super fund member who illegally withdrew money to prop up an ailing business highlighted the temptations facing trustees, legal experts said.

Unlike members of large pooled funds, the trustees of DIY super funds are in direct control of their scheme's financial transactions, creating the temptation to withdraw money illegally before they reach retirement age.

A judgment by the Administrative Appeals Tribunal of Australia outlines the plight of Lynn Smith and her husband, who ran a real estate business which they had been advised to place into voluntary administration after Macquarie Group, without notice, said it would no longer extend them credit.

The business contained the couple's only real asset, the rent roll. Ms Smith and her husband withdrew money from their self-managed fund "for the purposes of preserving the business", the decision reads.

The business was preserved, which enabled Ms Smith and her husband to repay the fund. By keeping the firm afloat, the owners were able to pay staff, who continued to pay income tax on those wages. The owners themselves also avoided drawing social security benefits.

However, the AAT upheld the tax commissioner's decision that the amount withdrawn from the fund be added to Ms Smith's assessable income and taxed at marginal rates.

As a result, Ms Smith will pay income tax on $50,000 in 2008 and $37,000 in 2009.

Lawyers were divided over whether Ms Smith and her husband, or the fund, were likely to face further punishment. The judgement makes no mention of other penalties.

According to the Tax Office, a self-managed fund that has been "used to assist the illegal release of super savings may be treated as non-complying and the fund's income taxed at the highest marginal tax rate." Furthermore, trustee can be disqualified, face fines of up to $220,000 or up to five years in prison.

The Tax Office refused to comment.

Peter Townsend of Townsend Business and Corporate Lawyers in Sydney said it was unlikely the tax commissioner would take further action, particularly as the case related to the 2008 financial year.

“The commissioner doesn’t make funds non-complying at the drop of a hat,” Mr Townsend said, noting that in some cases such a course of action could be viewed as counter-productive because it might force trustees to rely on the aged pension in retirement.

But Peter Bobbin, a principal of Argyle Lawyers, said it was hard to determine whether the Tax Office had applied further penalties because the judgment dealt only with a breach of a section of the tax law.

In another recent case, a self-managed fund was made non-compliant after one of the three trustees withdrew more than $40,000 over five years to pay for a drug addiction.