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Self managed superannuation funds: arrangements to acquire property that contravene superannuation law

The ATO has become aware that a number of arrangements entered into by self managed superannuation funds (SMSFs) to acquire property may not comply with superannuation laws. SMSF trustees and advisors should exercise caution, ensuring any arrangements to invest in property are correctly implemented according to the law.

Arrangements

There are two arrangements often utilised by a SMSF to acquire property that the Commissioner believes contravene superannuation law:

Property investments using limited recourse borrowing arrangements (LRBAs)

Subject to certain exceptions, trustees of SMSFs are prohibited from borrowing money. It is important to note that different conditions apply for arrangements entered into between 25 September 2007

and 6 July 2010 inclusive, and arrangements entered into on or after 7 July 2010. If the investment was made through a holding trust and not held directly by the SMSF trustee and is in respect of a single acquirable asset, the structure is not a breach of superannuation law and is known as a LRBA.

The Commissioner is reviewing arrangements entered into on or after 7 July 2010 that exhibit one or more of the following characteristics:

- the borrowing and the title of the property are held in the individual's name and not in the name of the trustee of the holding trust. The SMSF funds part of the initial deposit and the ongoing loan payments;
- the title of the property is held by the SMSF trustee, not the trustee of the holding trust;
- the trustee of the holding trust is not in existence and the holding trust is not established at the time the contract to



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acquire the asset is signed;

- the SMSF trustee acquires a residential property from the SMSF member;
- the acquisition comprises two or more separate titles and there is no physical or legal impediment to the two titles being dealt with, assigned or transferred separately; or
- the asset is a vacant block of land. The SMSF intends to use the same borrowing to construct a house on the land. The land is transferred to the holding trust prior to the house being built.

Property investments using related unit trust

Subject to limited exceptions, the trustee or investment manager of an SMSF is prohibited from intentionally acquiring assets from a related party. An exception to this is an investment in or loan to a related party, commonly referred to as an 'in-house asset'. The

total market value of the in-house assets must not exceed the 5% of the total market value of the fund's assets.

An SMSF investment in a related unit trust is excluded from the definition of an in-house asset and is excluded from the calculation of the 5% limit.

These arrangements include at least one of the following characteristics:

- the asset acquired by the unit trust is used as a security for the money borrowed by the members to subscribe units in the unit trust;
- the assets of the unit trust include an asset that was acquired from a related party of the superannuation fund which is not business real property; and/or
- the assets of the unit trust include real property that is leased to a related party of the superannuation fund, and the real property subject to the lease is not a business real property.

The Commissioner's key concerns

Superannuation regulatory issues relating to these structures

These structures give rise to the following issues relevant to the application of the *Superannuation Industry (Supervision) Act 1993 (SISA)* and the *Superannuation Industry (Supervision) Regulations 1994 (SISR)*:

Property investments using LRBAs

- the investment arrangements may be in breach of the sole purpose test in section 62 of the SISA;
- section 67 of the SISA, which prohibits the SMSF trustee from borrowing money or maintaining an existing borrowing, may have been breached;
- the asset acquired is not a single acquirable asset as required under section 67A(2) of the SISA because it comprises two or more proprietary rights;
- the acquirable asset is subject to a charge that would prohibit an SMSF trustee from borrowing money, or maintaining a borrowing of money under subparagraph 67A(1)(f); and
- the deposit paid by the SMSF and/or loan repayment by the SMSF may be considered as a payment of superannuation benefits, which contravenes Part 6 of the SISR where the title of the property is not held by the trustee of the holding trust.

Property investments using related unit trust

- the investment arrangements may be in breach of the sole purpose test in section 62 of the SISA;
- the SMSF's investment in the unit trust fails to meet the requirements of Regulation 13.22C;
- the SMSF's investment in the unit trust is an in-house asset under section 71 SISA, therefore counting towards the 5% limit under section 83 SISA.



Taxation issues

These structures give rise to a number of taxation issues:

Property investments using LRBAs

- the investment arrangements may be in breach of the sole purpose test in section 62 of the SISA;
- the SMSF's investment in the unit trust fails to meet the requirements of Regulation 13.22C of the SISR; and
- the SMSF's investment in the unit trust is an in-house asset under section 71 SISA, therefore counting towards the 5% limit under section 83 SISA.

Property investments using related unit trust

- an SMSF may become a non-complying superannuation fund for tax purposes and must include amounts of income from previous years in its assessable income under section 295-325 of the *Income Tax Assessment Act 1997*;
- the unit trust may incur a capital gains tax liability in relation to the disposal of the property;
- the members and the SMSF may be required to include a capital gain in their assessable income of an amount on redemption of their units in the unit trust.

Please keep in mind

SMSF trustees are responsible for ensuring that their SMSF complies with superannuation laws. All SMSF trustees carry equal responsibility for managing the SMSF, regardless of the level of their involvement in the day-to-day running of the fund.

Contravention of SISA provisions may result in a SMSF becoming a non-complying superannuation fund for tax purposes. If this occurs the SMSF is subject to the 45% tax rate that is applied to its income and the market value of its assets measured at the start of the income year in which the fund becomes non-complying. Additionally, a trustee of a fund may be liable for administrative and civil penalties, and in certain circumstances criminal charges may apply.

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