



Taxpayer Alert

TA 2012/7

Self managed superannuation funds arrangements to acquire property which contravene superannuation law

FOI status: may be released

Taxpayer Alerts are intended to be an 'early warning' of significant new and emerging higher risk tax and superannuation planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax and superannuation planning issues. Not all potential tax and superannuation planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert might obtain their own advice or contact the ATO to seek guidance in relation to the tax and superannuation regulatory issues covered in the Taxpayer Alert.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

The ATO has become aware that certain arrangements entered into by self managed superannuation funds (SMSFs) to acquire property do not comply with superannuation law.

The purpose of this Taxpayer Alert is to warn SMSF trustees and advisors to exercise care; ensuring any arrangements entered into by an SMSF to invest in property are properly implemented, particularly those involving limited recourse borrowing arrangements (LRBA) or the use of a related unit trust.

The ATO is concerned that some of these arrangements, if structured incorrectly, can not simply be restructured or rectified; and unwinding the arrangement may involve a forced sale of the asset which could cause a substantial loss to the fund.

Context for the arrangements

Property investments using LRBA

Subject to limited exceptions, trustees of SMSFs are prohibited from borrowing money. An SMSF is not prohibited from borrowing money, or maintaining a borrowing of money, providing the arrangement entered into satisfies the conditions contained in the superannuation laws. Different conditions apply for arrangements entered between 25 September 2007 and 6 July 2010 inclusive and arrangements entered into on or after 7 July 2010. Some of the requirements of this exception are that the investment is made through a holding trust and not held directly by the SMSF trustee; and the investment is in a single acquirable asset. These arrangements are commonly referred to as LRBA.

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. One exception is where the asset is an investment in or loan to a related party, commonly referred to as an 'in-house asset'. However the total market value of the SMSF's in-house assets must not at any time

referred to as an in-house asset. However, the total market value of the SMSF's in-house assets must not at any time exceed 5% of the total market value of the fund's assets. Where in-house assets for an SMSF exceed the 5% limit, the trustee needs to rectify the breach, usually within 12 months.

An SMSF's investment in a related unit trust is excluded from the definition of an in-house asset where the unit trust complies with the regulatory requirements contained in Div 13.3A of the Superannuation Industry (Supervision) Regulations 1994 (SISR). Therefore, such investments are excluded from the calculation of the 5% limit. Furthermore, the general prohibition on SMSFs acquiring assets from a related party does not apply where the SMSF's investment is in a unit trust which complies with those requirements.

Contravention of these conditions may result in the SMSF becoming a non-complying superannuation fund for tax purposes.

Description

This alert applies to arrangements with features substantially equivalent to the following:

Arrangement 1 - Property investments using LRBA

1. An SMSF enters into a LRBA post 7 July 2010 to acquire an asset.
2. The arrangement has at least one of the following features:
 - (a) The borrowing and the title of the property is held in the individuals' 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 repayments;
 - (b) The title of the property is held by the SMSF trustee not the trustee of the holding trust;
 - (c) The trustee of the holding trust is not in existence and the holding trust is not established at the time the contract to acquire the asset is signed;
 - (d) The SMSF trustee acquires a residential property from the SMSF member;
 - (e) 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
 - (f) 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.

Arrangement 2 - Property investments using related unit trust

1. An individual or individuals ('the fund members') establish an SMSF and rollover their existing superannuation benefits into the SMSF. Alternatively the individual or individuals are a member of an existing SMSF.
2. A unit trust ('the unit trust') is established for the purpose of acquiring a property. Alternatively an existing unit trust can also be used for the same purpose.
3. The unit trust is a related unit trust.
4. The fund members subscribe for units in the unit trust.

5.

The fund members may borrow money from a commercial lender to fund the subscription to units in the unit trust.

6.

The SMSF also subscribes to units in the unit trust.

7.

The trustee of the unit trust purchases an asset ('the asset') such as a property which is rented out.

8.

The arrangement has one or more of the following characteristics:

(a)

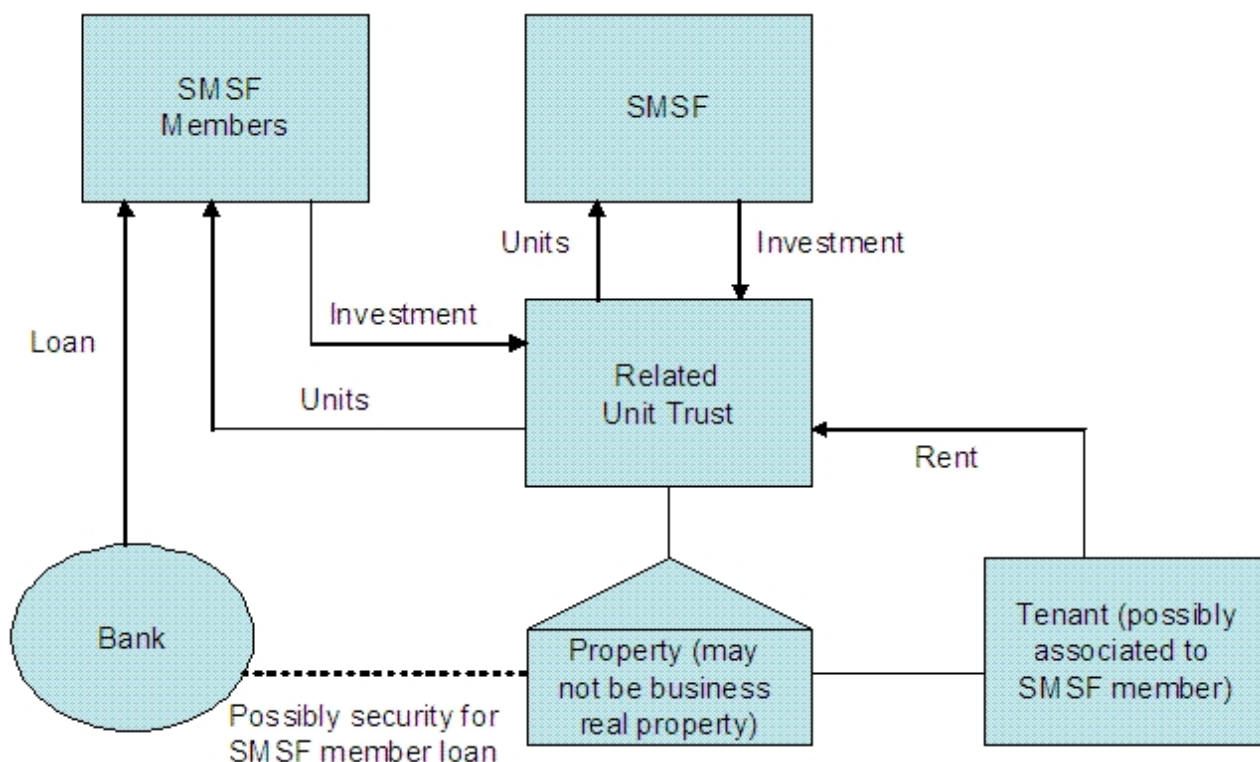
The asset acquired by the unit trust is used as a security for the money borrowed by the members to subscribe units in the unit trust;

(b)

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

(c)

The assets of the unit trust include real property which is leased to a related party of the superannuation fund, and the real property subject to the lease is not a business real property.



Features which concern us

Superannuation regulatory issues

The ATO considers that arrangements of this type 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), being whether:

Arrangement 1 - Property investments using LRBA

(a)

the investment arrangements may be in breach of the sole purpose test in section 62 of the SISA;

(b)

section 67 of the SISA which prohibits the SMSF trustee from borrowing money or maintaining an existing borrowing may have been breached;

- (c) the asset acquired is not a single acquirable asset as required under section 67A(2) of the SISA as it is comprised of two or more proprietary rights;
- (d) the acquirable asset is subject to a charge which would prohibit an SMSF trustee from borrowing money, or maintaining a borrowing of money under subparagraph 67A(1)(f); and
- (e) 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.

Arrangement 2 - Property investments using related unit trust

- (f) the investment arrangements may be in breach of the sole purpose test in section 62 of the SISA;
- (g) the SMSF's investment in the unit trust fails to meet the requirements of Regulation 13.22C of the SISR; and
- (h) 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

The ATO considers that arrangements of this type give rise to the following issues relevant to taxation laws, being whether:

Arrangement 1 - Property investments using LRBA

- (a) the member(s) may be required to include the SMSF loan repayments in their assessable income under Division 304 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- (b) the income and its associated deductions from the investment should be declared by the individual member(s) rather than by the SMSF where the investment is not held for the beneficial interest of the SMSF.

Arrangement 2 - Property investments using related unit trust

- (c) 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 ITAA 1997;
- (d) The unit trust may incur a capital gains tax liability in relation to the disposal of the property;
- (e) The members and the SMSF may be required to include a capital gain in their assessable income an amount on redemption of their units in the unit trust.

The ATO provides guidance to SMSF trustees on the issue of acquisition of an asset from a related party in Self Managed Superannuation Funds Ruling SMSFR 2010/1.

Self Managed Superannuation Fund Ruling SMSFR 2012/1 provides the Commissioner's view regarding the key concepts in relation to LRBA while SMSFR 2009/2 provides guidance on the general borrowing prohibition and a list of exceptions to the general prohibition.

Self Managed Superannuation Fund Ruling SMSFR 2009/4 explains the core concepts in the definition of 'in-house asset'.

Note 1: Some financial advisers and SMSF trustees may talk to you about the benefits of limited recourse borrowing and may encourage you to set up an SMSF. However setting up an SMSF to take advantage of limited

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and may encourage you to set up an SMSF. However setting up an SMSF to take advantage of limited recourse borrowing arrangements may not be a wise step for everyone. SMSFs can be suitable for people with a large amount of super and extensive skills in financial and legal matters. Individuals should think carefully and research to find out if an SMSF is right for their circumstances. For more information to help decide if an SMSF is the right choice for you, refer to www.moneySMART.gov.au.

Note 2: *SMSF trustees are ultimately responsible ensuring an SMSF complies with superannuation laws. All SMSF trustees carry equal responsibility for the managing of the SMSF regardless of the level of involvement in day-to-day running of the fund. SMSF trustees have the responsibility to keep proper and accurate tax and super records. There is also a legal obligation to have the SMSF independently audited annually and the auditor must be provided with records you keep. SMSF Trustees who do not comply with their duties and responsibilities under the superannuation laws, may face disqualification as a trustee, prosecution, your SMSF being deemed non-complying and losing its tax concessions and may face penalties. Refer to Thinking about self-managed super' (NAT 72579) for more information.*

Note 3: *Trustees should always consider the quality of the investment they are making and whether their fund can meet all of the future obligations under the LRBA. A trustee of an SMSF can only enter into such an arrangement where this is consistent with the investment strategy of the fund. The governing rules of an SMSF must allow the trustee of the fund to borrow before any LRBA can be entered into. For more information about trustee/member obligations, refer to Running a self-managed super fund.*

Note 4: *Contravention of SISA provisions may result in an SMSF becoming a non-complying superannuation fund for tax purposes. Where this occurs the SMSF is subject to the 45% tax rate which is applied to its income and the market value of its assets (other than undeducted contributions) measured at the start of the income year in which the fund becomes non-complying. In certain circumstances, the fund's trustee may also be liable to civil penalties or face criminal charges.*

Note 5: *An administrative penalty of up to \$2,200 may apply to a trustee who makes a false or misleading statement to the Commissioner. If you have any information about the current arrangement, phone us on **13 10 20**. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should also call us on **13 72 86** Fast Key Code **3 4**.*

Note 6: *You can apply for self-managed super funds specific advice (SMSFSA) about:*

- *your own SMSFs affairs*
- *another person's SMSFs affairs if you are their agent or legal personal representative.*

An SMSFSA sets out the Commissioner's opinion about the way the super laws apply, or would apply, to your SMSF in relation to a specified arrangement or circumstance. For more information, refer to How to apply for SMSF specific advice.

Date of Issue: 20 November 2012

Date of Effect: 20 November 2012

Subject References:

in house assets
 limited recourse borrowing arrangements
 self managed superannuation funds
 unit trusts

Legislative References:

Income Tax Assessment Act 1997
 Section 295-550
 Division 304
Superannuation Industry (Supervision) Act 1993
 section 62
 section 67
 subsection 67(4A)
 section 67A
 section 67B
 section 71
 section 83
Superannuation Industry (Supervision) Regulations 1994
 13.22C

Related Practice Statements:

PS LA 2008/15

Related Rulings/Determinations:

SMSFR 2009/2
SMSFR 2009/4
SMSFR 2010/1
SMSFR 2012/1

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