

## SELF MANAGED SUPER FUNDS

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## INTRODUCTION

**By Pauline Hammer**

Welcome investors.

Are you looking to acquire more than one apartment over multiple titles; an off the plan apartment maybe or looking to subdivide land?? Our first article, *ATO Clarification for Super Funds Borrowing* from Bryce Figot of DBA Lawyers is a must read for anyone contemplating borrowing within their SMSF for these purposes.

The Technical Director of SPAA, Peter Burgess posted an article on the SPAA member's webpage which I thought would be of interest to AIA regular readers. Peter provides clarity over the issue of appointing a parent or guardian as trustee in place of a child member.

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# ATO CLARIFICATION FOR SUPER FUNDS BORROWING

By Bryce Figot

## Introduction

In July 2010 a new law was introduced to govern how super fund trustees may borrow under a limited recourse borrowing arrangement. See ss 67A and 67B of the *Superannuation Industry (Supervision) Act 1993* (Cth). However, the new law left a number of questions unanswered.

These questions have been put to the Australian Taxation Office. Responses have been received in the NTLG Superannuation Technical Sub-Group meeting on 7 September 2010. This article considers those responses and their impact for SMSFs.

## Multiple loans for real estate spread over multiple titles

The new legislation states that a borrowing must be applied for a 'single' asset. The Explanatory Memorandum that accompanied the new legislation broadly states that 'a collection of buildings each under separate strata title' can not be treated as a single asset. Accordingly, a separate loan would be required for each title.

This is very relevant for SMSF trustees looking to acquire apartments because many apartments might be spread over multiple titles (eg, one title for the apartment itself and another title for the car park). Similarly, many farms are spread over multiple titles.

The ATO state that where assets are for practical purposes inseparable or where they are an 'incident ancillary asset of a very small value' the assets may be treated as one asset. However, they then state that a 'strata title with an accessory car park and a commercial premises over more than one title' do not necessarily fall within this category. The ATO say they would need to consider the facts of a particular case to make a decision.

The implication is that, unless a trustee has received positive SMSF specific advice from the ATO, the conservative approach would be to treat each title as a separate asset. Accordingly, a separate loan would be needed for each asset. This can be tricky because not all banks are willing to lend on this basis. Accordingly, before signing any purchase contract, SMSF trustees should check whether the property is spread over multiple titles and — if it is — be sure that they are comfortable with the implications before proceeding.

## No subdivision of land acquired using borrowings

Many SMSF trustees want to borrow to acquire real estate and then subdivide the land. However, the new legislation states that assets acquired using borrowings can only be replaced in very specific circumstances. None of those circumstances apply to real estate. The Explanatory Memorandum considered real estate that is acquired using a borrowing and subdivided. The Explanatory Memorandum states that the subdivided land would be a replacement asset and therefore this would not be permitted.

However, Explanatory Memoranda are not law. Further, there are a number of cases where subdivided land has been treated as the same as the original land. See, for example, *Brady King Pty Ltd v Commissioner of Taxation* (2008) 168 FCR 558 and *Sterling Guardian Pty Ltd v Commissioner of Taxation* (2006) 149 FCR 255.

Accordingly, the question was put as to whether a single title to real estate that has been purchased under a borrowing may then be subdivided while the loan is still being repaid.

The ATO adopted the view set out in the Explanatory Memorandum. Accordingly, for as long as the borrowings are still being repaid, the real estate should not be subdivided.

The implication is that if SMSF trustees want to borrow to acquire land they wish to subdivide, they must first fully pay off the loan before engaging in any subdivision.

## **Borrowing to acquire an off the plan ('OTP') apartment**

The ATO were asked how they view the purchase by a superannuation fund of an OTP apartment. An OTP apartment is usually purchased under a contract where the purchaser acquires the right to the apartment in the future (eg, in 12 to 18 months time, the subdivision has occurred and the apartment is built and on settlement the purchaser obtains a separate title with a completed apartment).

Under the new law, borrowing for expenses incurred in improving the acquirable asset are not permitted. It appears the reason for asking this question was to provide some comfort regarding the purchase of an OTP apartment would not be considered an improvement but the purchase of a completed apartment for s67A purposes.

The ATO indicated that the answer depends on the arrangement. One of the ATO's main concerns here appears to be whether the borrowing was after the apartment was completed and the land was subdivided. It is also understood that financiers will generally only lend on the security of OTP apartments after the apartment is substantially completed.

Accordingly, those wanting to undertake OTP purchases via the SMSF borrowing arrangement should consider obtaining SMSF specific advice before proceeding to ensure their particular OTP arrangement will satisfy the ATO's criteria for the new law.

## **Trust not a bare trust — separate GST registration might be required**

The new law (like the old law) required the asset being acquired with the borrowings to be held on trust. The law does not specify what type of trust. It has been very popular for the trust to be structured as a bare trust. One advantage with a bare trust is administrative savings for GST. The GST administrative saving comes from the fact that sometimes bare trusts do not need to be registered for GST, but rather the ABNs etc of their beneficiaries can be used instead. See GSTR 2008/3.

However, the ATO have expressed the view the trust on which the property is held can never be a bare trust. This view has wide reaching implications. The most immediate implication is that all 'bare trusts' for borrowing arrangements with commercial properties turning over more than \$75,000 must be separately registered for GST.

## **Can an asset remain in a 'bare trust' after the loan is repaid?**

The view that the 'trust' is not a bare trust raises questions as to whether the asset can remain in trust after the borrowing is repaid. The concern is whether — once the loan is repaid — the trust creates an in-house asset risk. The ATO have stated that they will discuss this matter with APRA and Treasury and in the meantime they will not take compliance action if it involves purely a custodial arrangement through a bare trust.

If the ATO do determine that assets can not remain in trust once the borrowings are repaid, this may give rise to stamp duty implications for many SMSFs. On its face, any such transfer gives rise to a duty liability because it is a transfer of dutiable property. Many jurisdictions have exemptions provided that a number of hurdles can be met. Such hurdles typically include that the SMSF trustee can demonstrate that it provided all of the purchase monies and was the real purchaser etc.

However, many SMSF trustees might lack documentation to evidence this to the satisfaction of the relevant state revenue office. This is especially the case where the deposit was paid by a related entity and journalised as a contribution. Other implications could also arise such as CGT and GST.

## **Conclusion**

Although some clarification has been received, a number of grey areas remain. SMSF trustees should be familiar with the remaining uncertainties before entering into borrowing arrangements.

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# APPOINTMENT OF A PARENT OR GUARDIAN AS TRUSTEE IN PLACE OF A CHILD MEMBER

By Peter Burgess

At a recent National Tax Liaison Group Superannuation Sub-group (NTLG) meeting, the Australian Taxation Office (ATO) clarified the operation of subsection 17A(3)(c) of the SIS Act in situations where a SMSF has a corporate trustee and there is a member of the fund who is under a legal disability because of age.

Subsection 17A(3) of the SIS Act provides that a superannuation fund does not fail to satisfy the conditions specified in subsection (1) or (2) by reason only that:

- a) A member of the fund has died and the legal personal representative of the member is a trustee of the fund or a director of a body corporate that is the trustee of the fund, in place of the member, during the period:
  - I. beginning when the member of the fund died; and
  - II. ending when death benefits commence to be payable in respect of the member of the fund; or
- b) The legal personal representative of a member of the fund is a trustee of the fund or a director of a body corporate that is a trustee of the fund, in place of the member, during any period when:
  - I. the member of the fund is under a legal disability; or
  - II. the legal personal representative has an enduring power of attorney in respect of the member of the fund; or
- c) If a member of the fund is under a legal disability because of age and does not have a legal personal representative – the parent or guardian of the member is a trustee of the fund in place of the member; or
- d) An appointment under section 134 of an acting trustee of the fund is in force.

If the SMSF has individual trustees, paragraph 17A(3)(c) applies to allow a parent or guardian of a member who is under 18 years of age to be a trustee of the fund in place of that member. The fund will also satisfy the definition of an SMSF in section 17A if the fund has a corporate trustee and the legal personal representative of a member who is under 18 years of age is appointed as a director of the corporate trustee in place of that member.

However, if the SMSF has a corporate trustee, a parent or guardian cannot be a director of the corporate trustee in place of a member who is under 18 years of age. Unlike paragraph 17A(3)(a) and (b) which both allow a legal personal representative of a member to be either a trustee or a director of a corporate trustee of the SMSF in place of a member, paragraph 17A(3)(c) makes no reference to a parent or guardian acting as a director of a corporate trustee. Importantly, a person is not a legal personal representative of another person simply because they are parent or guardian of that person.

The relevant Explanatory Memorandum (EM) states that paragraph 17A(3)(c) was inserted to address issues with the inclusion of minors as members of an SMSF. Paragraph 17A(3)(c) enables a parent or guardian to act as a trustee of a SMSF on a minor's behalf, where the minor is a member and where the minor does not have a legal personal representative. A parent acting as a trustee in place of the minor may also be a member of the same fund.

This EM appears to confirm that paragraph 17A(3)(c) was only intended to allow the parent or guardian to be a trustee in place of a minor member. The EM provides no explanation as to why paragraph 17A(3)(c) does not extend to the operation of corporate trustee arrangements.

In light of the above, in the ATO's view if neither subparagraph 17A(3)(b)(i) nor paragraph 17A(3)(c) applies, a fund with members under the age of 18 years with a corporate trustee will not satisfy the definition of an SMSF in section 17A of the SIS Act. The ATO is currently working with APRA to determine an appropriate response in situations where a fund may potentially fail the definition of a SMSF in section 17A because the fund has a corporate trustee with one or more members under the age of 18.

## **Implications for trustees and SMSF practitioners**

Under the current law, the ATO considers that a fund with a corporate trustee with one or more members under age 18 will not satisfy the definition of a SMSF in section 17A of the SIS Act unless a legal personal representative has been appointed as a director of the corporate trustee in place of the member who is under age 18.

A person is not a legal personal representative of another person simply by virtue of them being the parent or guardian of that person. However, a person who holds an enduring power of attorney for a member qualifies as that member's legal personal representative. A person who is under the age of 18 is incapable of appointing an enduring power of attorney. Therefore, in order for a fund with a corporate trustee with one or more minor members to satisfy the definition of a SMSF in section 17A, a legal personal representative must first be appointed for members under age 18 and then the legal personal representative must be appointed as a director of the corporate trustee in place of a member under age 18. Normally, in these situations, it would be the parent or guardian of the member under age 18 who is appointed as their legal personal representative. It is assumed that in such circumstances the valid appointment of a legal personal representative would be by court order.

The process by which a legal personal representative can be appointed as a director of the corporate trustee of a SMSF is outlined in ATO ruling SMSFR 2010/2. The appointment of the legal personal representative as a director of the corporate trustee and the removal of the member from this position, must be in accordance with the constitution (if any) of the corporate trustee, the SIS Act and the relevant provisions of the Corporations Act 2001.

*Peter Burgess is the Technical Director of SPAA. This is an article taken from the SPAA member's webpage.*

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