

ATO spotlight on non-cash contributions to super

The release of Taxpayer Alert 2008/12 has highlighted the need for SMSF trustees to act on arm's length terms at all times when dealing with a related party. The Alert focuses on benefits derived by an SMSF by way of non-cash contributions from members which may circumvent contributions limits.

In summary, a member can make up to:

- \$50,000 p.a. in concessional contributions (or \$100,000 p.a. until FY 2012 for members over 50 years). Any excess amounts are taxed at 31.5% (plus the usual 15% contributions tax); and
- \$150,000 p.a. in non-concessional contributions (or, for members under 65 years, up to \$450,000 averaged over three years). Any excess amounts are taxed at 46.5%.

The ATO is concerned that certain benefits conferred on funds may in effect circumvent these caps. The ATO recognises the following as areas of concern

- Contributing assets in kind to a fund without recording the contribution at the correct market value. (This could also breach other superannuation rules).
- A related party (eg, a member or employer) paying an expense of the fund without seeking reimbursement from the fund (or alternatively, the fund's trustee paying an expense but seeking reimbursement from the related party).
- A related party improving fund assets (eg, by paying for development costs to improve land owned by the fund).
- If a fund and a related party both own units in a non-g geared unit trust (or shares in a company), further units or shares are issued or the rights attaching to same are altered so that the value of the units or shares increases.

Funds involved in these activities risk these benefits being treated as contributions which could lead to significant tax if the member's caps are exceeded. Other issues could potentially arise, such as part of the fund's income being taxed at 45% as 'non-arm's length income' (aka 'special income') under section 295-550 of the ITAA 1997.

Impact on SMSF borrowing arrangements

SMSF trustees that borrow to acquire land may wish to improve or develop the land to enhance its value. However, the borrowing laws provide that trustees can only borrow to 'acquire' an asset and therefore the ATO has concerns that borrowing to improve or develop land is not a borrowing for an 'acquisition'.

Many SMSF members or their related parties may therefore be tempted to pay for property development from their own pocket while the fund simply borrows to buy the land. Trustees must take care to ensure the fund is not deriving a benefit or else risk the payment of the development costs being treated as a contribution.

SMSFs with borrowings supported by member guarantees should also be mindful of this issue. Members must consider whether a deemed contribution could arise if their SMSF defaults on its loan repayments and the member guarantors pay the shortfall without seeking to recover these costs from the fund (or waiving their right to do so).

SMSF and Trust Distributions

SMSFs with investments in related unit trusts may have unpaid present entitlements ('UPE'), eg, the trust has made paper distributions without having paid any money to the unitholders.

These UPEs in some cases may sit as book entries for some years. We have also come across a number of UPEs that have supposedly been reinvested by the SMSF back into the unit trust but have found inadequate documentation for them.

We have also seen many reinvestments undertaken based on \$1 per unit when the value of the unit trust has increased markedly and could be 2-3 times that amount per unit if the unit trust deed was followed.

These issues can result in serious problems, including:

- Possible breach of arm's length requirement: naturally, where the trustees of super funds deal with related unit trusts it should be on an arm's length basis. However, if UPEs are not being paid for a number of years, this raises questions of compliance with this rule.
- Possible breach of in-house asset rules: of course there are strict limitations on how much of a super fund's assets can be invested in or

loaned to a related party. The ATO certainly believe that in some circumstances UPEs can constitute a loan for the purposes of these rules. The ATO's draft ruling SMSFR 2008/D1 broadly treats an UPE as a loan to a related party if there has been an intention to provide credit or financial accommodation.

Accordingly, it is important to check SMSFs' balance sheets to ensure that either there are no UPEs or if there are, these are in compliance with the SIS Act, etc.

If it is intended to reinvest an UPE, it is vital that appropriate paperwork is created that extinguishes the UPE and results an issue of new units. The trust deed of the unit trust must be carefully followed in this regard and an appropriate valuation of units undertaken.

Given the fast approaching deadline of 30 June 2009 for reinvestment in related party geared unit trusts, any reinvestment must generally be made before this deadline. Any UPEs as of 1 July 2009 will generally not be capable of being reinvested and may constitute an-house asset under SMSFR 2008/D1.

Naturally, at DBA we have extensive experience with advising and documenting these matters.

SMSF Deed Updates

DBA's Annual Update Service provides a convenient and legally sound method of updating SMSF deeds to access the latest changes and strategies.

Prior to Australia's most substantial reform of the super rules ever in mid-2007, we generally recommended that deeds be updated at least every four to five years (as this reflected a number of prior major milestones in legislative and regulatory reforms). However, recently the pace of change has continued, (eg, recent changes include the new borrowing rules, a new terminal medical benefit and a number of other super and tax related changes).

Many of our clients, especially accountants and financial advisers, are therefore now committed to ensuring their SMSF deeds are updated every year and are reaping significant efficiencies as a result.

We have skilled SMSF lawyers review the prior document trail and ensure a valid update is effected. Many suppliers simply issue a new deed without a proper review resulting in unnecessary legal risks, eg, binding nominations being challenged. You will receive the best quality documentation and service from Australia's leading SMSF law firm whether you order via the Annual Update Service or in paper form.

Special Offer: Investment Strategy and Reserving Kit

Written investment strategies are a key part of SMSF compliance and benefit and protect trustees. They also protect advisers if sued. DBA Butler's new Investment Strategy Kit (25 + pages) is a very comprehensive and practical explanation of how to draft an SMSF investment strategy. It also includes three detailed sample strategies in MS Word format: 1: balanced, diversified strategy; 2 real estate only strategy (member in pension mode); and 3: gearing strategy to acquire real estate. The Kit is \$440 incl GST.

As a special offer, those who purchase the **Investment Strategy Kit** together with our **Investment Reserving Kit**, (normally \$440 incl GST) can do so for **\$800** incl GST, a saving of \$80.

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