

SMSF planning tips to avoid end-of-year headaches

SMSF compliance is more crucial than ever with the ATO sharpening its focus on many SMSF activities. DBA examines several common end-of-financial year headaches for advisers which can often be easily avoided. Active engagement with these issues during the financial year, and not just at year's end, is the key to smooth SMSF administration.

Monitoring contributions

Monitoring contributions into super has never been so important. Although the law provides some grounds for the return of excess amounts above a member's non-concessional contributions cap, these are limited and do not adequately cover some common situations in which excess contributions arise. Trustees might also be limited by the fund's deed if it does not allow them the discretion to return contributions in such situations; under most deeds a condition of release must be met.

The tax penalties for excess contributions can be significant: amounts above the concessional contributions cap (\$50,000 p.a. or \$100,000 p.a. until 30 June 2012 for those aged at least 50 years) are taxed at 31.5% (in addition to the usual 15% contributions tax). Contributions above the non-concessional cap (\$150,000 p.a. or \$450,000 averaged over three years for those aged under 65 years) incur penalty tax of 46.5%.

Dealing with excess contributions therefore tends to be very stressful for all parties involved. In light of the penalties and difficulties in returning excess amounts, members and their advisers should take all possible precautions to ensure no excess amounts are ever received by the fund.

The risk of excess amounts being contributed often arises towards the end of a financial year. Many members who plan to maximise contributions into super often contribute an amount equal to their cap shortly before year's end, often in haste in order to meet the 30 June deadline and forgetting that amounts may have already been contributed up to 12 months earlier. Some members might also not realise that contributions into the fund are final; for example, gross proceeds from the sale of a property or other assets outside super should not be parked in the fund temporarily before other amounts need to be deducted (eg, for CGT).

A simply yet highly effective way to minimise these costly scenarios is to adopt a practice of documenting every amount paid into the fund by way of resolution.

This forces the adviser and member to consider how much is actually intended to be contributed, what kind of contribution this is (ie, concessional or non-concessional, or, eg, under the member's lifetime \$1.045mil CGT cap), how much has already been contributed and what portion of the cap is utilised.

These kinds of details could be recorded in a 'revolving'-style trustee resolution which is simply amended each time an amount is contributed.

By adhering to this procedure, advisers and their SMSF clients can avoid having to justify how large sums of money made their way into a fund up to 12 months after this took place (or even up to three years later in the case of the \$450,000 test) and possibly the associated tax penalties.

Conditions of release

Much like excess contributions, some advisers find themselves at year's end struggling to justify why a large sum of money was withdrawn from their client's SMSF during a financial year. This clearly becomes a major problem if it is unclear whether the member had satisfied a necessary condition of release.

However, even with a valid condition of release, undocumented withdrawals could raise suspicions from regulatory authorities as to whether the amount was possibly a loan. Other questions that arise include: was this a one-off lump sum or was a pension commenced? If it was a pension, was the minimum annual amount paid before 30 June, are the assets segregated or unsegregated and has the client addressed this new pension interest in their succession plans (eg, is it reversionary, or is it addressed in their binding nomination)?

Even more confusingly, those who seek to document the benefit payment retrospectively also have to consider whether the fund's deed allowed for that benefit to be paid at the time; if not, they might seek to have the deed amended with 'retrospective' effect and the validity of this might be questionable, even if retrospective variations are allowed in the deed.

These thorny issues and unnecessary discussions with regulators are best overcome by simply ensuring any withdrawal is properly documented at the time. These days it may be tempting for members, especially those of us over 60 years who can access benefits tax-free, to treat an SMSF as an ATM from which amounts can be withdrawn *ad hoc*. Advisers can save themselves headaches and their clients compliance problems by emphasising the need to simply document withdrawals as they occur.

Timing reinvestments for the 30 June 2009 deadline

Most SMSF trustees with investments in pre-1999 geared unit trusts will understand the importance of the looming 30 June 2009 reinvestment deadline.

However, some may not yet have planned how distributions from the current 2008/09 year will be reinvested. Of course, a unit trust trustee will typically only prepare accounts after the end of a year and make a distribution accordingly: but recall that SMSF trustees must physically reinvest distributions by 30 June 2009. Trustees and advisers should therefore consider the possibility of preparing interim accounts and making an interim distribution for 2008/09 (say in May or June 2009) to ensure they are not caught out after 30 June with no ability to reinvest.

Pre-30 June action

Finally, many potential issues can be overcome simply by preparing draft financials and holding pre-30 June meetings with clients. Preparation is the key!

SMSF property development

SMSF trustees proposing to develop property should seek expert advice beforehand as development can give rise to numerous SIS issues. We outline some key aspects to watch out for:

- Trustees should ensure there will be no breach of the regulation against charging fund assets. Many building contracts typically create a charge over the land in favour of the builder (eg, to allow recovery for fees and costs of materials).

- Trustees should take extreme care if borrowing to purchase the land which will be developed. Although it may be possible to quarantine borrowed money for the land and use only existing cash for the development (refer to our August 2008 newsletter), expert advice should be obtained beforehand to ensure the development does not create additional risks of charging fund assets in connection with the borrowing.
- Although there is nothing which expressly prohibits an SMSF from carrying on a business, the ATO has long considered that SMSFs which carry on a business might be at risk of breaching the 'sole purpose test'. SMSF trustees should therefore consider whether the development could constitute the carrying on of a business.

Often, the timing of property development and when it is acquired by the SMSF will also be critical issues. For example, vacant land owned by members which is set to be developed in many cases will not be 'Business Real Property' (BRP) and cannot therefore be acquired by their SMSF. Exactly when the developed land becomes BRP is an important issue and trustees should seek expert advice beforehand.

Property acquisitions generally also give rise to numerous other concerns. For example, if acquiring property already subject to a lease, trustees should consider whether to assign or commence a new lease and, if subject to GST, whether a 'going concern' exemption applies.

NEW Geared Unit Trust Kit

The Geared Unit Trust Kit provides valuable guidance and practical tools for SMSFs who invested in a pre-August 1999 geared unit trust. SMSF trustees and advisers must ensure they understand this area and act promptly to ensure the SMSF's investment potential is maximised in the lead up to the 30 June 2009 deadline.

The Kit outlines options for dealing with the 30 June 2009 deadline and describes how further investments can be made before this date. The Kit includes a detailed explanatory Memo, sample SMSF resolutions and unit trust resolutions to assist advisers. The Kit is \$550 incl. GST. To order, simply return the form below.

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