

## **SMSF borrowings — holding or bare trusts?**

The ATO's view that a holding trust is not a bare trust has given rise to numerous concerns and places doubt on the associated tax principles.

This article focuses on the ATO's view and what this means for SMSFs. We also consider the related in-house asset ('IHA') issues.

### **ATO view — we have a trust**

#### *ATO's view*

In recent NTLG Superannuation Subcommittee Minutes, the ATO has stated that the holding trust is not a bare trust because of the charge over the property granted to the lender.

Industry conversely argues that a bare trustee typically has no substantive powers other than to hold the title to the property and do what it is told. Despite this, some bare trusts include all sorts of powers including the power to invest, develop, sell property, etc.

To date, we are not aware of any active compliance by the ATO on this issue.

#### *Document providers*

There are many law firms and other document providers who have been producing documents to facilitate SMSF borrowing, with the holding trust being established as a bare trust.

We note, that there are many document providers who establish the holding trust as a real trust for tax purposes even though they still call it a bare trust.

It is important that documents are drafted by a law firm or provider that understands the following consequences of the ATO's view.

### **Tax and other consequences**

#### *Goods and services tax ('GST')*

If the holding trust is a bare trust, then the holding trustee will be entitled to a number of administrative efficiencies pursuant to GSTR 2008/3.

Broadly, a look through approach is adopted by the ATO where a bare trustee is holding property on trust for a beneficiary. The beneficiary would be the entity

that has the liability to pay GST and that is entitled to input tax credits. It follows that the bare trustee would not need to register separately for GST.

Furthermore, if the property title were to be subsequently transferred from the bare trustee to the beneficiary on repayment of the borrowing, there would be no GST payable (see GSTR 2008/3, para 64).

However, this ruling only applies if the holding trust is a bare trust.

#### *GST going concern exemption*

Where commercial premises are purchased by an SMSF trustee through a limited recourse borrowing arrangement, the going concern exemption could be available.

In order to qualify for this exemption, both parties must be registered for GST (provided the correct transferee is registered). If the SMSF is registered and the ATO argue that the holding trust should have been registered instead, then the going concern exemption may be at risk.

#### *In-house assets*

The ATO have flagged that the SMSF's interest in the holding trust becomes an IHA when the loan has been paid off.

If a small amount of the loan was however left unpaid, the holding trustee could potentially sell the property to a third party at a later stage.

#### *Capital gains tax ('CGT')*

If the holding trust is considered a trust for tax purposes, then it follows that a CGT event would occur upon a transfer of the title to the SMSF trustee. However, this would not arguably apply if it is a bare trust.

Regardless, the government has announced that amending legislation will be released that will adopt a look through approach where the property is transferred from the holding trustee to the SMSF trustee. The legislation is proposed to have effect from the 2007–08 income year.

#### *Stamp duty*

Stamp duty may also apply on the subsequent transfer of the property title from the holding trustee to the SMSF trustee.

Stamp duty should be considered at the time when the property is being purchased and when the property title needs to be transferred in the future.

Stamp duty laws differ across the different states and territories. We recommend that a local conveyancing lawyer be engaged to advise on the stamp duty consequences of the transaction before the contract of sale is signed and on any subsequent transfer. The right advice may alleviate a second round of duty.

## Moving forward

The focus for SMSFs should be to ensure that the above risks are appropriately managed.

Hopefully, the ATO will provide some practical clarity on these issues soon. Naturally, it is critical that the documentation used for these arrangements is drafted and implemented correctly and no adverse issues arise. In the meantime, we need to watch this space!

## UPEs — traps for SMSFs

Broadly, an unpaid present entitlement ('UPE') is an amount payable by a trustee to a beneficiary of the trust typically from a distribution of trust income.

In an SMSF context UPEs generally arise from an unpaid trust distribution from a related unit trust.

As 30 June 2011 fast approaches, SMSFs with UPEs owing from related trusts should carefully consider whether these will be considered a loan by the ATO.

To minimise this risk, it is recommended that these types of UPEs are reviewed well in advance of 30 June 2011 and where relevant paid before this deadline.

Broadly, the ATO has stated in SMSFR 2009/3 that where a UPE remains unpaid for more than 12 months after 30 June, this will generally be construed as a loan to a related party of the SMSF. Therefore, the UPE will be treated as an IHA. The ATO generally expect such UPEs to be repaid prior to the finalisation of the related trust's financial statements, which usually is within 12 months of the end of the financial year.

We note that the ATO's views in SMSFR 2009/3 precede and differ from its views in its more recent income tax ruling and ATO practice statement in respect of family trust trustees owing UPEs to corporate beneficiaries in a Division 7A loan context (being TR 2010/3 and PS LA 2010/4). Interestingly, a different treatment applies to UPEs in the income tax arena, which provides a possible administrative solution to defer paying off a UPE for up to seven or 10 years in accordance with PS LA 2010/4. There is no equivalent solution in SMSFR 2009/3.

## SMSF Core Course — 13–15 April

This course is designed for financial planners, accountants, auditors, SMSF administrators and lawyers who want to become SMSF experts. This course is ideal for advisers with limited SMSF training who wish to fast track their SMSF skill development and become an SMSF expert. It also suits experienced practitioners who seek to refresh and consolidate their skills. Attendees will achieve a detailed and meaningful understanding of the SMSF rules and strategies as well as augmenting their knowledge with the seminal court cases, AAT decisions, ATO and APRA rulings, determinations and circulars. The course is taught over a three day period divided into modules, each with realistic and practical case studies.

To ensure a high level of participation and interaction we have capped the number of attendees. Register quickly to ensure a place.

For more information about the course and registration, visit <http://www.dbanetwork.com.au>.

## Online SMSF Update — 29 April

DBA Network's next Online SMSF Update is on Friday 29 April 2011 from 12pm — 1.30pm Eastern Standard Time. The cost is \$150 incl GST. You must register through CPD Live at <http://websem.dbanetwork.com.au>.

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