

## Conversion for pre-99 trusts

SMSF trustees who hold pre-August 1999 investments in related unit trusts will recall the transitional rules that allowed some further reinvestment in these trusts until 30 June 2009. With that deadline now behind us, many are looking for avenues to open up further investment.

A popular strategy which has emerged is to convert to a 'non-g geared' unit trust. By relying on the non-g geared trusts exception in Div 13.3A of the SIS Regulations, an SMSF trustee may then make further reinvestments without giving rise to in-house assets.

### *Is conversion possible?*

Some in the industry have recently expressed concern that the technical operation of the SIS regulations might prevent a trust from relying on a 'conversion' in order to make further investments in the trust.

The SIS provisions are technical and it is understandable that some might come to this unfavourable view. However, DBA's opinion is that conversion is allowed under SIS and an SMSF trustee may therefore make further investments in a properly converted non-g geared trust without falling foul of the in-house asset rules.

Given the difference of views, SMSF trustees should seek advice before undertaking a conversion strategy. A legal opinion supporting the fund's trustee could assist in the event the investments are questioned by an auditor.

According to recent statistics, the second most common type of SIS contravention reported to the ATO is a breach of the in-house asset rules. This indicates that these kinds of investments are coming under the magnifying glass of the SMSF auditor! Trustees and advisers must therefore be prepared to back up these investments, if challenged.

### *Downside to conversion?*

Pre-1999 unit trusts are widely regarded as valuable investment vehicles for SMSFs due to their flexibility and the range of investment activities they can undertake. Once a trust converts to a non-g geared trust, the trustee will be significantly restricted in the investments it can make (eg, no borrowings, no loans, no interests in other entities, plus other restrictions).

Further, in the event that the trust ceases to meet all of the requirements for a non-g geared trust, this could

have drastic in-house asset consequences for the SMSF because it is not possible to address this simply by rectifying the breach; once a trust falls outside the exception, it can never come back within the safe harbour.

However, a conversion strategy could be attractive for those who are comfortable that they can comply with the requirements into the future. SMSF trustees can now also borrow directly within the fund to acquire assets, which has reduced the need for gearing in unit trusts.

## ATO news on guarantees

The ATO has recently released its long-awaited final view on what constitutes a 'contribution' in TR 2010/1. The ATO has stuck to its guns on the subject of member guarantees provided to support a s 67(4A) 'instalment warrant'-style loan.

A payment made pursuant to a guarantee will generally be treated as a contribution. The question is not so much whether it is a contribution, but at what point in time it is treated as being made. The contribution is considered to be made:

- if the guarantor has no right of indemnity against the fund's trustee – at the time the guarantor makes the payment; or
- if the guarantor does have such a right – when its right expires (eg, under the statute of limitations) or when it takes formal steps to forego the right (eg, via a deed of release).

The ATO acknowledges that member guarantees are often provided to banks because the SMSF trustee often cannot obtain finance without this support. However, the ATO's view is that a guarantor's failure to deal in a 'commercial' manner with the SMSF trustee means it can be reasonably inferred that the guarantor's intention is to benefit the members of the fund.

Interestingly, this implies that if the guarantor and SMSF trustee had some commercial arrangement in place (eg, the guarantor is compensated for agreeing to act as guarantor) then the payment might not be a 'contribution'. However, this is untested and DBA's recommendation is generally to avoid giving guarantees wherever possible. (Some banks might not need a guarantee if the loan-to-value ratio is relatively low.) Contribution issues aside, there are also unresolved questions about whether guarantees generally comply with the borrowing laws in s 67(4A) (refer to Taxpayer Alert 2008/5).

## What is a contribution?

The ATO has recently issued TR 2010/1 on what is a contribution and when is it made to a superannuation fund. This ruling is extensive and clarifies a range of issues that related to the prior draft ruling TR 2009/D3.

In particular, a contribution is anything of value that increases the capital of a superannuation fund provided by a person whose purpose is to benefit one or more particular members or all members generally.

Note the addition of this 'purpose' test which was not in the draft ruling. The ATO relies on an example of what is not a contribution, such as a tenant that improves a landlord's premises, ie, they would generally be doing it for their own purposes rather than providing for someone's superannuation benefits.

An investment return from a fund's interest in a company or trust would generally not be a contribution as it is a return on invested moneys. However, a distribution from a discretionary trust would be considered a concessional contribution; such an amount is not income, profit or gain from an investment and the ATO would consider this to be for the purpose of providing benefits for the fund's members. A discretionary trust distribution to an SMSF could therefore be potentially subject to the excess contributions tax regime, which could potentially result in a 93% tax rate with a further tax penalty being the non-arm's length income (aka 'special income') provisions that result in a 45% tax rate.

The ATO confirms that the provision of superannuation benefits must be the sole purpose in making a contribution for it to be tax deductible. However, incidental consequences such as obtaining a tax deduction will not matter.

We have also noted from advisers that there is an increasing number of cases where non-concessional contributions made on behalf of a member have been treated as concessional contributions by the ATO.

These have typically involved a family trust or company making a contribution directly to the fund and reflecting the amount as a loan to the member by journal entry.

While the ATO acknowledges that a constructive receipt can occur where a payment is made to a third party on behalf of a fund in satisfaction of the fund's liability (for example, an insurer), the ATO applies a strict test in administering the contribution rules. In essence, they appear to require contributions to be made directly from the member or else it simply treats them as a concessional contribution. This results in the contribution being subject to tax in the fund and could also result in excess contributions tax.

In order to satisfy a constructive receipt or payment, there typically must be a liability that is offset, eg, where a beneficiary has a credit loan account from a family trust and directs the trustee to pay a contribution on their behalf with a consequent reduction to their loan account balance.

A recent AAT decision (*Jendahl Investments Pty Ltd v FCT* [2009] AATA 881) highlights the above risks as the tribunal decided that Mr Jensen had made concessional contributions as he was not able to provide evidence such as bank statements to prove the contributions were personal. The ATO's assessments of around \$356,000 on the amounts transferred directly from his family trust into his SMSF succeeded even though the ATO only provided hypothetical alternative scenarios.

There are many people who may retain a substantial part of their savings or share portfolio in their family trust who similarly wish to make personal or non-concessional contributions into super. However, given the above, the prudent course is now to ensure the cash or shares are transferred directly to the beneficiary who in turn then transfers the amount directly to the SMSF.

Thus, greater care should be exercised in managing contributions moving forward, especially if sourced from a family trust or company.

## SMSF Borrowing Documentation

DBA provides quality documentation for SMSF borrowings. This includes documents for:

- a direct loan from a bank, or
- a loan from a related party (eg, a related family trust, company or the members)

We offer both **documents only** or a **premium service** for those would also like our assistance in implementing the documents. For further information and pricing, please refer to the brochure forwarded with this newsletter.

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