DBA Butler Pty Ltd Lawyers

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Key Ruling on Contributions

The recently released draft tax ruling TR 2009/D3 outlines the ATO's view on a range of situations in which a 'contribution' is made to a super fund, including some important timing aspects. In this newsletter, we draw out some of the key points to be taken from the draft ruling.

SMSF borrowing and guarantees

The draft ruling discusses s 67(4A) or 'instalment warrant'-style borrowings by super fund trustees where the borrowing is supported by a guarantee (eg, given by one or more members of the fund). This is the first substantial comment by the ATO on this topic since it first raised concerns about guarantees in April 2008 (see taxpayer alert TA 2008/5).

The ATO states that if a payment is made under a guarantee (eg, the fund defaults and the guarantor is called upon to pay any outstanding amount), this will constitute a contribution to the fund if the guarantor has no right of indemnity against the fund. This is on the basis that the fund derives a benefit which ultimately increases the capital of the fund (ie, by not having to meet the liability it has incurred).

According to the ATO, a contribution is also made if the guarantor subsequently forgoes their right of indemnity or is prevented from enforcing it (eg, under the statute of limitations).

Further clarification still needed

While the ruling sheds some light on guarantees, some questions remain unanswered:

- The ATO does not clarify exactly when a person is taken to 'forego' a right of indemnity. For example, it is not clear how the ATO would treat a situation where a member guarantor makes a payment to a lender under a guarantee and has a right of indemnity, but simply takes no action to enforce it.
- Moreover, it is unclear how the ATO's analysis of guarantees sits with its general position that any expense or liability of a super fund paid for by another entity will count as a contribution to the fund if the fund does not reimburse the payer. This was stated in TA 2008/12 and in this draft ruling.
- The draft ruling appears to accept that, in practice, guarantees are being given for super fund loans. However, the ATO has not expressly clarified whether they consider that guarantees comply with the s 67(4A) borrowing law, given their earlier comments in TA 2008/5 that a guarantee could breach the limited recourse requirement.

However, what is clear is that payments made pursuant to a guarantee could have consequences for members' contributions caps, and possibly excess contributions tax. SMSF trustees should therefore closely examine their ability to repay a loan before the arrangement is entered into.

DBA recommends that all advisers ensure their SMSF clients understand the risks related to guarantees before proceeding. Some alternatives may be available, such as sourcing finance from a lender that does not require a guarantee (even a related party lender), using the non-geared unit trust structure instead of the SMSF borrowing or, where possible, maximising contributions to the fund to allow it to purchase the asset outright.

Related party loans?

Where the debt of a superannuation fund is forgiven, the ATO considers that a contribution has been made to the fund. This is particularly relevant where a fund has borrowed from a related party so trustees need to be mindful of possible consequences.

Distributions from a discretionary trust

An SMSF may qualify as a beneficiary under a member's discretionary family trust and may have therefore previously received distributions of either income or capital.

The ATO notes that this will be treated as a contribution to the SMSF, because unlike a distribution from a unit trust in which an SMSF holds units, a distribution from a discretionary trust cannot be justified as a return on investment or a profit or gain.

Some family trusts may have previously distributed to SMSFs due to the apparently attractive 15% tax rate, compared with the rates applying to its individual or corporate beneficiaries.

However, if the amount is to be counted as a contribution as the ATO argue, then the implications for contributions caps need to be considered, including any excess contributions tax. Excess concessional contributions ('CCs') are taxed at an additional 31.5%. Any excess CCs also become non-concessional contributions ('NCCs') and may push a member into excess-NCC territory, incurring an additional 46.5% on any excess NCCs.

The potential application of the non-arm's length (aka 'special') income provisions should also be considered. Thus, discretionary distributions to SMSFs could prove extremely costly if the ATO's view is correct as this will extend what previously was considered a contribution.

SGC & Excess Contributions

Employers and employees should now review their superannuation guarantee ('SG') position as the SG system may produce excess contributions tax even where employers are compelled to contribute.

By way of background, under the SG regime each employer is generally required to contribute 9% of an employee's salary to a complying fund each quarter.

An employer is only liable to provide superannuation up to the maximum contribution base which is currently $38,180 per quarter. This equates to a salary of $152,720, meaning that an employer is not compelled to provide any more superannuation support above this, ie, SG of $13,744.80 p.a. For a person under 50 years, this would only leave another $11,255.20 to be contributed by the same or other employers in 2009-10 without there being an excess contributions tax assessment.

Thus, if an employer has a locked in salary sacrifice arrangement that results in the employee's concessional contributions cap being exceeded, an additional 31.5% excess CC tax is payable. Moreover, there is nothing preventing an employee with multiple employers from contributing towards an employee's super fund that results in excess CC tax. Each employer is required to comply with the 9% contribution or pay the shortfall penalties. Even worse, if an employee makes their maximum NCCs, then they would also receive an excess NCC assessment since excess CCs count towards their NCC cap.

Prior to mid-2007 there was to be a mechanism where an employee could forever elect out of receiving SG support from a particular employer if they obtained appropriate evidence that they had exceeded their pension reasonable benefit limit ('RBL'). Sadly, there is no longer a mechanism where an employee can opt out of the SG system.

Advisers must therefore take extreme care in recommending contributing strategies. DBA's FY2010 SMSF Checklist can assist in this regard.

30 June 2009 Deadline for Related Unit Trusts

Many are aware of SMSFD 2007/1 which provides that a present entitlement once applied or dealt with as requested by an SMSF is taken to have been 'received'. However, many have overlooked that the SMSF must have made their investment in the related unit trust prior to the 30 June 2009 deadline. To do this the process of issuing units in the unit trust deed must be finalised prior to 30 June 2009. DBA's Geared Unit Trust kit provides instructions, checklists and example documents to guide you through this field and should allow you to get this done in time.

Products to assist with end-of-year planning

DBA offers unique products to assist advisers with their end-of-year planning. To order, simply tick the relevant box(es) below and complete and return this order form:

☐ **FY2010 SMSF Checklist** ($150 incl. GST): this outlines planning items every SMSF should consider, covering contributions, pensions, overseas issues, death benefit nominations, issues related to the fund's investments, annual administration requirements and more. The Checklist addresses issues relevant for each financial year having regard to current thresholds, deadlines and other topical issues for SMSF trustees.

☐ **Geared Unit Trust Kit** ($440 incl. GST): 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.

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