

SMSFs and unit trusts

An SMSF trustee's investment in a unit trust may be a prudent investment. However, as outlined below, there are a number of considerations that may impact this investment.

Allowable investments

Broadly, the in-house asset provisions contained in the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA') restrict SMSF trustees from investing in unit trusts. Particularly, an SMSF trustee cannot invest in a related trust, unless an exception applies.

Related unit trusts

A related unit trust is a unit trust that a member, or standard employer-sponsor, 'controls'. A member's relatives, business associates and related entities may be grouped for the purposes of this test.

Where a member's SMSF and their business partner's SMSF invest in a unit trust, they may be grouped in determining whether the member controls the trust. Similarly, where the member owns property jointly with another party, that party's interests may be grouped for the purposes of this test due to this constituting a partnership for tax purposes.

As such, we recommend that SMSF trustees carefully plan, and seek advice where necessary, before investing in a unit trust.

Non-g geared unit trust ('NGUT') exception

An SMSF trustee's investment in a unit trust, that is a related trust, will not constitute an in-house asset if the trust is a NGUT.

A NGUT has a variety of characteristics. Amongst other things, the trust must not have any borrowings or charges over its assets. Nor can a business be run from the trust.

Because of these restrictions, a NGUT may not be a suitable vehicle for property development. Property development often involves a charge over the asset in favour of the builder, or borrowings undertaken in order to keep the project moving forward. Also, a development may constitute a business depending on its size and scale.

An SMSF may be able to invest in a NGUT by purchasing units from a related party.

Unrelated trusts

An SMSF trustee can invest in a trust that is not a related trust. A common structure would be where three unrelated SMSF trustees invested one third each in a unit trust.

Because this structure is not considered an in-house asset, none of the NGUT restrictions would apply. However, we note that in recent case law the Commissioner has adopted a look through approach to the activities of the trust in determining contraventions of the SISA (see *ZDDD and Commissioner of Taxation* [2011] AATA 3).

Fixed trusts

It is important that SMSF trustees only invest in *fixed* trusts. Otherwise, any distributions received by the SMSF trustee will be non-arm's length income and taxed at a 45% rate.

Not all unit trusts are fixed trusts and we are aware of numerous types of fixed trusts. These include for trust loss and franking credit purposes, for distribution purposes, for land tax purposes (eg, NSW has special land tax provisions) and for general trust law purposes.

Broadly, a trust is a fixed trust for superannuation purposes if all the entitlements to income and capital are fixed and cannot be taken away from the unitholders. Many (non-DBA) unit trust deeds provide non-fixed entitlements and some provide discretionary or hybrid units with variable distributions. Further, under many deeds a majority of unitholders may be able to take away the income or capital rights of the minority. Naturally, these unit trust deeds are not appropriate for SMSFs to invest in.

Related party acquisitions

A trustee of an SMSF is prohibited from acquiring an asset from a related party of the SMSF (s 66, SISA). A related party includes the members of the SMSF.

On its face, where an SMSF trustee acquires units in a unit trust from the SMSF's members, it will generally have contravened the related party acquisition provisions unless the trust is a NGUT.

As an alternative, some believe that if the members redeemed their units and the trustee of the unit trust issued new units to the SMSF trustee, this would not contravene the prohibition.

However, we note that a trustee of an SMSF is prohibited from entering into or carrying out a scheme that is likely to result in it acquiring an asset from a related party. As such, the Commissioner could argue that this is a scheme that contravenes the prohibited conduct outlined in section 66 of SISA.

Arm's length dealings

There is a requirement that the trustee of an SMSF deal at arms length. To satisfy this requirement, *all* of the dealings of the trustee of the SMSF must be conducted on commercial terms.

This also applies to any dealings between the SMSF trustee and the trustee of a unit trust. For example, in the case where further units are issued to the trustee of the SMSF, these units must be issued for a market value price and not just for a nominal sum of, say, \$1 per unit.

Similarly, there is an arm's length risk where the SMSF trustee wanted to enter into a related party limited recourse borrowing arrangement in order to acquire units in a unit trust. The lender would only be able to take the units as security for the loan. Most commercial lenders may not lend on these terms.

Will the unit trust be taxed as a company?

A unit trust can be taxed as a company (ie, a public trading trust 'PTT') if both of the following tests are met:

- SMSFs hold at least 20% of the units in the trust; and
- the unit trust carries on activities beyond mere land ownership for the purpose of deriving rent and other passive investments such as investment in shares, units, loans, certain other financial instruments, etc.

Note, there is a safe harbour provided that at least 75% of the trust's gross revenue is derived from rent as long as the remaining gross revenue is not derived from carrying on a business that is not 'incidental and relevant' to renting land.

If a unit trust is a PTT, it is broadly taxed as a company rather than a trust, ie, it is taxed at the company tax rate and distributions are taxed like franked dividends. For example, a unit trust that develops a property and sells it (rather than holding it for long-term rental) and where SMSFs own more than a 20% unitholding, would be taxed as a company at a 30% tax rate on any net income.

Consequences

Where an SMSF trustee contravenes the above provisions the SMSF may be rendered non-complying. This could result in the SMSF losing its concessional tax treatment, as well as being liable to pay interest and penalties.

DBA Lawyers' SMSF Deed 2011-12

We have recently updated our SMSF trust deed to coincide with the new financial year. Some of the updates include enhanced powers to manage contributions (in particular, to allow a refund of up to \$10,000 in excess concessional contributions as outlined in the May 2011 Budget), enhanced BDBN and reversionary pension provisions, greater asset protection measures, updated borrowing provisions and flexibility for the 25% reduction in minimum pension payments for the 2011-12 financial year.

Now is the perfect time to take advantage of these updates. Visit <http://www.dbalawyers.com.au> for ordering information, or contact our office on (03) 9092 9400.

Pension kits

DBA Lawyers offers a range of kits, including documentation to roll back and commence account-based pensions, transition to retirement income streams and other pensions, as well as related SMSF kits.

Visit <http://www.dbalawyers.com.au/products-order-forms/pensions> for further information.

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